

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2005 AND 2004
(in thousands, except per share data)

	<u>2005</u>	<u>2004</u>
<u>Assets</u>		
Current assets:		
Cash and cash equivalents.....	\$ 92,130	\$ 73,302
Accounts receivable, net of allowance for doubtful accounts of \$193,754 and \$202,857 at December 31, 2005 and 2004, respectively	732,907	649,281
Inventories	77,939	75,327
Deferred income taxes	107,442	83,030
Prepaid expenses and other current assets	59,079	50,140
Total current assets	1,069,497	931,080
Property, plant and equipment, net	753,663	619,485
Goodwill, net	3,197,227	2,506,950
Intangible assets, net	147,383	11,462
Deferred income taxes	-	29,374
Other assets	138,345	105,437
Total assets	<u>\$5,306,115</u>	<u>\$4,203,788</u>
<u>Liabilities and Stockholders' Equity</u>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 764,453	\$ 668,987
Short-term borrowings and current portion of long-term debt	336,839	374,801
Total current liabilities	1,101,292	1,043,788
Long-term debt	1,255,386	724,021
Other liabilities	186,453	147,328
Commitments and contingencies		
Stockholders' equity:		
Common stock, par value \$0.01 per share; 300,000 shares authorized; 213,674 and 213,567 shares issued at December 31, 2005 and 2004, respectively	2,137	1,068
Additional paid-in capital	2,175,533	2,195,346
Retained earnings	1,292,510	818,734
Unearned compensation	(3,321)	(11)
Accumulated other comprehensive (loss) income	(6,205)	3,866
Treasury stock, at cost; 15,219 and 17,347 shares at December 31, 2005 and 2004, respectively	(697,670)	(730,352)
Total stockholders' equity	2,762,984	2,288,651
Total liabilities and stockholders' equity	<u>\$5,306,115</u>	<u>\$4,203,788</u>

The accompanying notes are an integral part of these statements.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003
(in thousands, except per share data)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net revenues	\$5,503,711	\$5,126,601	\$4,737,958
Operating costs and expenses:			
Cost of services	3,257,335	2,990,712	2,768,623
Selling, general and administrative	1,257,775	1,227,746	1,165,700
Amortization of intangible assets	4,730	6,703	8,201
Other operating expense (income), net	15,760	10,223	(1,020)
Total operating costs and expenses	<u>4,535,600</u>	<u>4,235,384</u>	<u>3,941,504</u>
Operating income	968,111	891,217	796,454
Other income (expense):			
Interest expense, net	(57,471)	(57,949)	(59,789)
Minority share of income	(19,495)	(19,353)	(17,630)
Equity earnings in unconsolidated joint ventures	26,185	21,049	17,439
Other, net	(6,876)	162	1,324
Total non-operating expenses, net	<u>(57,657)</u>	<u>(56,091)</u>	<u>(58,656)</u>
Income before taxes	910,454	835,126	737,798
Income tax expense	<u>364,177</u>	<u>335,931</u>	<u>301,081</u>
Net income	<u>\$ 546,277</u>	<u>\$ 499,195</u>	<u>\$ 436,717</u>
Earnings per common share:			
Basic	\$ 2.71	\$ 2.45	\$ 2.11
Diluted	\$ 2.66	\$ 2.35	\$ 2.02
Weighted average common shares outstanding:			
Basic	201,833	203,920	206,832
Diluted	205,530	214,145	217,578
Dividends per common share	\$ 0.36	\$ 0.30	\$ 0.075

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003
(in thousands)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:			
Net income	\$ 546,277	\$499,195	\$436,717
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	176,124	168,726	153,903
Provision for doubtful accounts	233,628	226,310	228,222
Deferred income tax provision	661	52,451	33,853
Minority share of income	19,495	19,353	17,630
Stock compensation expense	2,037	1,384	5,297
Tax benefits associated with stock-based compensation plans	33,823	71,276	30,496
Other, net	21,673	4,739	(1,583)
Changes in operating assets and liabilities:			
Accounts receivable	(238,421)	(266,404)	(254,865)
Accounts payable and accrued expenses	36,038	22,336	(6,795)
Integration, settlement and other special charges	(5,400)	(18,274)	(18,942)
Income taxes payable	15,382	1,163	26,493
Other assets and liabilities, net	10,266	16,525	12,373
Net cash provided by operating activities	<u>851,583</u>	<u>798,780</u>	<u>662,799</u>
Cash flows from investing activities:			
Business acquisitions, net of cash acquired	(814,219)	-	(237,610)
Capital expenditures	(224,270)	(176,125)	(174,641)
Increase in investments and other assets	(41,389)	(5,151)	(13,842)
Proceeds from disposition of assets	85	7,576	9,043
Net cash used in investing activities	<u>(1,079,793)</u>	<u>(173,700)</u>	<u>(417,050)</u>
Cash flows from financing activities:			
Proceeds from borrowings	1,100,186	304,921	450,000
Repayments of debt	(497,276)	(306,018)	(391,718)
Increase in book overdrafts	33,384	-	-
Purchases of treasury stock	(390,163)	(734,577)	(257,548)
Exercise of stock options	98,335	109,116	29,887
Dividends paid	(69,673)	(61,387)	-
Distributions to minority partners	(21,477)	(16,677)	(14,253)
Financing costs paid	(6,278)	(2,114)	(4,227)
Other	-	-	291
Net cash provided by (used in) financing activities	<u>247,038</u>	<u>(706,736)</u>	<u>(187,568)</u>
Net change in cash and cash equivalents	18,828	(81,656)	58,181
Cash and cash equivalents, beginning of year	<u>73,302</u>	<u>154,958</u>	<u>96,777</u>
Cash and cash equivalents, end of year	<u>\$ 92,130</u>	<u>\$ 73,302</u>	<u>\$154,958</u>

The accompanying notes are an integral part of these statements.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003
(in thousands)

	Shares of Common Stock Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Unearned Compensation	Accumulated Other Comprehensive (Loss) Income	Treasury Stock	Comprehensive Income
Balance, December 31, 2002	195,926	\$ 980	\$1,817,511	\$ (40,772)	\$ (3,332)	\$ (5,524)	\$ -	
Net income				436,717				\$436,717
Other comprehensive income						11,471		11,471
Comprehensive income								<u>\$448,188</u>
Dividend declared				(15,386)				
Shares issued to acquire Unilab ..	14,110	71	372,393					
Fair value of Unilab converted options			8,452					
Issuance of common stock under benefit plans	800	4	18,081		(4,313)			
Exercise of stock options	3,133	15	29,872					
Shares to cover employee payroll tax withholdings on stock issued under benefit plans	(361)	(2)	(9,791)					
Tax benefits associated with stock- based compensation plans			30,496					
Amortization of unearned compensation					5,299			
Purchases of treasury stock	(7,981)						(257,548)	
Balance, December 31, 2003	205,627	1,068	2,267,014	380,559	(2,346)	5,947	(257,548)	
Net income				499,195				\$499,195
Other comprehensive loss						(2,081)		(2,081)
Comprehensive income								<u>\$497,114</u>
Dividends declared				(61,020)				
Issuance of common stock under benefit plans	404	1	1,314		951		12,623	
Exercise of stock options	6,949		(136,932)				246,048	
Shares to cover employee payroll tax withholdings on stock issued under benefit plans	(179)	(1)	(7,548)					
Tax benefits associated with stock- based compensation plans			71,276					
Conversion of contingent convertible debentures	74		222				3,102	
Amortization of unearned compensation					1,384			
Purchases of treasury stock	(16,655)						(734,577)	
Balance, December 31, 2004	196,220	1,068	2,195,346	818,734	(11)	3,866	(730,352)	
Net income				546,277				\$546,277
Other comprehensive loss						(10,071)		(10,071)
Comprehensive income								<u>\$536,206</u>
Adjustment for 2-for-1 stock split ..		1,068	(1,068)					
Dividends declared				(72,501)				
Issuance of common stock under benefit plans	516	1	4,620		(5,347)		17,683	
Exercise of stock options	3,893		(69,691)				168,026	
Shares to cover employee payroll tax withholdings on stock issued under benefit plans			(7)					
Tax benefits associated with stock- based compensation plans			33,823					
Conversion of contingent convertible debentures	5,632		12,510				237,136	
Amortization of unearned compensation					2,037			
Purchases of treasury stock	(7,806)						(390,163)	
Balance, December 31, 2005	198,455	\$2,137	\$2,175,533	\$1,292,510	\$ (3,321)	\$ (6,205)	\$ (697,670)	

The accompanying notes are an integral part of these statements.

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 largest clinical laboratory testing business in the United States. Prior to January 1, 1997, Quest Diagnostics was a wholly owned subsidiary of Corning Incorporated ("Corning"). On December 31, 1996, Corning distributed all of the outstanding shares of common stock of the Company to the stockholders of Corning as part of the "Spin-Off Distribution".

As the nation's leading provider of diagnostic testing and services for the healthcare industry, Quest Diagnostics offers a broad range of clinical laboratory testing services to patients, physicians, hospitals, healthcare insurers, employers, governmental institutions and other commercial clinical laboratories. Quest Diagnostics is the leading provider of esoteric testing, including gene-based testing. The Company is also the leading provider of testing for drugs-of-abuse. Through the Company's national network of laboratories and patient service centers, and its esoteric testing laboratory and development facilities, Quest Diagnostics offers comprehensive and innovative diagnostic testing, information and services used by physicians and other healthcare professionals to make decisions to improve health. The Company is also a leading provider of anatomic pathology services, testing to support clinical trials of new pharmaceuticals worldwide, and risk assessment services for the life insurance industry.

During 2005, Quest Diagnostics processed approximately 144 million requisitions through its extensive network of laboratories and patient service centers 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. While the Company does not have any relationships with variable interest entities, as defined in Financial Accounting Standards Board ("FASB") Interpretation No. 46 "Consolidation of Variable Interest Entities", as revised ("FIN 46"), the existence of any such entity would require consolidation if the Company were 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. 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, 2005 and 2004, the Company's investments in affiliates accounted for under the equity method of accounting totaled \$36.5 million and \$35.8 million, respectively. The Company's share of equity earnings from investments in affiliates, accounted for under the equity method, totaled \$26.2 million, \$21.0 million and \$17.4 million, respectively, for 2005, 2004 and 2003. All significant intercompany accounts and transactions are eliminated in consolidation.

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 settlement. In 2005, 2004 and 2003, approximately 18%, 17% and 17%, respectively, of net revenues were generated by Medicare and Medicaid programs. Under capitated arrangements with healthcare insurers, 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.

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

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.

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, adjusted for the after-tax impact of the interest expense associated with the Company's 1 $\frac{3}{4}$ % contingent convertible debentures due 2021 (the "Debentures"), 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 the Debentures, and outstanding stock options and restricted common shares granted under the Company's Amended and Restated Employee Long-Term Incentive Plan and Amended and Restated Director Long-Term Incentive Plan.

On June 20, 2005, the Company effected a two-for-one stock split through the issuance of a stock dividend of one new share of common stock for each share of common stock held by stockholders of record on June 6, 2005. References to the number of common shares and per common share amounts in the accompanying consolidated balance sheets and consolidated statements of operations, including earnings per common share calculations and related disclosures, have been restated to give retroactive effect to the stock split for all periods presented.

In September 2004, the Emerging Issues Task Force ("EITF") reached a final consensus on Issue 04-8, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share", ("Issue 04-8"), effective December 31, 2004. Pursuant to Issue 04-8, the Company included the dilutive effect of its Debentures in its diluted earnings per common share calculations using the if-converted method, regardless of whether or not the holders of these securities were permitted to exercise their conversion rights. The Debentures were called for redemption by the Company in December 2004, and redeemed as of January 18, 2005. See Note 10 for further discussion of the Debentures.

The computation of basic and diluted earnings per common share (using the if-converted method) was as follows (in thousands, except per share data):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income available to common stockholders – basic.....	\$546,277	\$499,195	\$436,717
Add: Interest expense associated with the Debentures, net of related tax effects.....	82	3,275	3,303
Net income available to common stockholders – diluted	<u>\$546,359</u>	<u>\$502,470</u>	<u>\$440,020</u>
Weighted average common shares outstanding – basic	201,833	203,920	206,832
Effect of dilutive securities:			
Debentures	153	5,714	5,714
Stock options	3,533	4,472	4,687
Restricted common stock	11	39	345
Weighted average common shares outstanding – diluted	<u>205,530</u>	<u>214,145</u>	<u>217,578</u>
Basic earnings per common share	<u>\$ 2.71</u>	<u>\$ 2.45</u>	<u>\$ 2.11</u>
Diluted earnings per common share	<u>\$ 2.66</u>	<u>\$ 2.35</u>	<u>\$ 2.02</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>2005</u>	<u>2004</u>	<u>2003</u>
Stock options	337	603	4,018

Stock-Based Compensation

Statement of Financial Accounting Standards ("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") encourages, but does not require, companies to record compensation cost for stock-based compensation plans at fair value. In addition, SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation, and amends 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.

The Company has chosen to adopt the disclosure only provisions of SFAS 148 and continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and related interpretations. Under this approach, the cost of restricted stock awards is expensed over their vesting period, while the imputed cost of stock option grants and discounts offered under the Company's Employee Stock Purchase Plan ("ESPP") is disclosed, based on the vesting provisions of the individual grants, but not charged to expense. Stock-based compensation expense recorded in accordance with APB 25, relating to restricted stock awards, was \$2.0 million, \$1.4 million and \$5.3 million in 2005, 2004 and 2003, respectively.

The Company has several stock ownership and compensation plans, which are described more fully in Note 12. The following table presents net income and basic and diluted earnings per common share, had the Company elected to recognize compensation cost based on the fair value at the grant dates for stock option awards and discounts granted for stock purchases under the Company's ESPP, consistent with the method prescribed by SFAS 123, as amended by SFAS 148 (in thousands, except per share data):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income, as reported	\$546,277	\$499,195	\$436,717
Add: Stock-based compensation under APB 25	2,037	1,384	5,297
Deduct: Total stock-based compensation expense determined under fair value method for all awards, net of related tax effects	(32,623)	(43,710)	(52,351)
Pro forma net income	<u>\$515,691</u>	<u>\$456,869</u>	<u>\$389,663</u>
Earnings per common share:			
Basic – as reported	<u>\$ 2.71</u>	<u>\$ 2.45</u>	<u>\$ 2.11</u>
Basic – pro forma	<u>\$ 2.56</u>	<u>\$ 2.23</u>	<u>\$ 1.88</u>
Diluted – as reported	<u>\$ 2.66</u>	<u>\$ 2.35</u>	<u>\$ 2.02</u>
Diluted – pro forma	<u>\$ 2.50</u>	<u>\$ 2.13</u>	<u>\$ 1.82</u>

The fair value of each option granted prior to January 1, 2005 was estimated on the date of grant using the Black-Scholes option-pricing model. The fair value of each stock option award granted subsequent to January 1, 2005 was estimated on the date of grant using a lattice-based option valuation model. Management believes a lattice-based option valuation model provides a more accurate measure of fair value. The expected volatility in connection with the Black-Scholes option-pricing model was based on the historical volatility of the Company's stock, while 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 stock. The weighted average assumptions used in valuing options granted in the periods presented are:

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Dividend yield	0.7%	0.7%	0.0%
Risk-free interest rate.....	4.0%	3.1%	2.8%
Expected volatility	23.0%	47.2%	48.1%
Expected holding period, in years	6	5	5

The majority of options granted in 2003 were issued prior to the declaration of the Company's initial quarterly cash dividend in the fourth quarter of 2003 and as such carry a dividend yield of 0%, thereby reducing the weighted average dividend yield for 2003 to 0.0%.

Foreign Currency

Assets and liabilities of foreign subsidiaries are translated into U.S. dollars at year-end exchange rates. 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 income within stockholders' equity. Gains and losses from foreign currency transactions are included within "other operating expense (income), 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 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 clients and their dispersion across many different geographic regions, and is limited to certain customers who are large buyers of the Company's services. To reduce risk, the Company routinely assesses the financial strength of these customers and, consequently, believes that its accounts receivable credit risk exposure, with respect to these customers, 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 of the related revenue. The Company has implemented 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 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 supplies, are valued at the lower of cost (first in, first out method) or market.

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

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 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 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 five 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 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 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 not amortized into results of operations, but instead are 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, 2005 or 2004.

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) publicly available information regarding comparable publicly-traded companies in the clinical laboratory testing industry, (ii) the financial projections and future prospects of the Company's business, including its growth opportunities and likely operational improvements, and (iii) 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

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

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 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 conformity with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"), 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, net" in the consolidated statements of operations. Unrealized gains and losses for available-for-sale securities are recorded as a component of accumulated other comprehensive income within stockholders' equity. Gains and losses on securities sold are based on the average cost method.

Investments at December 31, 2005 and 2004 consisted of the following:

	<u>2005</u>	<u>2004</u>
Available-for-sale equity securities	\$20,429	\$21,949
Trading equity securities	25,738	20,917
Other investments	<u>29,726</u>	<u>13,601</u>
Total	<u>\$75,893</u>	<u>\$56,467</u>

Investments in available-for-sale equity securities consist primarily 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 primarily of investments in preferred and common shares of privately held companies.

As of December 31, 2005 and 2004, the Company had gross unrealized (losses) gains from available-for-sale equity securities of (\$11.1) million and \$4.2 million, respectively. For the years ended December 31, 2005, 2004 and 2003, gains from trading equity securities totaled \$1.6 million, \$1.8 million and \$1.9 million, respectively, and are included in "other, net" within the consolidated statements of operations. In addition, for the year ended December 31, 2005, "other, net" includes a \$7.1 million charge associated with the write-down of an investment.

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Financial Instruments

The Company's policy for managing exposure to market risks may include the use of financial instruments, including derivatives. 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 trading purposes.

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), as amended, requires that all derivative instruments be recorded on the balance sheet at their fair value. 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.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable and accrued expenses approximate fair value based on the short maturity of these instruments. At December 31, 2005 and 2004, the fair value of the Company's debt was estimated at \$1.6 billion and \$1.2 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, 2005 and 2004, the estimated fair value exceeded the carrying value of the debt by \$39 million and \$84 million, respectively.

The Company's Debentures had a contingent interest component that would have required the Company to pay contingent interest based on certain thresholds, as outlined in the indenture governing such notes. The contingent interest component, which is more fully described in Note 10, was considered to be a derivative instrument subject to SFAS 133, as amended. The Debentures were called for redemption by the Company in December 2004, and redeemed as of January 18, 2005. At December 31, 2004 the derivative was recorded at its fair value in the consolidated balance sheet and was not material.

Comprehensive (Loss) Income

Comprehensive (loss) income 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 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. SFAS 123R is effective for annual periods beginning after January 1, 2006. The Company adopted SFAS 123R effective January 1, 2006 using the modified prospective approach. 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 except that compensation costs will be recognized in the Company's results of operations. The Company expects the estimated impact of SFAS 123R to (i) reduce diluted earnings per common share by approximately \$0.20, (ii) reduce operating income as a percentage of revenues by approximately 1%, and (iii) require the tax benefits associated with the exercise of stock options be included in cash flows from financing activities. In 2005, tax benefits from the exercise of stock options increased cash from operations by \$33.8 million.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections" ("SFAS 154"), which replaces APB No. 20 "Accounting Changes", and SFAS No. 3 "Reporting Accounting Changes in Interim Financial Statements". SFAS 154 changes the requirements for the accounting for and reporting of a change in accounting principle, and applies to all voluntary changes in accounting principles, as well as changes required by an accounting pronouncement in the unusual instance it does not include specific transition provisions. Specifically, SFAS 154 requires retrospective application to prior periods' financial

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statements, unless it is impracticable to determine the period-specific effects or the cumulative effect of the change. SFAS 154 is effective for the Company beginning January 1, 2006.

3. BUSINESS ACQUISITIONS

Acquisition of LabOne, Inc.

On November 1, 2005, the Company completed its acquisition of LabOne, Inc. ("LabOne") in a transaction valued at approximately \$947 million, including approximately \$138 million of assumed debt of LabOne. LabOne provides health screening and risk assessment services to life insurance companies, as well as clinical diagnostic testing services to healthcare providers and drugs-of-abuse testing to employers.

Under the terms of the merger agreement, the Company paid \$43.90 per common share in cash or \$768 million in total to acquire all of the outstanding common shares of LabOne. In addition, the Company paid \$33 million in cash for outstanding stock options of LabOne. Pursuant to the terms of the merger agreement, upon the change in control of LabOne, LabOne's outstanding stock options became fully vested and exercisable and were cancelled in exchange for the right to receive an amount, for each share subject to the stock option, equal to the excess of \$43.90 per share over the exercise price per share of such option. The aggregate purchase price of \$809 million includes transaction costs of approximately \$8 million.

In conjunction with the acquisition of LabOne, the Company repaid approximately \$127 million of debt, representing substantially all of LabOne's existing outstanding debt as of November 1, 2005.

The Company financed the all cash purchase price and related transaction costs associated with the LabOne acquisition, and the repayment of substantially all of LabOne's outstanding debt with the net proceeds from a \$900 million private placement of senior notes (see Note 10) and cash on-hand.

Through the acquisition of LabOne, the Company acquired all of LabOne's operations, including its health screening and risk assessment services for life insurance companies, its clinical diagnostic testing services, and its drugs-of-abuse testing for employers. LabOne has 3,100 employees and principal laboratories in Lenexa, Kansas, as well as in Cincinnati, Ohio.

The acquisition of LabOne was accounted for under the purchase method of accounting. As such, the cost to acquire LabOne was allocated to the respective assets and liabilities acquired based on their estimated fair values as of the closing date. A preliminary allocation of the costs to acquire LabOne has been made to certain assets and liabilities of LabOne based on preliminary estimates. The Company is continuing to assess the estimated fair values of the assets and liabilities acquired and the portion of goodwill allocable to its clinical laboratory testing business and its risk assessment business. The consolidated financial statements include the results of operations of LabOne subsequent to the closing of the acquisition.

The preliminary allocation of the cost to acquire LabOne is as follows:

	Estimated Fair Values as of November 1, 2005
Current assets	\$ 132,699
Property, plant and equipment	86,396
Intangible assets	139,500
Goodwill	680,109
Other assets	596
Total assets acquired	<u>1,039,300</u>
Current liabilities	48,402
Long-term liabilities	46,754
Long-term debt	135,079
Total liabilities assumed	<u>230,235</u>
Net assets acquired	<u>\$ 809,065</u>

Of the \$139 million of acquired intangible assets, \$130 million was assigned to customer relationships that are being amortized over 20 years and \$9 million was assigned to trade names that are not subject to

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amortization. Of the \$680 million allocated to goodwill, approximately \$47 million is expected to be deductible for tax purposes.

Acquisition of Unilab Corporation

On February 28, 2003, the Company completed the acquisition of Unilab Corporation ("Unilab"), the leading commercial clinical laboratory in California. In connection with the acquisition, the Company paid \$297 million in cash and issued 14.1 million shares of Quest Diagnostics common stock to acquire all of the outstanding capital stock of Unilab. In addition, the Company reserved approximately 0.6 million shares of Quest Diagnostics common stock for outstanding stock options of Unilab which were converted upon the completion of the acquisition into options to acquire shares of Quest Diagnostics common stock (the "converted options").

The aggregate purchase price of \$698 million included the cash portion of the purchase price of \$297 million and transaction costs of approximately \$20 million, with the remaining portion of the purchase price paid through the issuance of 14.1 million shares of Quest Diagnostics common stock (valued at \$372 million or \$26.40 per share, based on the average closing stock price of Quest Diagnostics common stock for the five trading days ended March 4, 2003) and the issuance of approximately 0.6 million converted options (valued at approximately \$9 million, based on the Black Scholes option-pricing model).

In conjunction with the acquisition of Unilab, the Company repaid \$220 million of debt, representing substantially all of Unilab's then existing outstanding debt, and related accrued interest. Of the \$220 million, \$124 million represents payments related to the Company's cash tender offer, which was completed on March 7, 2003, for all of the outstanding \$101 million principal amount and related accrued interest of Unilab's 12¾% Senior Subordinated Notes due 2009 and \$23 million of related tender premium and associated tender offer costs.

The Company financed the cash portion of the purchase price and related transaction costs, and the repayment of substantially all of Unilab's outstanding debt and related accrued interest, with the proceeds from a new \$450 million amortizing term loan due June 2007 and cash on-hand. During 2003, the Company repaid \$145 million of principal outstanding under the term loan due June 2007. During 2004, the Company refinanced the remaining \$305 million of principal outstanding under the term loan due June 2007 with \$100 million of borrowings under the Company's senior unsecured revolving credit facility, \$130 million of borrowings under the Company's secured receivables credit facility and \$75 million of borrowings under the Company's term loan due December 2008.

As part of the Unilab acquisition, Quest Diagnostics acquired all of Unilab's operations, including its primary testing facilities in Los Angeles, San Jose and Sacramento, California, and approximately 365 patient service centers and 35 rapid response laboratories and approximately 4,100 employees. As the leading commercial clinical laboratory in California, the acquisition of Unilab further solidified the Company's leading position within the clinical laboratory testing industry, and further enhanced its national network and access to its comprehensive range of services for physicians, hospitals, patients and healthcare insurers.

In connection with the acquisition of Unilab, as part of a settlement agreement with the United States Federal Trade Commission, the Company entered into an agreement to sell to Laboratory Corporation of America Holdings, Inc., ("LabCorp"), certain assets in northern California for \$4.5 million, including the assignment of agreements with four independent physician associations ("IPA") and leases for 46 patient service centers (five of which also serve as rapid response laboratories) (the "Divestiture"). Approximately \$27 million in annual net revenues were generated by capitated fees under the IPA agreements and associated fee-for-service testing for physicians whose patients use these patient service centers, as well as from specimens received directly from the IPA physicians. The Company completed the transfer of assets and assignment of the IPA agreements to LabCorp and recorded a \$1.5 million gain in the third quarter of 2003 in connection with the Divestiture, which is included in "other operating expense (income), net" within the consolidated statements of operations.

Pro Forma Combined Financial Information

The following unaudited pro forma combined financial information for the years ended December 31, 2005 and 2004 assumes that the LabOne acquisition was completed on January 1, 2004. The unaudited pro forma

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combined financial information for the year ended December 31, 2003 assumes that the Unilab acquisition and the Divestiture were completed on January 1, 2003 (in thousands, except per share data):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net revenues	\$5,936,600	\$5,610,919	\$4,803,875
Net income	547,643	497,758	444,944
Basic earnings per common share:			
Net income	\$ 2.71	\$ 2.44	\$ 2.13
Weighted average common shares outstanding – basic	201,833	203,920	209,104
Diluted earnings per common share:			
Net income	\$ 2.66	\$ 2.34	\$ 2.04
Weighted average common shares outstanding – diluted	205,530	214,145	219,872

The unaudited pro forma combined financial information presented above reflects certain reclassifications to the historical financial statements of LabOne and Unilab to conform the acquired companies' 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, 2005 exclude \$14.3 million of transaction related costs, which were incurred and expensed by LabOne in conjunction with its acquisition by Quest Diagnostics. Pro forma results for the year ended December 31, 2003 exclude \$14.5 million of transaction related costs, which were incurred and expensed by Unilab in conjunction with its acquisition by Quest Diagnostics.

4. INTEGRATION OF ACQUIRED BUSINESSES

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"). SFAS 146, which the Company adopted effective January 1, 2003, requires that a liability for a cost associated with an exit activity, including those related to employee termination benefits and contractual obligations, be recognized when the liability is incurred, and not necessarily the date of an entity's commitment to an exit plan, as under previous accounting guidance. The provisions of SFAS 146 apply to integration costs associated with actions that impact the employees and operations of Quest Diagnostics. Costs associated with actions that impact the employees and operations of an acquired company, such as LabOne or Unilab, are accounted for as a cost of the acquisition and included in goodwill in accordance with EITF No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination".

Integration of LabOne, Inc.

The plan and related costs associated with the integration of LabOne's operations into the Company's laboratory network have not been finalized, as such, management has not yet finalized its estimate of integration costs. Management expects a significant portion of these costs will require cash outlays and will primarily relate to severance and other integration-related costs, including the elimination of excess capacity and workforce reductions.

Integration of Unilab Corporation

During the fourth quarter of 2003, the Company finalized its plan related to the integration of Unilab into Quest Diagnostics' laboratory network. As part of the plan, following the sale of certain assets to LabCorp as part of the Divestiture, the Company closed its previously owned clinical laboratory in the San Francisco Bay area and completed the integration of remaining customers in the northern California area into its laboratories in San Jose and Sacramento. As of December 31, 2005, the Company operated two laboratories in the Los Angeles metropolitan area. As part of the integration plan, the Company plans to open a new regional laboratory in the Los Angeles metropolitan area into which it will integrate all of its business in the area. The Company expects to integrate its business into this new facility during the first quarter of 2006.

During 2003, the Company recorded \$9 million of costs associated with executing the Unilab integration plan. The majority of these integration costs related to employee severance and contractual obligations associated with leased facilities and equipment. Employee groups affected as a result of this plan include those involved in

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the collection and testing of specimens, as well as administrative and other support functions. Of the \$9 million in costs, \$7.9 million was recorded in the fourth quarter of 2003 and related to actions that impact the employees and operations of Unilab, was accounted for as a cost of the Unilab acquisition and included in goodwill. Of the \$7.9 million, \$6.8 million related to employee severance benefits for approximately 150 employees, with the remainder primarily related to contractual obligations. In addition, \$1.1 million of integration costs, related to actions that impact Quest Diagnostics' employees and operations and comprised principally of employee severance benefits for approximately 30 employees, were accounted for as a charge to earnings in the third quarter of 2003 and included in "other operating expense (income), net" within the consolidated statements of operations. As of December 31, 2004, accruals related to the Unilab integration plan totaled \$3.0 million. The actions associated with the Unilab integration plan, including those related to severed employees, were completed in 2005. The remaining accruals associated with the Unilab integration were not material at December 31, 2005.

5. TAXES ON INCOME

The Company's pretax income consisted of \$904 million, \$826 million and \$736 million from U.S. operations and approximately \$6.0 million, \$9.1 million and \$1.4 million from foreign operations for the years ended December 31, 2005, 2004 and 2003, respectively.

The components of income tax expense (benefit) for 2005, 2004 and 2003 were as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Current:			
Federal	\$298,991	\$233,635	\$214,729
State and local	62,232	50,527	51,771
Foreign	2,293	(682)	728
Deferred:			
Federal	(2,320)	41,316	29,271
State and local	2,981	11,135	4,582
Total	<u>\$364,177</u>	<u>\$335,931</u>	<u>\$301,081</u>

A reconciliation of the federal statutory rate to the Company's effective tax rate for 2005, 2004 and 2003 was as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</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	5.0
Impact of foreign operations	0.1	0.1	0.2
Non-deductible meals and entertainment expense	0.2	0.2	0.3
Other, net	<u>0.1</u>	<u>0.3</u>	<u>0.3</u>
Effective tax rate	<u>40.0%</u>	<u>40.2%</u>	<u>40.8%</u>

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The tax effects of temporary differences that give rise to significant portions of the deferred taxes at December 31, 2005 and 2004 were as follows:

	<u>2005</u>	<u>2004</u>
Current deferred tax asset:		
Accounts receivable reserve	\$ 32,598	\$ 28,020
Liabilities not currently deductible.....	<u>74,844</u>	<u>55,010</u>
Total current deferred tax asset	<u>\$ 107,442</u>	<u>\$ 83,030</u>
Non-current deferred tax asset (liability):		
Liabilities not currently deductible.....	\$ 69,071	\$ 55,534
Net operating loss carryforwards	9,663	14,247
Depreciation and amortization	<u>(100,752)</u>	<u>(40,407)</u>
Total non-current deferred tax (liability) asset.....	<u>\$ (22,018)</u>	<u>\$ 29,374</u>

The non-current deferred tax liability of \$22 million at December 31, 2005 is included in other liabilities in the consolidated balance sheet.

As of December 31, 2005, the Company had estimated net operating loss carryforwards for federal and state income tax purposes of \$24 million and \$311 million, respectively, which expire at various dates through 2025. As of December 31, 2005 and 2004, deferred tax assets associated with net operating loss carryforwards for federal and state income tax purposes of \$22 million and \$30 million, respectively, have each been reduced by a valuation allowance of \$14 million and \$16 million, respectively.

Income taxes payable at December 31, 2005 and 2004 were \$29 million and \$28 million, respectively, and consisted primarily of federal income taxes payable of \$19 million and \$25 million, respectively.

The Company provides reserves for potential tax exposures that may arise from examinations by federal or state tax authorities. Management believes that while the ultimate resolution of these matters will not be material to the Company's financial position, resolution of these matters could be material to the Company's results of operations or cash flows in the period in which the resolution of such matters is determined.

In conjunction with the Spin-Off Distribution, the Company entered into a tax sharing agreement with its former parent and a former subsidiary, that provide the parties with certain rights of indemnification against each other. In conjunction with its acquisition of SmithKline Beecham Clinical Laboratories, Inc. ("SBCL"), which operated the clinical laboratory 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.

The American Jobs Creation Act of 2004 (the "Act") was signed into law on October 22, 2004. The provisions of the Act did not have a material effect on the Company's consolidated results of operations or financial condition.

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6. SUPPLEMENTAL CASH FLOW AND OTHER DATA

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Depreciation expense	\$ 171,394	\$162,024	\$145,701
Interest expense	(61,446)	(60,154)	(60,630)
Interest income	<u>3,975</u>	<u>2,205</u>	<u>841</u>
Interest, net	(57,471)	(57,949)	(59,789)
Interest paid	49,976	51,781	59,394
Income taxes paid	314,534	209,156	211,966
<u>Businesses acquired:</u>			
Fair value of assets acquired	\$1,039,300	\$ -	\$989,778
Fair value of liabilities assumed	230,235	-	291,422
<u>Non-cash financing activities:</u>			
Conversion of contingent convertible debentures	\$ 244,338	\$ 3,197	\$ -
Fair value of common stock issued to acquire Unilab	-	-	372,464
Fair value of converted options issued in conjunction with the Unilab acquisition	-	-	8,452

7. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at December 31, 2005 and 2004 consisted of the following:

	<u>2005</u>	<u>2004</u>
Land	\$ 36,255	\$ 34,301
Buildings and improvements	329,441	276,661
Laboratory equipment, furniture and fixtures	823,799	761,926
Leasehold improvements	190,329	167,656
Computer software developed or obtained for internal use	171,724	149,292
Construction-in-progress	<u>98,897</u>	<u>43,291</u>
	1,650,445	1,433,127
Less: accumulated depreciation and amortization	<u>(896,782)</u>	<u>(813,642)</u>
Total	<u>\$ 753,663</u>	<u>\$ 619,485</u>

8. GOODWILL AND INTANGIBLE ASSETS

Goodwill at December 31, 2005 and 2004 consisted of the following:

	<u>2005</u>	<u>2004</u>
Goodwill	\$3,385,280	\$2,695,003
Less: accumulated amortization	<u>(188,053)</u>	<u>(188,053)</u>
Goodwill, net	<u>\$3,197,227</u>	<u>\$2,506,950</u>

The changes in the gross carrying amount of goodwill for the years ended December 31, 2005 and 2004 are as follows:

	<u>2005</u>	<u>2004</u>
Balance as of January 1	\$ 2,695,003	\$ 2,706,928
Goodwill acquired during the year	697,766	-
Other	<u>(7,489)</u>	<u>(11,925)</u>
Balance as of December 31	<u>\$ 3,385,280</u>	<u>\$ 2,695,003</u>

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For the year ended December 31, 2005, the Company recorded a \$7.5 million charge which is included in other operating expense (income), net in the consolidated statement of operations, to write-off all of the goodwill associated with its test kit manufacturing subsidiary, NID. See Note 15 for further details. For the year ended December 31, 2004, the reduction in goodwill was primarily related to an increase in pre-acquisition tax net operating losses and credit carryforwards associated with businesses acquired.

Amortizing intangible assets at December 31, 2005 and 2004 consisted of the following:

	Weighted Average Amortization Period	December 31, 2005			December 31, 2004		
		Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Amortizing intangible assets:							
Customer-related intangibles	20 years	\$172,522	\$(39,297)	\$133,225	\$42,225	\$(37,197)	\$ 5,028
Non-compete agreements	5 years	45,707	(44,221)	1,486	44,942	(42,348)	2,594
Other	6 years	7,044	(3,772)	3,272	6,850	(3,010)	3,840
Total	20 years	<u>\$225,273</u>	<u>\$(87,290)</u>	<u>\$137,983</u>	<u>\$94,017</u>	<u>\$(82,555)</u>	<u>\$11,462</u>

Amortization expense related to intangible assets was \$4,730, \$6,703 and \$8,201 for the years ended December 31, 2005, 2004 and 2003, respectively.

The estimated amortization expense related to amortizable intangible assets for each of the five succeeding fiscal years and thereafter as of December 31, 2005 is as follows:

**Fiscal Year Ending
December 31,**

2006	\$ 9,374
2007	7,983
2008	7,790
2009	7,375
2010	7,128
Thereafter	98,333
Total	<u>\$137,983</u>

Intangible assets not subject to amortization at December 31, 2005 consisted of \$9.4 million of tradenames resulting from the acquisition of LabOne on November 1, 2005 (see Note 3).

9. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at December 31, 2005 and 2004 consisted of the following:

	<u>2005</u>	<u>2004</u>
Accrued wages and benefits	\$275,709	\$265,126
Accrued expenses	266,716	247,134
Trade accounts payable	193,385	128,488
Income taxes payable	28,643	28,239
Total	<u>\$764,453</u>	<u>\$668,987</u>

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10. DEBT

Short-term borrowings and current portion of long-term debt at December 31, 2005 and 2004 consisted of the following:

	<u>2005</u>	<u>2004</u>
Borrowings under Secured Receivables Credit Facility	\$ 60,000	\$129,921
Senior Notes due July 2006	274,844	-
Contingent Convertible Debentures called for redemption in December 2004	-	244,660
Current portion of long-term debt	1,995	220
Total short-term borrowings and current portion of long-term debt	<u>\$336,839</u>	<u>\$374,801</u>

Long-term debt at December 31, 2005 and 2004 consisted of the following:

	<u>2005</u>	<u>2004</u>
Industrial Revenue Bonds due September 2009	\$ 7,200	\$ -
Borrowings under Credit Facility	-	100,000
Term loan due December 2008	75,000	75,000
Senior Notes due July 2006	-	274,531
Senior Notes due November 2010	399,273	-
Senior Notes due July 2011	274,392	274,281
Senior Notes due November 2015	498,427	-
Debentures due June 2034	2,858	-
Other	231	429
Total	1,257,381	724,241
Less: current portion	1,995	220
Total long-term debt	<u>\$1,255,386</u>	<u>\$724,021</u>

2004 Debt Refinancings

On April 20, 2004, the Company entered into a new \$500 million senior unsecured revolving credit facility which replaced a \$325 million unsecured revolving credit facility. Under the new \$500 million senior unsecured revolving credit facility (the "Credit Facility"), which matures in April 2009, interest is based on certain published rates plus an applicable margin that will vary over an approximate range of 90 basis points based on changes in the Company's public debt rating. At the option of the Company, it may elect to enter into LIBOR-based interest rate contracts for periods up to 180 days. Interest on any outstanding amounts not covered under the 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, 2005 and 2004, the Company's borrowing rate for LIBOR-based loans was LIBOR plus 0.50% and 0.625%, respectively. The Credit Facility is guaranteed by the Company's wholly owned subsidiaries that operate clinical laboratories in the United States (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.

In addition, on April 20, 2004, the Company entered into a new \$300 million receivables securitization facility which replaced a \$250 million receivables securitization facility that matured in April 2004. The new \$300 million receivables securitization facility (the "Secured Receivables Credit Facility") matures in April 2007. 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, 2005 and 2004, the Company's borrowing rate under the Secured Receivables Credit Facility was 4.7% and 2.7%, respectively. The Secured Receivables Credit Facility is supported by one-year back-up facilities provided by two banks on a committed basis. Borrowings outstanding under the Secured Receivables Credit Facility, if any, are classified as a current liability on the Company's consolidated balance sheet since the lenders fund the borrowings through the issuance of commercial paper which matures at various dates within one year from the date of issuance and the term of the one-year back-up facilities described above.

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In conjunction with the debt refinancings, the Company recorded a \$2.9 million charge to earnings in the second quarter of 2004 representing the write-off of deferred financing costs associated with the debt that was refinanced. The \$2.9 million charge was included in interest expense, net within the consolidated statements of operations for the year ended December 31, 2004.

Industrial Revenue Bonds

In connection with the acquisition of LabOne, 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 adjusted weekly based on LIBOR plus approximately 0.08% or 4.5% as of December 31, 2005. The bonds are secured by the Lenexa, Kansas laboratory facility and an irrevocable bank letter of credit.

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. After considering the discounts, the effective interest rates on the Senior Notes due 2006 and the Senior Notes due 2011 are 6.9% and 7.6%, respectively. The 2001 Senior Notes require semiannual interest payments which commenced January 12, 2002. The 2001 Senior Notes are unsecured obligations of the Company and rank equally with the Company's other unsecured senior obligations. The 2001 Senior Notes 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 1, 2010 ("Senior Notes due 2010"); and (b) \$500 million aggregate principal amount of 5.45% senior notes due November 1, 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 were issued at a discount of \$0.8 million, and the Senior Notes due 2015 were issued at a discount of \$1.6 million. 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 will commence 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.

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 comprehensive income) and amortized as an adjustment to interest expense over the term of the Senior Notes due 2015.

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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. At the option of the Company, it may elect to enter into LIBOR-based interest rate contracts for periods up to 180 days. Interest on any outstanding amounts not covered under the 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, 2005 and 2004, the Company’s borrowing rate for LIBOR-based loans was LIBOR plus 0.50% and 0.55%, respectively. The term loan due December 2008 requires principal repayments of the initial amount borrowed equal to 20% on each of the third and fourth anniversary dates of the funding and the remainder of the outstanding balance on December 31, 2008. The term loan due December 2008 is guaranteed by the Subsidiary Guarantors and contains various covenants similar to those under the Credit Facility.

Debentures due June 2034

In connection with the acquisition of LabOne, 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 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, reflecting a discount of \$1.6 million based on the net present value of the estimated remaining obligations, at current interest rates. The Debentures due June 2034 are no longer convertible into shares of common stock of LabOne or the Company. The Debentures due June 2034 require semi-annual interest payments in June and December.

Contingent Convertible Debentures

On November 26, 2001, the Company completed its \$250 million offering of its Debentures. The net proceeds of the offering, together with cash on hand, were used to repay all of the \$256 million principal that was then outstanding under the Company’s secured receivables credit facility. The Debentures, which paid a fixed rate of interest semi-annually commencing on May 31, 2002, had a contingent interest component, which was considered to be a derivative instrument subject to SFAS 133, as amended, that would have required the Company to pay contingent interest based on certain thresholds, as outlined in the indenture governing the Debentures. For income tax purposes, the Debentures were considered to be a contingent payment security. As such, interest expense for tax purposes was based on an assumed interest rate related to a comparable fixed interest rate debt security issued by the Company without a conversion feature. The assumed interest rate for tax purposes was 7% for 2004.

The Debentures were guaranteed by the Subsidiary Guarantors and did not have a sinking fund requirement.

Each one thousand dollar principal amount of Debentures was convertible initially into 22.858 shares of the Company’s common stock, which represented an initial conversion price of \$43.75 per share. Holders were able to surrender the Debentures for conversion into shares of the Company’s common stock under any of the following circumstances: (1) if the sales price of the Company’s common stock was above 120% of the conversion price (or \$52.50 per share) for specified periods; (2) if the Company called the Debentures; or (3) if specified corporate transactions occurred.

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In December 2004, the Company called for redemption all of its outstanding Debentures. Under the terms of the Debentures, the holders of the Debentures had an option to submit their Debentures for redemption at par plus accrued and unpaid interest or convert their Debentures into shares of the Company's common stock at a conversion price of \$43.75 per share. Through December 31, 2004, \$3.2 million of principal of the Debentures were converted into less than 0.1 million shares of the Company's common stock. The outstanding principal of the Debentures at December 31, 2004 was classified as a current liability within short-term borrowings and current portion of long-term debt on the Company's consolidated balance sheet. As of January 18, 2005, the redemption was completed and \$0.4 million of principal was redeemed for cash and \$249.6 million of principal was converted into approximately 5.7 million shares of the Company's common stock.

Letter of Credit Lines

The Company has two lines of credit with two financial institutions totaling \$85 million for the issuance of letters of credit (the "letter of credit lines"). The letter of credit lines mature in December 2006 and are guaranteed by the Subsidiary Guarantors. As of December 31, 2005, there are \$69 million of outstanding letters of credit under the letter of credit lines.

As of December 31, 2005 long-term debt, including capital leases, maturing in each of the years subsequent to December 31, 2006, is as follows:

Year ending December 31,

2007.....	\$ 16,829
2008.....	61,806
2009.....	1,800
2010.....	399,273
2011.....	274,392
Thereafter.....	<u>501,286</u>
Total long-term debt.....	<u><u>\$1,255,386</u></u>

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.

Preferred Share Purchase Rights

Each share of Quest Diagnostics common stock trades with a preferred share purchase right, which entitles stockholders to purchase one-hundredth of a share of Series A Preferred Stock upon the occurrence of certain events. In conjunction with the SBCL acquisition, the Board of Directors of the Company approved an amendment to the preferred share purchase rights. The amended rights entitle stockholders to purchase shares of Series A Preferred Stock at a predefined price in the event a person or group (other than SmithKline Beecham) acquires 20% or more of the Company's outstanding common stock. The preferred share purchase rights expire December 31, 2006.

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Accumulated Other Comprehensive (Loss) Income

The components of accumulated other comprehensive (loss) income for 2005, 2004 and 2003 were as follows:

	<u>Foreign Currency Translation Adjustment</u>	<u>Market Value Adjustment</u>	<u>Deferred Gain</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>
Balance, December 31, 2002	\$(2,480)	\$(3,044)	\$ -	\$(5,524)
Translation adjustment	2,169	-	-	2,169
Market value adjustment, net of tax expense of \$6,201	<u>-</u>	<u>9,302</u>	<u>-</u>	<u>9,302</u>
Balance, December 31, 2003	(311)	6,258	-	5,947
Translation adjustment	1,650	-	-	1,650
Market value adjustment, net of tax benefit of \$2,515	<u>-</u>	<u>(3,731)</u>	<u>-</u>	<u>(3,731)</u>
Balance, December 31, 2004	1,339	2,527	-	3,866
Translation adjustment	(3,287)	-	-	(3,287)
Market value adjustment, net of tax benefit of \$6,057	<u>-</u>	<u>(9,238)</u>	<u>-</u>	<u>(9,238)</u>
Deferred gain, less reclassifications	<u>-</u>	<u>-</u>	<u>2,454</u>	<u>2,454</u>
Balance, December 31, 2005	<u>\$(1,948)</u>	<u>\$(6,711)</u>	<u>\$2,454</u>	<u>\$(6,205)</u>

The market value adjustments for 2005, 2004 and 2003 represented unrealized holding gains (losses), net of taxes. The deferred gain for 2005 represented the \$2.5 million the Company received upon the settlement of its Treasury Lock Agreements, net of amounts reclassified as a reduction to interest expense (see Note 10).

Dividend Policy

On October 21, 2003, the Company's Board of Directors declared its first payment of a quarterly cash dividend of \$0.075 per common share. During each of the quarters of 2005 and 2004, the Company's Board of Directors has declared a quarterly cash dividend of \$0.09 and \$0.075 per common share, respectively. On January 26, 2006, the Company's Board of Directors increased the quarterly cash dividend per common share to \$0.10.

Share Repurchase Plan

In 2003, the Company's Board of Directors authorized a share repurchase program, which permitted the Company to purchase up to \$600 million of its common stock. In July 2004 and January 2005, the Company's Board of Directors authorized the Company to purchase up to an additional \$300 million and \$350 million, respectively, of its common stock. Under a separate authorization from the Board of Directors, in December 2004 the Company repurchased 5.4 million shares of its common stock for approximately \$254 million from GlaxoSmithKline plc. For the year ended December 31, 2005, the Company repurchased approximately 7.8 million shares of its common stock at an average price of \$49.98 per share for \$390 million. For the year ended December 31, 2005, the Company reissued approximately 5.6 million shares and 4.3 million shares, respectively, in connection with the conversion of its Debentures and for employee benefit plans. At December 31, 2005, \$122 million of the share repurchase authorization remained available. In January 2006, the Company's Board of Directors expanded the share repurchase authorization by an additional \$600 million, bringing the total amount authorized and available for repurchases to \$722 million.

12. STOCK OWNERSHIP AND COMPENSATION PLANS

Employee and Non-employee Directors Stock Ownership Programs

In 2005, the Company established the Amended and Restated Employee Long-Term Incentive Plan (the "ELTIP") to replace the Company's prior Employee Equity Participation Programs established in 1999 (the

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“1999 EEPP”) and 1996 (the “1996 EEPP”). The ELTIP provides for three types of awards: (a) stock options, (b) stock appreciation rights and (c) incentive 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 Quest Diagnostics common stock at 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 prescribed vesting period, as determined by the Board of Directors. The stock options expire on the date designated by the Board of Directors but in no event more than seven years from date of grant. Grants of stock appreciation rights allow eligible employees to receive a payment based on the appreciation of Quest Diagnostics common stock in cash, shares of Quest Diagnostics 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 Quest Diagnostics common stock on the date of grant. Stock appreciation rights 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. Under the incentive stock provisions of the plan, the ELTIP allows eligible employees to receive awards of shares, or the right to receive shares, of Quest Diagnostics 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 prescribed vesting period, which ranges primarily from three to four years. The fair market value of the shares awarded is recorded as unearned compensation. The amount of unearned compensation is subject to adjustment based upon changes in earnings estimates, if any, during the initial year of grant and is amortized to compensation expense over the prescribed vesting period. Key executive, managerial and technical employees are eligible to participate in the ELTIP. The provisions of the 1999 EEPP and the 1996 EEPP were similar to those outlined above for the ELTIP. Certain options granted under the 1999 EEPP and the 1996 EEPP remain outstanding.

The ELTIP increased the maximum number of shares of Quest Diagnostics common stock that may be optioned or granted to 48 million shares, after giving effect for the Company’s two-for-one stock split effected on June 20, 2005 (see Note 2). In addition, any remaining shares under the 1996 EEPP 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 Quest Diagnostics common stock at no less than the fair market value on the date of grant and incentive stock awards. The incentive stock awards are generally earned on achievement of certain performance goals. The maximum number of shares that may be issued under the DLTIP is 2 million shares, after giving effect for the Company’s two-for-one stock split effected on June 20, 2005 (see Note 2). The stock options expire seven years from date of grant and generally vest over three years. During 2005, 2004 and 2003, grants under the DLTIP totaled 110, 180 and 188 thousand shares, respectively.

Transactions under the stock option plans were as follows (options in thousands, except per share amounts):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Options outstanding, beginning of year	16,752	20,480	17,844
Options granted	2,777	4,428	6,352
Options exercised	(3,990)	(7,042)	(3,232)
Options terminated	(491)	(1,114)	(484)
Options outstanding, end of year	<u>15,048</u>	<u>16,752</u>	<u>20,480</u>
Exercisable	8,660	8,516	11,412
Weighted average exercise price:			
Options granted	\$ 49.66	\$ 40.85	\$ 26.67
Options exercised	25.87	16.06	10.15
Options terminated	24.48	29.65	29.16
Options outstanding, end of year	34.33	29.49	22.43
Exercisable, end of year	28.81	23.95	17.01
Weighted average fair value of options at grant date	\$ 14.15	\$ 17.23	\$ 11.61

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The following relates to options outstanding at December 31, 2005:

Options Outstanding				Options Exercisable	
Range of Exercise Price	Shares (in thousands)	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Shares (in thousands)	Weighted Average Exercise Price
\$ 3.97 - \$ 5.10	86	2.5	\$ 4.36	86	\$ 4.36
\$ 6.46 - \$ 9.58	842	3.7	6.84	842	6.84
\$15.03 - \$22.38	245	4.4	15.26	245	15.26
\$23.27 - \$34.79	5,457	6.6	26.35	4,320	26.42
\$35.01 - \$52.50	7,895	7.2	42.45	3,160	39.59
\$52.62 - \$53.27	523	6.4	53.25	7	52.84

The following summarizes the activity relative to incentive stock awards granted in 2005, 2004 and 2003 (shares in thousands):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Incentive shares, beginning of year	-	576	1,470
Incentive shares granted	113	-	204
Incentive shares vested	(1)	(538)	(1,066)
Incentive shares forfeited and canceled	(5)	(38)	(32)
Incentive shares, end of year	<u>107</u>	<u>-</u>	<u>576</u>
Weighted average fair value of incentive shares at grant date	\$49.71	\$ -	\$ 24.94

Employee Stock Purchase Plan

Under the Company's Employee Stock Purchase Plan ("ESPP"), 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 lower of its beginning-of-quarter or end-of-quarter market price. In 2005, the Company's ESPP was amended such that effective July 1, 2005, the purchase price of the stock will be 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 8 million. The ESPP will terminate effective December 31, 2006. The Company plans to submit for approval by the shareholders at its 2006 Annual Meeting of Shareholders an extension of the plan. Approximately 409, 460 and 544 thousand shares of common stock were purchased by eligible employees in 2005, 2004 and 2003, respectively.

Defined Contribution Plan

The Company maintains a qualified defined contribution plan covering substantially all of its employees, and matches employee contributions up to a maximum of 6%. The Company's expense for contributions to its defined contribution plan aggregated \$64 million, \$62 million and \$54 million for 2005, 2004 and 2003, 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 eligible compensation in excess of their defined contribution plan limits. In addition, certain members of senior management have an additional opportunity to defer up to 95% of their variable incentive compensation. 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. Although the Company is currently contributing all participant deferrals and matching amounts to a trust, the funds in the trust, totaling \$25.7 million and \$20.9 million at December 31, 2005 and 2004, respectively, are general assets of the

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Company and are subject to any claims of the Company's creditors. The Company's expense for matching contributions to this plan were \$0.8 million, \$0.7 million and \$0.4 million for 2005, 2004 and 2003, respectively.

13. RELATED PARTY TRANSACTIONS

At December 31, 2005, GlaxoSmithKline plc ("GSK"), the result of the merger of Glaxo Wellcome and SmithKline Beecham in December 2000, beneficially owned approximately 18% of the outstanding shares of Quest Diagnostics common stock. During 2004, the Company repurchased approximately 7.8 million shares of its common stock for approximately \$355 million from GSK.

GSK has a long-term contractual relationship with Quest Diagnostics under which Quest Diagnostics is the primary provider of testing to support GSK's clinical trials testing requirements worldwide (the "Clinical Trials Agreements"). Net revenues, primarily derived under the Clinical Trials Agreements were \$68,806, \$73,894 and \$50,060 for 2005, 2004 and 2003, respectively.

In addition, under the SBCL acquisition agreements, 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 both December 31, 2005 and 2004, accounts payable and accrued expenses included \$28 million due to SmithKline Beecham, primarily related to tax benefits associated with indemnifiable matters.

14. COMMITMENTS AND CONTINGENCIES

Minimum rental commitments under noncancelable operating leases, primarily real estate, in effect at December 31, 2005 are as follows:

Year ending December 31,

2006	\$134,406
2007	105,705
2008	82,352
2009	67,499
2010	50,222
2011 and thereafter	<u>146,842</u>
Minimum lease payments	587,026
Noncancelable sub-lease income	<u>(94)</u>
Net minimum lease payments	<u><u>\$586,932</u></u>

Operating lease rental expense for 2005, 2004 and 2003 aggregated \$140 million, \$133 million and \$121 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 is subject to contingent obligations under certain leases and other instruments incurred in connection with real estate activities and other operations associated with LabOne and certain of its predecessor companies. The contingent obligations arise out of certain land leases with two Hawaiian trusts relating to land in Waikiki upon which a hotel is built and a land lease for a parking garage in Reno, Nevada. While its title and interest to the subject leases have been transferred to third parties, the land owners have not released the original obligors, including predecessors of LabOne, from their obligations under the leases. In early February 2006, the subtenant of the hotel in Waikiki filed for Chapter 11 bankruptcy protection in Honolulu. The subtenant has publicly indicated that the filing will have no impact on the operations of the hotel and therefore, the Company believes the subtenant will continue to pay the rent and real estate taxes on the subject leased property. Should the current subtenants of the leased properties fail to pay their rent and real estate taxes for the subject leased property, the default could trigger liability for LabOne as well as other sublessors. The rent payments under the Hawaiian land leases are subject to market value adjustments every ten years beginning in 2007. Given that the Hawaiian land leases are subject to market value adjustments, the total contingent obligations under such leases cannot be precisely estimated, but are likely to total several hundred million dollars. The contingent obligation of the Nevada lease is estimated to be approximately \$6 million. The

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Company believes that the leasehold improvements on the leased properties are significantly more valuable than the related lease obligations. Based on the circumstances above, no liability has been recorded for any potential contingent obligations related to the land leases. 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, 2005, the approximate total future purchase commitments are \$55 million, of which \$28 million are expected to be incurred in 2006.

In support of its risk management program, the Company has standby letters of credit issued under its letter of credit lines to ensure its performance or payment to third parties, which amounted to \$69 million at December 31, 2005. The letters of credit, which are renewed annually, primarily represent collateral for current and future automobile liability and workers' compensation loss payments.

The Company has entered into several settlement agreements with various government and private payers during recent years relating to industry-wide billing and marketing practices that had been substantially discontinued by the mid-1990s. 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 related to billing practices filed under the qui tam provisions of the False Claims Act and other federal and state statutes. These lawsuits include class action and individual claims by patients arising out of the Company's billing practices. In addition, the Company is involved in various legal proceedings arising in the ordinary course of business. Some of the proceedings against the Company involve claims that are substantial in amount.

During the fourth quarter of 2004, the Company and its test kit manufacturing subsidiary, NID, each received a subpoena from the United States Attorney's Office for the Eastern District of New York. The Company and NID have been cooperating with the United States Attorney's Office. In connection with such cooperation, the Company has been providing information and producing various business records of NID and the Company, including documents related to testing and test kits manufactured by NID. This investigation by the United States Attorney's Office could lead to civil and criminal damages, fines and penalties and additional liabilities from third party claims. In the second and third quarters of 2005, the U.S. Food and Drug Administration ("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 is cooperating with the FDA and has filed its responses to the Form 483. Noncompliance with the FDA regulatory requirements or failure to take adequate and timely corrective action could lead to regulatory or enforcement action against NID and/or the Company, including, but not limited to, a warning letter, injunction, suspension of production and/or distribution, seizure or recall of products, fines or penalties, denial of pre-market clearance for new or changed products, recommendation against award of government contracts and criminal prosecution.

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 U.S. 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 from 1995 to the present. The Company is cooperating with the United States Attorney's Office and the Office of the Inspector General.

Management has established reserves in accordance with generally accepted accounting principles for the matters discussed above. 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, the Company understands that 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.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
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As a general matter, providers of clinical laboratory 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 laboratory 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. The basis for claims reserves considers 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. BUSINESS SEGMENT INFORMATION

The Company's clinical laboratory testing business currently represents its one reportable business segment. The clinical laboratory testing business accounts for approximately 95% of consolidated net revenues in each of the three years ended December 31, 2005. Clinical laboratory testing is an essential element in the delivery of healthcare services. Physicians use laboratory tests to assist in the detection, diagnosis, evaluation, monitoring and treatment of diseases and other medical conditions. Clinical laboratory testing is generally categorized as clinical testing and anatomic pathology testing. Clinical testing is performed on body fluids, such as blood and urine. Anatomic pathology testing is performed on tissues, including biopsies, and other samples, such as human cells. Customers of the clinical laboratory testing business include patients, physicians, hospitals, employers, governmental institutions and other commercial clinical laboratories.

All other operating segments include the Company's non-clinical laboratory testing businesses and consist of its risk assessment services business, its clinical trials testing business, its test kit manufacturing subsidiary, NID, and its healthcare information technology business, MedPlus. The Company's risk assessment business, acquired as part of the LabOne acquisition in 2005 (see Note 3), provides underwriting support services to the life insurance industry including teleunderwriting, specimen collection and paramedical examinations, laboratory testing, medical record retrieval, motor vehicle reports, telephone inspections and credit checks. The Company's clinical trials testing business provides clinical laboratory testing performed in connection with clinical research trials on new drugs. NID manufactures and markets diagnostic test kits and systems. MedPlus is a developer and integrator of clinical connectivity and data management solutions for healthcare organizations, physicians and clinicians.

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. No one customer accounted for ten percent or more of net revenues in 2005, 2004, or 2003.

The following table is a summary of segment information for the years ended December 31, 2005, 2004 and 2003. 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.

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net revenues:			
Clinical laboratory testing business	\$5,247,465	\$4,910,753	\$4,555,688
All other operating segments	<u>256,246</u>	<u>215,848</u>	<u>182,270</u>
Total net revenues	<u>\$5,503,711</u>	<u>\$5,126,601</u>	<u>\$4,737,958</u>
Operating earnings (loss):			
Clinical laboratory testing business	\$1,083,395 (a)	\$ 971,395	\$ 863,498 (b)
All other operating segments	(30,750)(c)	19,331	18,227
General corporate expenses	<u>(84,534)</u>	<u>(99,509)(d)</u>	<u>(85,271)</u>
Total operating income	968,111	891,217	796,454
Non-operating expenses, net	<u>(57,657)</u>	<u>(56,091)</u>	<u>(58,656)</u>
Income before income taxes	910,454	835,126	737,798
Income tax expense	<u>364,177</u>	<u>335,931</u>	<u>301,081</u>
Net income	<u>\$ 546,277</u>	<u>\$ 499,195</u>	<u>\$ 436,717</u>

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Depreciation and amortization:			
Clinical laboratory testing business	\$ 156,920	\$ 148,803	\$ 134,101
All other operating segments	13,289	11,987	10,263
General corporate	<u>5,915</u>	<u>7,936</u>	<u>9,539</u>
Total depreciation and amortization	<u>\$ 176,124</u>	<u>\$ 168,726</u>	<u>\$ 153,903</u>
Capital expenditures:			
Clinical laboratory testing business	\$ 204,471	\$ 167,203	\$ 161,421
All other operating segments	15,889	6,543	9,706
General corporate	<u>3,910</u>	<u>2,379</u>	<u>3,514</u>
Total capital expenditures	<u>\$ 224,270</u>	<u>\$ 176,125</u>	<u>\$ 174,641</u>

- (a) During 2005, the Company recorded a \$6.2 million charge primarily related to forgiving amounts owed by patients and physicians, and related property damage as a result of the hurricanes in the Gulf Coast.
- (b) During 2003, operating income includes \$3.3 million of gains on the sale of certain operating assets, partially offset by a \$1.1 million charge associated with the integration of Unilab (See Note 4).
- (c) During the fourth quarter of 2005, NID instituted its second product hold due to quality issues. The hold remains in effect for substantially all of NID's products while NID works to address the issues and return product to market. The latest product hold has caused the Company to reevaluate the financial outlook for NID. As a result of this analysis, the Company recorded a charge of \$16 million in the fourth quarter to write off certain of NID's assets. The charge includes the write-off of all of the goodwill associated with NID of \$7.5 million and other write-offs totaling \$8.5 million, principally related to products and equipment inventory. In addition, during the second quarter of 2005, in connection with its first product hold, NID recorded a charge of approximately \$3 million, principally related to products and equipment inventory. These charges, coupled with the operating losses at NID stemming from the product holds, together with the costs to rectify NID's quality issues and comply with an ongoing government investigation and regulatory review of NID, have reduced operating income compared to the prior year by approximately \$50 million.
- (d) During 2004, the Company recorded a \$10.3 million charge associated with the acceleration of certain pension obligations in connection with the succession of the Company's prior CEO.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
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16. SUMMARIZED FINANCIAL INFORMATION

As described in Note 10, the 2005 Senior Notes, the 2001 Senior Notes and the Debentures 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 January 2005, the Company completed its redemption of all of its outstanding Debentures (see Note 10 for further details).

In conjunction with the Company's Secured Receivables Credit Facility described in Note 10, the Company maintains a wholly owned non-guarantor subsidiary, Quest Diagnostics Receivables Incorporated ("QDRI"). Through March 31, 2004, the Company and the Subsidiary Guarantors, with the exception of American Medical Laboratories, Incorporated ("AML") and Unilab, transferred all private domestic receivables (principally excluding receivables due from Medicare, Medicaid and other federal programs, and receivables due from customers of its joint ventures) to QDRI. Effective with the second quarter of 2004, the Company and Subsidiary Guarantors, including AML and Unilab, transfer all private domestic receivables to QDRI. However, LabOne, which was acquired by Quest Diagnostics on November 1, 2005 (see Note 3), does not transfer its private domestic receivables to QDRI. QDRI utilizes the transferred receivables to collateralize 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. On February 28, 2003, Quest Diagnostics acquired Unilab (see Note 3), which has been included in the accompanying condensed consolidating financial data, subsequent to the closing of the acquisition, as a Subsidiary Guarantor. LabOne has been included in the accompanying condensed consolidating financial data, subsequent to the closing of the acquisition, as a Subsidiary Guarantor.

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

Condensed Consolidating Balance Sheet
December 31, 2005

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Assets					
Current assets:					
Cash and cash equivalents.....	\$ 76,941	\$ 4,759	\$ 10,430	\$ -	\$ 92,130
Accounts receivable, net	31,611	152,314	548,982	-	732,907
Other current assets.....	43,932	116,099	84,429	-	244,460
Total current assets	152,484	273,172	643,841	-	1,069,497
Property, plant and equipment, net	200,438	523,907	29,318	-	753,663
Goodwill and intangible assets, net	156,314	3,142,702	45,594	-	3,344,610
Intercompany receivable (payable)	418,892	(14,091)	(404,801)	-	-
Investment in subsidiaries	3,199,319	-	-	(3,199,319)	-
Other assets	94,050	7,754	37,784	(1,243)	138,345
Total assets	<u>\$4,221,497</u>	<u>\$3,933,444</u>	<u>\$351,736</u>	<u>\$(3,200,562)</u>	<u>\$5,306,115</u>
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable and accrued expenses	\$ 433,310	\$ 293,705	\$ 37,438	\$ -	\$ 764,453
Short-term borrowings and current portion of long-term debt	35,306	240,553	60,980	-	336,839
Total current liabilities	468,616	534,258	98,418	-	1,101,292
Long-term debt	932,950	321,458	978	-	1,255,386
Other liabilities	56,947	107,121	23,628	(1,243)	186,453
Stockholders' equity	2,762,984	2,970,607	228,712	(3,199,319)	2,762,984
Total liabilities and stockholders' equity	<u>\$4,221,497</u>	<u>\$3,933,444</u>	<u>\$351,736</u>	<u>\$(3,200,562)</u>	<u>\$5,306,115</u>

Condensed Consolidating Balance Sheet
December 31, 2004

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Assets:					
Current assets:					
Cash and cash equivalents.....	\$ 56,424	\$ 6,058	\$ 10,820	\$ -	\$ 73,302
Accounts receivable, net	22,365	75,359	551,557	-	649,281
Other current assets.....	12,032	109,100	87,365	-	208,497
Total current assets	90,821	190,517	649,742	-	931,080
Property, plant and equipment, net	213,416	379,952	26,117	-	619,485
Goodwill and intangible assets, net	158,021	2,315,015	45,376	-	2,518,412
Intercompany receivable (payable)	493,578	(124,047)	(369,531)	-	-
Investment in subsidiaries	2,109,612	-	-	(2,109,612)	-
Other assets	49,031	49,100	36,680	-	134,811
Total assets	<u>\$3,114,479</u>	<u>\$2,810,537</u>	<u>\$388,384</u>	<u>\$(2,109,612)</u>	<u>\$4,203,788</u>
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable and accrued expenses	\$ 368,363	\$ 268,420	\$ 32,204	\$ -	\$ 668,987
Short-term borrowings and current portion of long-term debt	244,713	167	129,921	-	374,801
Total current liabilities	613,076	268,587	162,125	-	1,043,788
Long-term debt	170,293	551,771	1,957	-	724,021
Other liabilities	42,459	80,155	24,714	-	147,328
Stockholders' equity	2,288,651	1,910,024	199,588	(2,109,612)	2,288,651
Total liabilities and stockholders' equity	<u>\$3,114,479</u>	<u>\$2,810,537</u>	<u>\$388,384</u>	<u>\$(2,109,612)</u>	<u>\$4,203,788</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, 2005

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net revenues	\$874,113	\$4,356,819	\$553,965	\$(281,186)	\$5,503,711
Operating costs and expenses:					
Cost of services	491,029	2,572,377	193,929	-	3,257,335
Selling, general and administrative	102,040	916,153	260,216	(20,634)	1,257,775
Amortization of intangible assets	1,628	3,084	18	-	4,730
Royalty (income) expense	(352,743)	352,743	-	-	-
Other operating expense, net	8,288	7,447	25	-	15,760
Total operating costs and expenses	<u>250,242</u>	<u>3,851,804</u>	<u>454,188</u>	<u>(20,634)</u>	<u>4,535,600</u>
Operating income	623,871	505,015	99,777	(260,552)	968,111
Non-operating expenses, net	<u>(97,718)</u>	<u>(219,654)</u>	<u>(837)</u>	<u>260,552</u>	<u>(57,657)</u>
Income before taxes	526,153	285,361	98,940	-	910,454
Income tax expense	206,703	117,140	40,334	-	364,177
Income before equity earnings	319,450	168,221	58,606	-	546,277
Equity earnings from subsidiaries	226,827	-	-	(226,827)	-
Net income	<u>\$546,277</u>	<u>\$ 168,221</u>	<u>\$ 58,606</u>	<u>\$(226,827)</u>	<u>\$ 546,277</u>

Condensed Consolidating Statement of Operations
For the Year Ended December 31, 2004

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net revenues	\$822,020	\$4,041,608	\$513,500	\$(250,527)	\$5,126,601
Operating costs and expenses:					
Cost of services	460,768	2,351,348	178,596	-	2,990,712
Selling, general and administrative	108,401	886,332	252,113	(19,100)	1,227,746
Amortization of intangible assets	1,399	5,269	35	-	6,703
Royalty (income) expense	(330,751)	330,751	-	-	-
Other operating expense, net	9,883	79	261	-	10,223
Total operating costs and expenses	<u>249,700</u>	<u>3,573,779</u>	<u>431,005</u>	<u>(19,100)</u>	<u>4,235,384</u>
Operating income	572,320	467,829	82,495	(231,427)	891,217
Non-operating expenses, net	<u>(70,821)</u>	<u>(212,658)</u>	<u>(4,039)</u>	<u>231,427</u>	<u>(56,091)</u>
Income before taxes	501,499	255,171	78,456	-	835,126
Income tax expense	204,280	102,069	29,582	-	335,931
Income before equity earnings	297,219	153,102	48,874	-	499,195
Equity earnings from subsidiaries	201,976	-	-	(201,976)	-
Net income	<u>\$499,195</u>	<u>\$ 153,102</u>	<u>\$ 48,874</u>	<u>\$(201,976)</u>	<u>\$ 499,195</u>

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
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Condensed Consolidating Statement of Operations
For the Year Ended December 31, 2003

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net revenues	\$ 791,399	\$3,709,590	\$467,559	\$(230,590)	\$4,737,958
Operating costs and expenses:					
Cost of services	457,819	2,147,387	163,417	-	2,768,623
Selling, general and administrative	76,626	880,951	223,762	(15,639)	1,165,700
Amortization of intangible assets	1,723	6,461	17	-	8,201
Royalty (income) expense	(308,495)	308,495	-	-	-
Other operating expense (income), net ...	119	(2,197)	1,058	-	(1,020)
Total operating costs and expenses	<u>227,792</u>	<u>3,341,097</u>	<u>388,254</u>	<u>(15,639)</u>	<u>3,941,504</u>
Operating income	563,607	368,493	79,305	(214,951)	796,454
Non-operating expenses, net	<u>(65,689)</u>	<u>(202,146)</u>	<u>(5,772)</u>	<u>214,951</u>	<u>(58,656)</u>
Income before taxes	497,918	166,347	73,533	-	737,798
Income tax expense	204,795	66,539	29,747	-	301,081
Income before equity earnings	293,123	99,808	43,786	-	436,717
Equity earnings from subsidiaries	143,594	-	-	(143,594)	-
Net income	<u>\$ 436,717</u>	<u>\$ 99,808</u>	<u>\$ 43,786</u>	<u>\$(143,594)</u>	<u>\$ 436,717</u>

Condensed Consolidating Statement of Cash Flows
For the Year Ended December 31, 2005

	<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	\$ 546,277	\$ 168,221	\$ 58,606	\$(226,827)	\$ 546,277
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	51,943	113,506	10,675	-	176,124
Provision for doubtful accounts	5,659	43,669	184,300	-	233,628
Other, net	(203,458)	33,809	20,511	226,827	77,689
Changes in operating assets and liabilities	<u>174,884</u>	<u>(214,707)</u>	<u>(142,312)</u>	<u>-</u>	<u>(182,135)</u>
Net cash provided by operating activities ...	575,305	144,498	131,780	-	851,583
Net cash used in investing activities	(1,020,236)	(176,202)	(15,243)	131,888	(1,079,793)
Net cash provided by (used in) financing activities	<u>465,448</u>	<u>30,405</u>	<u>(116,927)</u>	<u>(131,888)</u>	<u>247,038</u>
Net change in cash and cash equivalents	20,517	(1,299)	(390)	-	18,828
Cash and cash equivalents, beginning of year	56,424	6,058	10,820	-	73,302
Cash and cash equivalents, end of year ..	<u>\$ 76,941</u>	<u>\$ 4,759</u>	<u>\$ 10,430</u>	<u>\$ -</u>	<u>\$ 92,130</u>

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
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Condensed Consolidating Statement of Cash Flows
For the Year Ended December 31, 2004

	<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	\$ 499,195	\$ 153,102	\$ 48,874	\$(201,976)	\$ 499,195
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Depreciation and amortization	56,399	101,856	10,471	-	168,726
Provision for doubtful accounts	4,940	43,638	177,732	-	226,310
Other, net	(71,374)	1,754	16,847	201,976	149,203
Changes in operating assets and liabilities	163,057	(118,129)	(289,582)	-	(244,654)
Net cash provided by (used in) operating activities	652,217	182,221	(35,658)	-	798,780
Net cash used in investing activities	(150,826)	(105,597)	(7,841)	90,564	(173,700)
Net cash provided by (used in) financing activities	(586,555)	(72,557)	42,940	(90,564)	(706,736)
Net change in cash and cash equivalents...	(85,164)	4,067	(559)	-	(81,656)
Cash and cash equivalents, beginning of year	141,588	1,991	11,379	-	154,958
Cash and cash equivalents, end of year	<u>\$ 56,424</u>	<u>\$ 6,058</u>	<u>\$ 10,820</u>	<u>\$ -</u>	<u>\$ 73,302</u>

Condensed Consolidating Statement of Cash Flows
For the Year Ended December 31, 2003

	<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	\$ 436,717	\$ 99,808	\$ 43,786	\$(143,594)	\$ 436,717
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	53,611	91,501	8,791	-	153,903
Provision for doubtful accounts	4,944	64,835	158,443	-	228,222
Other, net	(78,968)	2,463	18,604	143,594	85,693
Changes in operating assets and liabilities	54,277	(178,027)	(117,986)	-	(241,736)
Net cash provided by operating activities ...	470,581	80,580	111,638	-	662,799
Net cash used in investing activities	(271,820)	(96,957)	(17,342)	(30,931)	(417,050)
Net cash provided by (used in) financing activities	(136,188)	10,991	(93,302)	30,931	(187,568)
Net change in cash and cash equivalents...	62,573	(5,386)	994	-	58,181
Cash and cash equivalents, beginning of year	79,015	7,377	10,385	-	96,777
Cash and cash equivalents, end of year	<u>\$ 141,588</u>	<u>\$ 1,991</u>	<u>\$ 11,379</u>	<u>\$ -</u>	<u>\$ 154,958</u>