

We expect to continue pursuing growth through acquisitions. Historically, as the clinical laboratory industry consolidated, acquisitions contributed a significant portion of our growth. We believe that organic growth will become more significant, while acquisitions will continue to be an important contributor to growth.

The clinical laboratory industry remains highly fragmented. We expect to continue to selectively evaluate potential acquisitions of regional clinical laboratories that can be integrated into our existing laboratories, thereby increasing access for patients and enabling us to reduce costs and improve efficiencies. See “Recent Acquisition” for a discussion of our recent acquisitions. We will also selectively assess potential acquisition opportunities that will increase clinical capabilities, geographic presence, or move us into related adjacent spaces, both domestically and internationally. During 2005, through the acquisition of LabOne, we entered into a new testing-related field, providing laboratory testing and risk assessment services to the life insurance industry.

Rapid development of new tests and technologies continues. In addition, hospitals and physician office laboratories increasingly are internalizing testing, moving testing closer to the patient. As a result, we will consider acquiring or exclusively licensing selective products to complement the services we provide.

Technology is making possible the convergence of various healthcare disciplines. Information technology will eventually enable doctors to diagnose and treat disease by aggregating a patient’s genetic predisposition, diagnostic test results and diagnostic images into a patient-centric electronic medical record available in a timely fashion at the point of care. Having such clinical data in one easily accessed place will enable better decision-making and drive improved outcomes for patients. Accordingly, potential acquisitions in adjacent industries such as healthcare information technology and diagnostic imaging may also be considered. Our acquisition of MedPlus in 2001 was our first acquisition of a healthcare information technology company.

People enable us to realize our mission. In this regard, an important challenge is to prepare our workforce for the future. Our people strategy is built on concepts of stringent employee selection, effective engagement and ongoing development resulting in a staff of highly qualified and motivated employees who are committed to our goals. In addition, we are committed to improving the health of our employees and reducing healthcare costs for them and our Company. Through our HealthyQuest initiative, we provide employees with the opportunity to lose weight, quit smoking and generally pursue healthier lifestyles. Quest Diagnostics is recognized as a “best place to work” in numerous locales as a consequence of our workplace initiatives that reflect our belief that people are our most important asset. We take diversity seriously, believing that our organization should reasonably reflect the communities that we serve. We strive to make all of our employees effective ambassadors of our Company.

Recent Acquisition

On November 1, 2005, we acquired LabOne, Inc., or 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. LabOne operates major laboratories in Lenexa, Kansas, and Cincinnati, Ohio, as well as a state-of-the-art call center in Lee’s Summit, Missouri, and provides paramedical examination services throughout the United States and Canada to serve the life insurance industry. The acquisition of LabOne supports our growth strategy in a number of ways, including: solidifying our leadership position in diagnostic testing by expanding access for physicians and patients and giving us added presence in several geographic areas; strengthening our drugs-of-abuse testing business and establishing us as the leader in a new testing net related business, providing health screening and risk assessment services to the life insurance industry.

Our Services

For 2005, our clinical laboratory testing business accounted for approximately 95% of our net revenues, with the balance derived from clinical trials testing, risk assessment services and other services and products. Laboratory testing includes routine testing and gene-based and esoteric testing, which generated approximately 78% and 17%, respectively, of our net revenues. Clinical trials testing generated less than 3% of our net revenues and risk assessment services generated less than 1% of our net revenues. We derive approximately 2% of our net revenues from foreign operations. We expect that the risk assessment business will represent approximately 4% of our net revenues in 2006, bringing the total net revenues attributable to our non-clinical testing businesses to approximately 8% of our consolidated net revenues.

Routine Testing

Routine tests measure various important bodily health parameters such as the functions of the kidney, heart, liver, thyroid and other organs. Commonly ordered tests include:

- blood cholesterol level;
- blood chemistries;
- complete blood cell counts;
- Pap tests;
- urinalyses;
- pregnancy and other prenatal tests; and
- alcohol and other substance-abuse tests.

We perform routine testing through our network of major laboratories, rapid response laboratories and patient service centers. We also perform routine testing at the hospital laboratories we manage. Major laboratories offer a full line of routine clinical tests. Rapid response laboratories are smaller facilities where we can quickly perform an abbreviated menu of routine tests for customers that require rapid turnaround times. Patient service centers are facilities where specimens are collected, and are typically located in or near a building used by medical professionals.

We operate 24 hours a day, 365 days a year. We perform and report most routine procedures within 24 hours. The majority of test results are delivered electronically.

Esoteric Testing

Esoteric tests are those tests that require more sophisticated technology, equipment or materials, professional “hands-on” attention from highly skilled and technical personnel, and that may be performed less frequently than routine tests. Because it is not cost-effective for most hospital and clinical laboratories to perform low-volume esoteric tests in-house, they generally refer many of these tests to an esoteric clinical testing laboratory that specializes in performing these more complex tests. Due to their complexity, esoteric tests are generally reimbursed at higher levels than routine tests.

Our two esoteric testing laboratories, which conduct business as Quest Diagnostics Nichols Institute, are among the leading esoteric clinical testing laboratories in the world. In 1998, our esoteric testing laboratory in San Juan Capistrano, California, was the first clinical laboratory in North America to achieve International Organization for Standardization, or ISO, 9001 certification. Our esoteric testing laboratory in Chantilly, Virginia enables us to provide full esoteric testing services on the east coast. Our two esoteric testing laboratories perform hundreds of esoteric tests that are not routinely performed by our regional laboratories. These esoteric tests are generally in the following fields:

- endocrinology and metabolism (the study of glands, their hormone secretions and their effects on body growth and metabolism);
- genetics (the study of chromosomes, genes and their protein products and effects);
- hematology (the study of blood and bone marrow cells) and coagulation (the process of blood clotting);
- HLA and immunogenetics (solid organ and bone marrow transplantation; eligibility for vaccines and immunotherapy);
- immunology (the study of the immune system including antibodies, immune system cells and their effects);
- microbiology and infectious diseases (the study of microscopic forms of life including bacteria, viruses, fungi and other infectious agents);
- oncology (the study of abnormal cell growth including benign tumors and cancer);
- serology (a science dealing with body fluids and their analysis, including antibodies, proteins and other characteristics); and
- toxicology (the study of chemicals and drugs and their effects on the body’s metabolism).

New Test Introductions

We intend to build upon our reputation as a leading innovator in the clinical laboratory industry by continuing to introduce new diagnostic tests. As the industry leader with the largest and broadest laboratory network and the leading provider of esoteric testing, we believe that we are the best partner for developers of new technology and tests to introduce their products to the marketplace.

We continued to be a leading innovator in the industry in 2005, through tests that we developed at Quest Diagnostics Nichols Institute, the largest provider of molecular diagnostic testing in the United States, as well as through relationships with technology developers. We believe that we are one of the leaders in transferring technical innovations to the market, through our relationships with the academic community and pharmaceutical and biotechnology firms, as well as collaborations with emerging medical technology companies that develop and commercialize novel diagnostics, pharmaceutical and device technologies.

We primarily focus our resources on three disease states, cardiovascular disease, cancer and infectious disease, as well as on continued advancements in molecular diagnostics. During 2005, we introduced approximately 75 new and improved assays, including:

- The initial two tests in a family of new plasma-based tests for leukemia and lymphoma. We believe that these tests, which are based on technology licensed from M.D. Anderson Cancer Center, will reduce and, in the future, might replace the need for painful bone marrow biopsies.
- A gene-based assay to help physicians identify metastatic Cancers of Unknown Primary origin. Cancer of unknown primary origin refers to metastatic cancer in which cancer cells are found somewhere in the body, but the place of origin where they first started growing cannot be identified from physical examination, pathologic analysis or other forms of diagnostic testing. This test is intended to aid physicians in identifying the primary site of origin of cancer, establishing prognosis and determining appropriate therapy.
- We also added tests to support our leadership in infectious diseases and endocrinology, including testing using liquid chromatography-tandem mass spectrometry (LC-MS/MS), as well as tests in immunology, particularly autoimmune disorders and coagulation, an increasingly important factor in cancer treatment, cardiovascular health and pre-surgical preparation.

We proactively search for new opportunities in screening, diagnosis, prognosis, treatment choice and treatment monitoring. We believe that, with the unveiling of the human genome, and its extension into proteomics, new genes and combinations of proteins will continue to be discovered at an accelerating pace and will result in ever more complex and thorough predictive and diagnostic testing. We believe that we are well positioned to benefit from these advances.

As testing methods become more complex, we believe that it is also important to provide sound medical and scientific consultation to ensure the correct application and interpretation of the test results. Our medical and scientific directors are always available for consultation to our customers. In 2005, we further enhanced our consultation programs, supported with our enhanced reporting initiatives, particularly in the complex areas of hematopathology and coagulation. We believe consultation services will provide higher confidence in the adoption of the new tests we develop and lead to improved client satisfaction and improved patient outcomes.

Risk Assessment Services

We believe that we are the largest provider of risk assessment services to the life insurance industry in the United States. Our risk assessment services comprise 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 laboratory tests performed and data gathered by us are specifically designed to assist an insurance company in objectively evaluating the mortality and morbidity risks posed by policy applicants. The majority of the testing is performed on specimens of individual life insurance policy applicants, but also includes specimens of individuals applying for individual and group medical and disability policies. We also provide risk assessment services in Canada.

Clinical Trials Testing

We believe that we are the world's second largest provider of clinical laboratory testing performed in connection with clinical research trials on new drugs. Clinical research trials are required by the Food and Drug

Administration, or FDA, and other international regulatory authorities to assess the safety and efficacy of new drugs. We have clinical trials testing centers in the United States and in the United Kingdom. We also provide clinical trials testing in Australia, Singapore and South Africa through arrangements with third parties. Clinical trials involving new drugs are increasingly being performed both inside and outside the United States. Approximately 50% of our net revenues from clinical trials testing in 2005 represented testing for GlaxoSmithKline plc, or GSK. We currently have a long-term contractual relationship with GSK, under which we are the primary provider of testing to support GSK's clinical trials testing requirements worldwide.

Other Services and Products

We manufacture and market diagnostic test kits and systems primarily for esoteric testing through our Nichols Institute Diagnostics subsidiary. These are sold principally to hospitals, clinical laboratories and dialysis centers, both domestically and internationally.

Our MedPlus subsidiary is a developer and integrator of clinical connectivity and data management solutions for healthcare organizations, physicians and clinicians primarily through its ChartMaxx® electronic medical record system for hospitals and our Care360 suite of products. The Care360 Physician Portal was developed by MedPlus and enables physicians to order diagnostic tests and review laboratory results from Quest Diagnostics online. In addition, the Care360 Physician Portal enables physicians to electronically prescribe medications, view clinical and administrative information from multiple sources, file certain documents into a patient-centric health record maintained in our repository and share confidential patient information with medical colleagues in a manner that is consistent with HIPAA privacy and security requirements.

Payers and Customers

We provide testing services to a broad range of healthcare providers. We consider a "payer" as the party that pays for the test and a "customer" as the party who refers the test to us. Depending on the billing arrangement and applicable law, the payer may be (1) the physician or other party (such as a hospital, another laboratory or an employer) who referred the testing to us, (2) the patient, or (3) a third party who pays the bill for the patient, such as an insurance company, Medicare or Medicaid. Some states, including New York, New Jersey and Rhode Island, prohibit us from billing physician clients. During 2005, only three customers accounted for 5% or more of our net revenues, and no single customer accounted for more than 8% of our net revenues. We believe that the loss of any one of our customers would not have a material adverse effect on our financial condition, results of operations or cash flows.

The following table shows current estimates of the breakdown of the percentage of our total volume of requisitions and net revenues associated with our clinical laboratory testing business during 2005 applicable to each payer group:

	Requisition Volume as % of Total Volume	Net Revenues as % of Total Clinical Laboratory Testing Net Revenues
Patient	2% – 5%	5% – 10%
Medicare and Medicaid.....	15% – 20%	15% – 20%
Physicians, Hospitals, Employers and Other Monthly-Billed Clients	30% – 35%	20% – 25%
Healthcare Insurers-Fee-for-Service	30% – 35%	40% – 45%
Healthcare Insurers-Capitated.....	15% – 20%	5% – 10%

Physicians

Physicians requiring testing for patients are the primary referral source of our clinical laboratory testing volume. Testing referred by physicians is typically billed to healthcare insurers, government programs such as Medicare and Medicaid, patients and physicians. Physicians are typically billed on a fee-for-service basis based on negotiated fee schedules. Fees billed to patients and healthcare insurers are based on the laboratory's patient fee schedule, subject to any limitations on fees negotiated with the healthcare insurers or with physicians on