

The diagnostic testing industry remains fragmented and highly competitive. Government payers, such as Medicare (which principally serves patients 65 years and older) and Medicaid (which principally serves indigent patients), as well as private payers and large employers, continue to take steps to control the cost, utilization and delivery of healthcare services, including clinical laboratory services. We expect reductions in reimbursement from Medicare and Medicaid will continue to be implemented from time to time. The continuing consolidation among healthcare insurers has resulted in fewer but larger insurers with significant bargaining power to negotiate fee arrangements with healthcare providers, including clinical laboratories. See “Recent Changes in Payer Relationships” and “Payers and Customers – Healthcare Insurers”.

While the diagnostic testing industry in the United States will be impacted by a number of factors and may continue to experience intensified pricing pressure in the near term, we believe it will continue to grow over the long term as a result of the following:

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

Quest Diagnostics, as the largest clinical laboratory testing company with a leading position in most of its domestic geographic markets and service offerings, is well positioned to benefit from the long-term growth expected in the industry.

### **Corporate Strategy and Growth Opportunities**

Our mission is to be the undisputed world leader in diagnostic testing, information and services. We focus on Patients, Growth and People to help achieve our goals.

**Patients** are at the center of everything we do. Increasingly, patients and their doctors have a choice when it comes to selecting a healthcare provider, and we strive to give them new and compelling reasons to put their trust in us. We differentiate our Company to patients and doctors by:

- *Providing the Highest Quality Services and a Unique Patient Experience:* We strive to provide the highest quality in all that we do including: phlebotomy and specimen transport services; analytical testing processes in our laboratories; accurate and timely lab reports; and billing information. We use Six Sigma and Lean processes to continuously reduce defects, enhance quality, and further increase the efficiency of our operations. Six Sigma is a management approach that utilizes a thorough understanding of customer needs and requirements, root cause analysis, process improvements and rigorous tracking and measuring to enhance quality. Lean streamlines processes and eliminates waste. We also use Six Sigma and Lean principles to help standardize operations and processes across our Company and identify and adopt company best practices. Our phlebotomists are specially trained to provide a unique patient experience. Patients are served at our patient service centers within 20 minutes, on average, and even faster where we have deployed our automated appointment scheduling.
- *Offering Unparalleled Access and Distribution:* We offer the broadest test menu and national access to testing services, with facilities in substantially all of the major metropolitan areas in the United States. Our test menu includes more than 3,000 tests. We operate a nationwide network of greater than 2,100 of our own patient service centers, principal laboratories located in more than 30 major metropolitan areas throughout the United States and about 150 smaller “rapid response” laboratories that enable us to serve patients, physicians, hospitals, employers and other healthcare providers throughout the United States. We also operate approximately 65 locations in the United States and Canada where we provide paramedical examinations. We believe that customers seek to utilize laboratory-testing providers that offer a comprehensive range of tests and services and the most convenient access to those services.

**Growth** is driven organically and through acquisition. Over the long term, we expect to grow organically at or above the industry growth rate by gaining more customers and selling more to existing customers. Historically, our industry has focused primarily on service levels and aggressive pricing to drive organic volume growth. We believe that the differentiation we are creating through our focus on Six Sigma quality, unparalleled access and distribution, the most comprehensive test menu and innovative test and information technology offerings provides us with a competitive advantage and enables us to compete on more than price alone. Additionally, we are

investing in sales and marketing, providing the sales force with better tools and training and adding innovative new products to sell. We are specifically focused on driving profitable organic growth in higher-growth areas by being a leading innovator. Our principal areas of focus include:

- *Physician Sub Specialties:* While we provide a strong value proposition in routine and esoteric clinical testing, we have not been the provider of choice for the testing needs of certain physician specialists. During 2006, we enhanced our test menu and service capabilities to more effectively compete in several physician sub specialties, including urology, gastroenterology, hematology and oncology, where we have had a smaller market share. We plan to continue to enhance our test menu and service capabilities in these areas as well as in dermatology. We have also been enhancing our esoteric anatomic pathology capabilities and service offerings and have added specially trained sales representatives to service pathologists in hospitals as well as hematology/oncology offices.
  - *Innovation Leadership:* We intend to build upon our reputation as a leading innovator in the clinical laboratory industry by continuing to introduce new tests, technology and services. As the industry leader with the largest and broadest network and the leading provider of esoteric testing, we believe that we are the best partner for developers of new technologies and tests to introduce their products to the marketplace. Through our relationships with the academic community, pharmaceutical and biotechnology firms and emerging medical technology companies that develop and commercialize novel diagnostics, pharmaceutical and device technologies, we believe that we are one of the leaders in transferring technical innovation to the market. Our innovation activities are focused on:
    - *Gene-Based and Other Esoteric Testing Capabilities:* We intend to remain a leading innovator in the diagnostic testing industry by continuing to introduce new tests, technologies and services. We believe that gene-based and other esoteric tests are the fastest growing area within the diagnostic testing industry. We believe that we have the largest gene-based and esoteric testing business in the United States, with over \$1 billion in net revenues during 2006, and that this business is growing approximately 10% per year. We believe that the unveiling of the human genome and the linkages of genes and the proteins they produce with disease will result in more complex and thorough predictive and diagnostic testing. We believe that we are well positioned to benefit from this growth. We intend to focus on commercializing diagnostic applications of discoveries in the areas of functional genomics and proteomics.
    - *Information Technology:* We continue to invest in the development and improvement of information technology products for customers and healthcare providers. We develop differentiated products that provide more convenient ordering and reporting of laboratory tests and better access to patient-centric information. We believe that these products enhance the value we provide to our customers and result in increased customer loyalty. Our Care360™ products, including our Care360 Physician Portal, enable doctors to order diagnostic tests and review laboratory results from Quest Diagnostics online. In addition, the Care360 Physician Portal enables doctors to electronically prescribe medication, view clinical and administrative information from various sources, file certain documents into a patient-centric health record maintained in our repository and share confidential information with medical colleagues in a manner consistent with the Health Insurance Portability and Accountability Act of 1996, or HIPAA.
- The Care360 Physician Portal and related Care360 products allow us to replace older technology products used by some physicians and thereby offer a better solution. Demand has been growing for our information technology solutions as physicians have expanded their usage of the Internet. By the end of 2006, over 100,000 physicians were using our Care360™ products and approximately 50% of our orders and over 90% of our test results were being transmitted via the Internet. The Care360 Physician Portal was developed by MedPlus, our wholly owned healthcare information technology subsidiary. MedPlus' ChartMaxx® patient record systems and Care360 connectivity system are designed to support the creation and management of electronic patient records, by bringing together, in one patient-centric view, information from various sources, including physician's records and laboratory and hospital data. We intend to expand the services offered through our portal over time through both internal development and the formation of strategic relationships.
- *Near Patient Testing (also known as Point of Care Testing):* Technology changes are enabling testing to move closer to the patient, and are becoming increasingly available and reliable. We are well positioned to offer choice and integrated solutions to physicians, hospitals, clinics and retail customers for the testing methods that are most appropriate for each patient and practice. We intend to acquire and develop novel technology platforms and systems to meet the needs of our clients. We also intend to provide electronic data links through our Care360 desktop system so that tests performed outside our central laboratories,

near the patient will be available for electronic medical records and will display in similar format to tests performed in our centralized laboratories. This will differentiate our near patient testing products from other products that are not integrated into our customers' electronic records. Since July 2006, we have made several acquisitions that enable us to serve this near patient testing market, including HemoCue, Focus Diagnostics and Enterix. See "Recent Acquisitions". We believe that these acquisitions and our overall near patient strategy will strengthen our relationship with our customers by enabling us to offer more solutions that improve their effectiveness and the care of their patients by enabling faster diagnosis and treatment. We will consider additional acquisitions or exclusive licenses of selective products to complement the products and services we provide.

- *Acquisitions and International Expansion:* The clinical laboratory industry in the United States remains fragmented. We expect to continue to selectively evaluate potential acquisitions of domestic clinical laboratories that can be integrated into our existing laboratories, thereby increasing access for patients and enabling us to reduce costs and improve efficiencies. While over the long term we believe positive industry factors in the U.S. diagnostic testing industry and the differentiated services we offer to our customers will enable us to grow organically, we see a number of opportunities to grow beyond our current principal business of operating diagnostic testing laboratories in the United States. We are actively exploring opportunities, including acquisitions, in the area of near patient testing to augment our laboratory testing business. Given that physicians and hospitals are primary sources for both near patient testing and laboratory performed tests, we believe providing both services will strengthen our relationships with customers and accelerate our growth.

Additionally, we see opportunities to bring our experience and expertise in diagnostic testing to international markets, particularly developing countries where the testing markets are highly fragmented and less mature. In addition, expansion into near patient testing and international markets will diversify our revenue base, and add businesses which are growing faster and are more profitable than our principal business of U.S. based clinical laboratory testing.

*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 Acquisitions

On January 31, 2007, we acquired POCT Holding AB ("HemoCue"), a company headquartered in Angelholm, Sweden, that specializes in near patient testing, in an all-cash transaction valued at approximately \$420 million, including \$123 million of assumed debt of HemoCue. HemoCue, which has annualized revenues of approximately \$90 million, is the leading global provider in near patient testing for hemoglobin, with a growing share in the near patient markets for professional glucose and microalbumin testing. HemoCue's handheld systems are used in physician's offices, blood banks, hospitals, diabetes clinics and public health clinics. In developing countries these systems are used as the primary means to screen for anemia. The measurement of hemoglobin is important for patients being treated by transfusion, or undergoing dialysis or chemotherapy, where instant test results can lead to immediate treatment decisions. Approximately 50% of HemoCue's products are sold outside the United States. HemoCue has a strong product development pipeline, based on its pioneering use of its patented microfluidic systems, and is currently developing new tests, including one to determine white blood cell counts. This test will help physicians quickly determine the presence of an infection and, consequently, the need for antibiotic treatment, potentially reducing the overuse of antibiotics, an ongoing public health concern. In addition, we intend to make HemoCue's near patient handheld systems compatible with our Care360 portal, which enables doctors to store, access and share patient information. We financed the purchase price through a \$450 million one-year term loan.

In September 2006 we acquired Enterix, Inc. ("Enterix"), an Australia-based company, in an all-cash transaction valued at approximately \$44 million. Enterix manufactures the InSure™ fecal immunochemical test for screening for colorectal cancer and also performs the InSure™ test for patients. Prior to the acquisition, we