

## **Item 1. Business**

### **Overview**

We are the nation's leading provider of diagnostic testing, information and services, providing insights that enable physicians and other healthcare professionals to make decisions to improve health. We offer patients and physicians the broadest access to diagnostic laboratory services through our nationwide network of laboratories and our owned patient service centers. We provide interpretive consultation through the largest medical and scientific staff in the industry, with more than 500 M.D.'s and Ph.D.'s around the country. We are the leading provider of esoteric testing, including gene-based testing and the leading provider of testing for drugs of abuse. We are also a leading provider of anatomic pathology services, testing for clinical trials and risk assessment services for the life insurance industry. We empower healthcare organizations and clinicians with state-of-the-art information technology solutions that can improve patient care and medical practice.

During 2006, we generated net revenues of \$6.3 billion and processed approximately 151 million requisitions for testing. Each requisition form accompanies a patient specimen, indicating the tests to be performed and the party to be billed for the tests. Our customers include patients, physicians, hospitals, employers, governmental institutions and other commercial clinical laboratories.

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 approximately 150 smaller "rapid response" laboratories (including, in each case, facilities operated at our joint ventures). We provide full esoteric testing services, including gene-based testing, on both coasts through our Quest Diagnostics Nichols Institute laboratory facilities, located in San Juan Capistrano, California and Chantilly, Virginia, as well as infectious and immunologic disease testing through our Focus Diagnostics ("Focus Diagnostics") laboratory facility, located in Cypress, California. We also have laboratory facilities in Mexico City, Mexico, San Juan, Puerto Rico and Heston, England.

We are a Delaware corporation. We sometimes refer to our subsidiaries and ourselves as the "Company" or "Quest Diagnostics". We are the successor to MetPath Inc., a New York corporation that was organized in 1967. From 1982 to 1996, we were a subsidiary of Corning Incorporated, or Corning. On December 31, 1996, Corning distributed all of the outstanding shares of our common stock to the stockholders of Corning. In August 1999, we completed the acquisition of SmithKline Beecham Clinical Laboratories, Inc., or SBCL, which operated the clinical laboratory business of SmithKline Beecham plc, or SmithKline Beecham.

Our principal executive offices are located at 1290 Wall Street West, Lyndhurst, New Jersey 07071, telephone number: (201) 393-5000. Our filings with the Securities and Exchange Commission, or the SEC, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, are available free of charge on our website as soon as reasonably practicable after they are filed with, or furnished to, the SEC. Our website is [www.questdiagnostics.com](http://www.questdiagnostics.com).

### **The United States Clinical Laboratory Testing Market**

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. Many clinical laboratory tests are considered routine and can be performed by most commercial clinical laboratories. Tests that are not routine and that require more sophisticated equipment and highly skilled personnel are considered esoteric tests. Esoteric tests, including gene-based tests, are generally referred to laboratories that specialize in performing those tests.

We estimate that the United States clinical laboratory testing market had approximately \$45 billion in annual revenues in 2006. Most laboratory tests are performed by one of three types of laboratories: commercial clinical laboratories; hospital-affiliated laboratories; and physician-office laboratories. In 2006, we believe that hospital-affiliated laboratories accounted for approximately 60% of the market, commercial clinical laboratories approximately one-third and physician-office laboratories the balance.

Orders for laboratory testing are generated from physician offices, hospitals and employers. As such, factors including changes in the United States economy which can affect the number of unemployed and uninsured, and design changes in healthcare plans which impact the number of physician office and hospital visits, can impact the utilization of laboratory testing.

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