

Quest Diagnostics Incorporated
Q4 and Full Year 2007 Earnings Call
Conference Call Script
February 21, 2008

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

Some of our commentary and answers to questions may contain forward-looking statements. You are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date that they are made and which reflect management's current estimates, projections, expectations or beliefs and which involve risks and uncertainties that could cause actual results and outcomes to be materially different. Risks and uncertainties that may affect the future results of the company include, but are not limited to, adverse results from pending or future government investigations, lawsuits or private actions, the competitive environment, changes in government regulations, changing relationships with customers, payers, suppliers and strategic partners and other factors described in the Quest Diagnostics 2006 Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K.

A copy of our earnings press release is available, and the text of our prepared remarks will be available later today in the "quarterly updates" section of our website at www.questdiagnostics.com.

A downloadable spreadsheet with our results and supplemental analysis are also available on the website.

Now, here is Surya Mohapatra.

Surya Mohapatra: Thank you, Laure.

During the quarter we re-established strong growth in revenues, earnings and cash flow.

- Consolidated revenues grew to \$1.8 billion;
- Operating margin grew to 17.6%, the third consecutive quarter of strong improvement;
- And, cash flow was strong: \$355 million for the quarter.

We entered 2007 with uncertainty regarding industry pricing and access to health plan contracts. Over the past 12 months, we have taken many decisive actions to reduce that uncertainty and drive strong performance improvements. These short term issues did not paralyze us from executing our long term growth strategy. As a result, we are a stronger company now than compared to 12 months ago.

- During the year, we renewed or expanded relationships with most of the major health plans;
- We drove productivity improvements while improving service, and embarked on an initiative to reduce our cost structure by an additional \$500 million;
- We continued to build our near-patient testing business by acquiring HemoCue, a leader in that industry;

- We continued to lead with innovations, both in medicine and information technology;
- We established a presence in the growing Indian market;
- And, with the acquisition of AmeriPath, we became the world leader in cancer diagnostics.

- Our longer term goals are:
 - To grow revenues profitably above the industry growth rate;
 - To expand operating income to 20% of revenues;
 - To derive 10% of consolidated revenues from international business within 5 years.

Later I will elaborate on these growth plans, but first, Bob will review our performance and guidance.

Bob Hagemann: Thanks, Surya.

As you heard from Surya, and as you see in the results, we've continued to make excellent progress in improving earnings over the course of the year.

Despite the loss of a contract with our largest private payer, intensified pricing pressure, and an increased competitive environment, in the quarter we managed to improve our revenues and profits over the prior year.

This progress stems from the decisive actions we took in the first quarter; and the hard work throughout the year to re-establish revenue growth, streamline our operations and enhance our service offerings. With the actions we have taken and the plans we have in place, we are solidly positioned for sustained revenue and earnings growth.

In addition, we have continued our discussions with the government in an effort to reach a settlement regarding its investigation of NID, a test kit manufacturing subsidiary closed in 2006. As a result of further discussions we have increased the reserve we established in the third quarter by \$190 million, to \$241 million, and recorded the charge as part of discontinued operations. While this is a substantial increase to the reserve, we believe we are closer to either settling this matter or determining that an acceptable settlement cannot be reached. Given that we are in ongoing discussions, what we can say is limited and is contained in Footnote 6 to the earnings release. Obviously, we want to put this matter behind us quickly; however, it remains unclear as to how long it may take to bring it to closure. We are committed to do what we believe is right for our company and shareholders. If we are unable to reach an acceptable settlement, we are fully prepared to litigate this matter.

Now let's turn to fourth quarter performance from continuing operations. In order to assist in making comparisons, as I go through our results, I'll highlight the impact of AmeriPath on a number of key metrics. In addition, to highlight our progress, I'll point out improvements in certain metrics over the last several quarters.

Revenues were \$1.8 billion, 14.3% above the prior year, with AmeriPath contributing about 13 percent growth. Revenues for our clinical testing business, which account for over 90% of our total revenues, were 13.1% above the prior year, with AmeriPath

contributing 14%. Volume was about one-half percent below the prior year, and about 6% below, without the AmeriPath acquisition. This reflects continued improvement from the third quarter. Revenue per requisition increased 13.7%, with 8.3% of the increase due to AmeriPath. The balance of the increase in revenue per requisition continues to be primarily driven by a positive test mix.

We estimate that consolidated revenues were reduced by a little over 5% due to our change in status with United, with clinical testing volume reduced by about 8%, partially offset by a positive impact to revenue per requisition of 2%. The positive impact to revenue per requisition is associated with higher reimbursement on the retained United work.

Throughout the fourth quarter we saw little change in our United volume and continue to maintain over 20% of the previously contracted level. We expect that some additional United volume will move over time. However, we continue to be encouraged by physicians' decisions to select Quest Diagnostics, when given a choice, and have seen no further loss of discretionary work during the quarter.

Adjusted for the change associated with United, we saw further improvement in our base volume growth of about 2% compared to that of the third quarter. The improvement principally related to our new Aetna agreement and improved productivity of our sales force.

Organic revenue growth in our non-clinical testing businesses as a group, which includes our clinical trials testing business and the risk assessment business, was 10% for the fourth quarter.

The acquisition of HemoCue contributed about one and a half percent to consolidated revenue growth.

Operating income as a percentage of revenues was 17.6% for the quarter, compared to 18% in the prior year. Our base business, before the results of AmeriPath, is now achieving margins above the prior year level. Fourth quarter margins reflect further improvement of about one percentage point from the year-over-year comparison in the third quarter, which itself reflected significant improvement from the first two quarter comparisons. As I mentioned earlier, these improvements are due to actions taken to reduce our cost structure, higher revenue per requisition, and improved volume.

Bad debt expense as a percentage of revenues was 4.4%, and 3.6% before the inclusion of AmeriPath. This is an improvement of almost half a percent compared to the third quarter, and it comes from our base business. AmeriPath, which carries a higher bad debt rate than the rest of our business (much of it due to the in-patient work done for hospitals and billing systems conversions), will increase our bad debt expense by about 1% for the time being. As I mentioned last quarter, while it is taking us longer than we expected to reduce AmeriPath's bad debt, the eventual synergy opportunity related to bad debt remains unchanged.

Diluted earnings per share from continuing operations were \$.79 compared to \$.77 in the prior year. The impact of the change in contract status with United has now been fully offset, and we are back on the path of sustained revenue and earnings growth.

Included in footnote 5 to the earnings release is a table, which summarizes the impact to various revenue measures for a number of the items discussed.

Cash from operations for the quarter was very strong at \$355 million, and above the prior year for the second consecutive quarter. During the quarter we reduced debt by \$225 million, bringing the total debt reduction since the AmeriPath acquisition to over \$400 million. Cash at quarter end was \$168 million, similar to the Q3 level. Capital expenditures were \$76 million in the quarter.

Days sales outstanding improved to 48 days, 2 days better than Q3, and back to the prior year level, despite AmeriPath adding 2 days to our total.

Looking back on 2007, the fourth quarter capped off a year of tremendous progress despite some significant challenges.

- Our program to reduce costs by \$500 million is in full swing. We had over \$100 million of this benefit in our run rate as we exited 2007, and are on track to achieve the full amount as we exit 2009.
- Much of the benefit will be in our laboratories, where we are deploying Lean Six Sigma, and plan to realize substantial productivity gains.
- Additionally, we are driving efficiencies in other areas by better aligning our service capacity with patient and sample flows.
- We are driving more of our purchasing through master contracts to take better advantage of our scale.
- We are rapidly deploying customer connectivity which reduces costs in specimen data entry and billing, and helps lower our bad debt.
- We are improving the efficiency of our logistics routes using advanced route optimization tools, and we are transitioning to lower cost and more fuel efficient logistics vehicles.
- We have streamlined our management structure, established clear targets, and have deployed the mechanisms to monitor and drive execution.

And, we exited the year with annualized revenues of \$7 billion, improved profitability from the year before, and growing momentum as we entered 2008.

Now, let's turn to our outlook for 2008. Our current guidance for results from continuing operations is as follows:

- We expect revenue growth to approximate 9%.
- We expect operating income as a percentage of revenues to approach 17%.
- We expect cash from operations to approximate \$900 million. And we expect capital expenditures of between \$280 and \$300 million.

- And lastly, we expect diluted earnings per share to be between \$3.00 and \$3.20, excluding any potential special charges.

Earnings per share are after about 20 cents of investments we are making in 2008 to accelerate long-term revenue and earnings growth. Approximately 13 cents is associated with development and deployment of standard systems, across both the AmeriPath practices and our clinical labs, which will enable significant productivity gains and improved customer service. And, approximately 7 cents is attributable to start up costs of our India operations, which we expect to be a major contributor to our future growth.

Now I'll turn it back to Surya.

Surya Mohapatra: Thanks, Bob.

2007 was an important year in which we drove performance improvements and continued to build the foundation for sustained growth.

We grow our business by focusing on sales, service and science.

- Our sales force is energized and driving results.
- During the fourth quarter, we accelerated underlying revenue growth by almost 3% compared to that of the third quarter.
- Excluding the impact of acquisitions and United, fourth quarter revenues grew about 5%.

Patients, doctors and health plans appreciate our quality, access and convenience. We continue to expand the use of our unique appointment scheduling system for our patient service centers.

- One clear sign that patients and physicians care about the superior service we provide is our ability to retain the majority of the discretionary business despite the United contract change.
- We see the opportunity to accelerate growth by working with payers and employers to shift more of their testing to us which is currently going out of network or to higher priced providers.
- We continue to lead the industry with important new tests and the most complete testing menu for physicians. With AmeriPath, we are the clear leader in clinical pathology, anatomic pathology as well as gene-based and esoteric testing. And, as technology enables testing to move closer to the patient, we are prepared, with a growing platform in near-patient, or point-of-care testing.

We continue to diversify our revenue base. Of our \$7 billion in revenues, about 35% is now coming from anatomic pathology and gene-based and esoteric testing, versus 26% of our \$4 billion in revenues in 2002.

Our acquisition of AmeriPath made us the clear leader in cancer diagnostics. We have strengthened our integrated offering of clinical, AP and esoteric testing for hospitals, specialists and primary care physicians.

- We continue to be excited about the opportunity to accelerate our growth in anatomic pathology. A lot of tissue specimens come from primary care physicians. This is a significant growth opportunity – and one that AmeriPath

- previously had no way of realizing, due to its limited infrastructure to reach these doctors.
- Our AmeriPath pathologists, who are critical assets, are very supportive and eager to realize these benefits.
 - And, AmeriPath recently signed a new multi-year contract with UnitedHealthcare.

We are entering the decade of diagnostics. The healthcare world is moving from a focus on curative care to a reliance on early detection, prevention, and expanded use of personalized and targeted medicine.

- Molecular tests are now used for more than diagnostics -- to predict patient outcomes, determine genetic predisposition and monitor response to drug therapy.
- For example, our Comparative Genomic Hybridization microarray was initially validated to identify mental retardation in newborns. Now we are applying it to other testing areas, such as Leukemia.
- We have introduced several blood tests to reduce patient pain and provide early detection. For example, our Hepascore liver fibrosis panel uses a non-invasive approach to predict significant liver fibrosis or cirrhosis in patients with hepatitis C without requiring a liver biopsy. Also, our expanding Leumeta family of cancer diagnostics enable physicians to monitor leukemia and lymphoma early using blood specimens without painful bone-marrow biopsies.

We continue to invest in our Information Technology, which is an important differentiator and a key enabler of almost everything we do.

- We are investing to upgrade and standardize systems across our company, including connecting AmeriPath's systems to our Care360 portal.
- We now have 125,000 physician users of our Care360 products.
- We see tremendous opportunities to use healthcare IT to make our diagnostic insights more easily available to doctors, hospitals and, eventually, to patients, to improve medical safety and help drive better healthcare decisions.

Point of care testing will help us diversify further and also drive growth in the physician business by offering doctors choice and convenience. They can select traditional laboratory testing or in-office testing depending on the needs of each patient. The \$6 billion market for point of care tests is growing at an estimated rate of 8% to 10% a year, and we are well positioned to benefit from the shift toward point-of-care testing.

- During the quarter, we received FDA clearance for two new tests -- the HerpeSelect Express HSV-2 test and a White Blood Cell test on our HemoCue platform. These tests are designed to be simple enough for use in clinics and other point of care settings, and can produce results within minutes.
- The ability of physicians to provide counsel on treatment options and lifestyle changes during a single office visit can benefit patients who are anxious about their test results or who may be unwilling or unable to return for a second visit.

India is an enormous growth opportunity, and one in which we will be investing over the next several years.

- Our offerings in India will include advanced esoteric testing for hospitals, physicians and patients, clinical trials testing for global pharmaceutical companies; and clinical testing for life insurance companies.
- We also see opportunities over time to reduce our costs to perform clinical trials testing using our Indian facility.

In summary:

- 2007 was a year of significant achievements. We took bold and decisive actions to deal with short-term business issues and strengthen the foundation of our company for long-term sustainable growth.
- We re-established growth in revenues, earnings and cash flow.
- We exited the year as a stronger company.
- The opportunities before us are better than ever before.
- And, we are excited about our future and committed to superior long-term shareholder returns.

We will now take your questions. Operator?

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