Quest Diagnostics
Third Quarter 2006
Conference Call Prepared Remarks

Thursday, October 19, 2006, 8:30 am EST

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 that are based on current expectations and involve risks and uncertainties that could cause actual results and outcomes to be materially different. Certain of these risks and uncertainties may include, but are not limited to, competitive environment, changes in government regulations, changing relationships with customers, payers, suppliers and strategic partners and other factors described in the Quest Diagnostics Incorporated 2005 Form 10-K and subsequent filings.

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.

We reported strong financial results for the Third quarter.

- Revenues increased 16%;
- Earnings from continuing operations grew 21% to 82 cents per share;
- And cash flow was $235 million, a 32% increase over 2005.

Our business is performing very well.

Now, I will turn it over to Bob, who will discuss our third quarter financial performance. Then I will address the UnitedHealthcare situation and also the growth drivers for our business.

Bob Hagemann: Thanks, Surya.

It was another quarter of strong results, driven by the performance of our clinical testing business. As we go through the numbers, I'll separately quantify each of the major factors impacting the quarter.

Revenues from continuing operations grew just over 16% for the quarter, with the acquisition of LabOne contributing just over 9%, and the recently completed acquisition of Focus Diagnostics contributing 1%. A little over half of the LabOne revenues were generated from the risk assessment business, with the remainder classified as clinical testing.

Our clinical testing business, which accounts for over 90% of our total revenues, grew 10.5% during the quarter, on a volume increase of about 5% and an increase in revenue per requisition of 5.4%. LabOne contributed almost 5% growth to the clinical testing business, principally reflected in volume. The increase in revenue per requisition continues to be primarily driven by a shift to a more esoteric test mix and an increase in the number of tests ordered per requisition.

Please note, the quarterly revenue and volume comparisons to the prior year were reduced by about 1% due to the number of business days in the quarter, and increased by almost half a percent due to last year's hurricanes.

Operating income, as a percentage of revenues, was 18.5% for the quarter, and reflects an improvement of about one-and-a-half percent from the prior year on an apples-to-apples basis, driven by the performance of our clinical testing business. Our clinical testing margins continue to benefit from solid top line growth, efficiencies from the use of our physician connectivity solutions, and continued benefits from our Six Sigma and consolidation efforts.

Expense associated with FAS 123R reduced margins by about 1%, and results of the LabOne business, which for now carry lower margins than the rest of our operations, reduced margins by another 1%. We remain on track to realize the $40 million in annual synergies we committed to in connection with LabOne, most of which will be realized in 2007.

Diluted earnings per share from continuing operations increased 21% to 82 cents. The growth in earnings was driven principally by strong performance in our clinical testing business. In addition, two cents of the improvement was driven by a lower tax rate, resulting from the resolution of certain income tax contingencies in the quarter.

Included in Footnote 7 to our earnings release is a table which summarizes the impact to revenues, operating income and EPS, of the various items I just discussed.

Cash from operations in the quarter was $235 million, an increase of $57 million from the prior year. During the quarter we spent $230 million on acquisitions, made capital expenditures of $45 million and repurchased $22 million of common stock. Days sales outstanding were 48 days compared to 46 days at year-end. A temporary stoppage in Medicare payments caused a one-day increase in DSOs. Subsequent to the end of the quarter, Medicare payments resumed, and the DSO impact reversed.

In addition to funding the Focus and Enterix acquisitions, we repaid our $275 million note which came due. We utilized our existing credit facilities and cash on hand to complete these transactions.

The wind down of NID's operations is complete. As such, we have classified NID as a discontinued operation for all periods presented. During the quarter NID generated a two-cent per share loss, which included facility closure and severance costs.

Turning to guidance: as we typically do, we will provide 2007 guidance in January in conjunction with our year-end call, at which time we will provide additional information related to our change in status with United.

For the full year 2006, we expect results from continuing operations as follows:

We expect revenues to grow approximately 15 percent. This excludes the impact of potential additional acquisitions.

We expect operating income as a percentage of revenues to approximate 17.5%. This includes the impact of FAS 123R, which is estimated to reduce margins by approximately 1%, and also includes the impact of integration charges recorded in the first quarter.

We expect cash from operations to approximate $850 million, and capital expenditures to be between $180 and $200 million.

And lastly, we expect diluted earnings per common share to be between $3.05 and $3.10.

Now, I'll turn it back to Surya.

Surya Mohapatra: Thanks, Bob.

Now I will discuss the United situation and our growth opportunities.

As you know, our existing contract with UnitedHealthcare continues to run through the end of 2006, and we will become a non-contracted, or out-of-network provider, effective January, 2007.

We have had a long-standing relationship with United, and it is unfortunate that we could not come to reasonable terms.

United accounts for approximately 7% of our revenues. It's going to take some time before we can estimate the financial impact of this contract change. And, for competitive reasons, we will not discuss our market strategy.

What we can discuss, is our goal, which is to keep as much of the United business as possible– now and after January 1st.

We are developing and implementing comprehensive plans to achieve that goal.

- We have mobilized key leaders across the company to develop plans for retaining business and reducing costs to the extent that volume changes.
- We are continuing to evaluate our rights as an out-of-network provider in each of the states and for each of the plans and are preparing to defend those rights. And,
- We are educating patients, their physicians and employers that there is a difference between laboratories, and that when it comes to healthcare, they do have a choice.

We are grateful for the support we have received from patients, physicians and employers for the position we have taken.

We estimate we serve approximately half of United's members. We believe that this is a result of our expanded network and high quality service. For example, in the New York tri-state area, we have more than 300 and in California, we have more than 450 of our own patient service centers, staffed with skilled phlebotomists, focused on enhancing the patient experience.

More than 90,000 doctors have come to rely on us for electronic ordering and delivery of test results over the last several years.

United has eliminated Quest Diagnostics as an in-network provider. This could have the effect of trying to limit the ability of doctors and patients to choose. But doctors and patients can continue to choose Quest Diagnostics after January 1 as an out-of-network provider and avoid unpleasant disruptions.

It takes years to build trust with physicians and patients, and we strongly believe that the service we provide them is not a commodity. Laboratory test results drive more than 70% of healthcare decisions. We believe in the value we bring, and have invested to enhance patient care.

One thing is certain: each of our 42,000 employees is focused on continuing to provide superior service to all of our patients and physicians. We will fight for every doctor and every patient.

At the same time, we continue to drive our growth strategy.

We will grow organically, by winning new customers and introducing new tests, and through selective acquisitions. We are encouraged by the third quarter results.

- Gene based tests for women's health continued to grow in double digits. This was driven by continued strong increases in HPV and chlamydia/gonorrhea testing.
- Additionally, we have further strengthened our industry-leading endocrinology offering. We are seeing strong acceptance of testing using tandem mass spectrometers to provide increased sensitivity and specificity for many of our hormone, vitamin and toxicology tests.
- Also, allergy testing using ImmunoCAP grew more than 20%.

And we continue to build our pipeline of innovation to ensure new tests for future growth.

We are enhancing our connectivity solutions, which drive loyalty among physicians. Our Care360 platform has enabled us to receive nearly half of lab orders and send more than 80% of test results online.

We are also driving growth through selective acquisitions. During the third quarter, we completed the acquisitions of Focus and Enterix and now have the worldwide rights to their proprietary tests for infectious disease and colorectal cancer.

Focus provides innovative diagnostics for infectious disease, autoimmune disorders and genetic testing. Its HerpesSelect test is the gold standard for laboratories worldwide.

Enterix provides the InSure test for colorectal cancer screening. The FDA recently cleared a new version of InSure that can be performed in physicians' offices. We anticipate introducing this test early in 2007.

Additionally, our integration of LabOne is on track, and we have completed the consolidation of labs in southern California.

We continue to be bi-focal. We are working to optimize our operating performance in the short term, including retaining the United business. At the same time, we are taking the necessary steps to ensure long-term profitable growth.

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In closing:

- Our business is performing very well.
- We remain focused on driving profitable growth.

As a healthcare service provider, putting patients first is our first responsibility.

We will now take your questions. Operator?

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