Quest Diagnostics
Quarter ended June 30, 2006
Conference Call Prepared Remarks
Monday July 24, 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.

Some of the financial measures we will be discussing today are non-GAAP measures. A copy of our earnings press release, which contains information that is required under Regulation G, 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 second quarter.

- Revenues increased 15%;
- Earnings per share grew to 78 cents per share, excluding NID;
- And cash flow was $170 million.

Our business continues to perform well.

We are expanding margins and driving profitability through a combination of revenue growth and operational efficiencies.

And, in early July, we acquired Focus Diagnostics, a world leader and innovator in infectious and immunologic diseases, which further strengthens our esoteric testing business.

Now Bob will share with you our financial performance.

Bob Hagemann: Thanks, Surya.

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

Consolidated revenues grew 15% for the quarter, with the acquisition of LabOne contributing about 10%. 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 10.3% during the quarter, on a volume increase of about 6% and an increase in revenue per requisition of about 4%. LabOne contributed

almost 5% growth to the clinical testing business, principally reflected in volume. The increase in revenue per requisition is 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 revenue and volume comparisons for the quarter were reduced by about 1% due to the timing of the Easter holiday, which fell in the second quarter this year, compared to the first quarter last year. As we've previously noted, the first quarter comparisons benefited by about 1% for the same reason. The impact on a year-to-date basis is neutral.

NID had revenues which were $13 million less than last year, and reduced consolidated revenue growth by 1%.

Operating income, as a percentage of revenues, was 16.6% for the quarter, and reflects about a percent and a half improvement 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 use of our electronic connectivity solutions, and continued benefits from our Six Sigma efforts.

During the quarter we finalized our plans for the discontinuance of NID's operations and recorded costs of $28 million associated with those activities, which are well underway. About $21 million of the wind-down costs are reflected in "other operating expense," with the balance included in cost of services. We had preliminarily estimated the costs to be up to $45 million. NID's total pre-tax losses for the quarter were $35 million and reduced consolidated margins by 2.2% and EPS by $0.12. We are providing results and guidance with and without the impact of NID because we expect to treat NID as a discontinued operation later this year, once all operating activities have ceased. The ongoing government investigation of NID continues, and we are fully cooperating. At this time we are not in a position to estimate, what, if any, liabilities may result.

Expense associated with FAS 123R reduced margins by 1.3%, and results of the LabOne business, which will carry lower margins than the rest of our operations until we've realized most of the expected $40 million in synergies, reduced margins by .8%. Lastly, the timing of Easter reduced margin comparisons by about 30 basis points.

During the quarter we recorded a non-cash charge of $12 million to write down our investment in Vasogen, a Canadian biotech company. Vasogen's share price dropped upon announcing the results of the clinical trial for its congestive heart failure treatment, and we view it as unlikely that the stock will recover in the near term. The charge was recorded in "other expense" below the operating income line.

Included in Footnotes 6 and 7 to our earnings release are tables which summarize the impact to revenues, operating income and EPS, of the various items I just discussed.

Diluted earnings per share grew to $0.78, excluding the impact of NID, and were reduced by $0.04 due to the Vasogen write-down. The growth in earnings was driven principally by strong performance in our clinical testing business.

Cash from operations in the quarter was $170 million, compared to $234 million in the prior year. The timing of various items which benefited the first quarter, reversed in this quarter. For the first half cash from operations is up over $40 million from the prior year. Days sales outstanding were 45 days compared to 46 days at year-end.

During the quarter we repurchased 2.6 million common shares for $150 million. Capital expenditures for the quarter totaled $46 million.

Shortly after the end of the quarter, we completed the acquisition of Focus Diagnostics, and repaid our $275 million note which came due. We borrowed $375 million under our existing credit facilities and used cash on hand to complete these transactions.

Turning to full-year guidance: we expect to treat NID as a discontinued operation before the year is out. Therefore, guidance will be presented for continuing operations, before the impact of NID.

- We expect revenues to grow approximately 15 percent. This includes the partial-year impact of the Focus acquisition but 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 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 $210 and $230 million.

- We expect NID, which will be treated as a discontinued operation, to generate pre-tax losses, including the $28 million second quarter charge, of approximately $60 to $68 million, or 20 – 23 cents per diluted share.

- And lastly, we expect diluted earnings per common share from continuing operations to be between $2.95 and $3.05.

A reconciliation of our previous guidance to our current guidance is included in Footnote 8 to the earnings release.

Now, I'll turn it back to Surya.

Surya Mohapatra: Thanks, Bob.

Our diagnostic testing business is strong and growing. I'd like to spend a few minutes talking about the drivers of our performance.

We drive profitable growth organically and through acquisition.

During the quarter, organic growth was driven by strong increases in a number of higher-value tests, both routine and esoteric.

- Gene-based tests for women's health, grew more than 15% in the quarter. These include tests for HPV as well as other sexually transmitted diseases such as chlamydia, gonorrhea and herpes virus. HPV testing in particular has been growing rapidly. As doctors and their patients become better educated about new guidelines for cervical cancer screening, they are ordering the HPV test more often, along with a Pap test.

- Cardiovascular testing continues to show strong growth, particularly expanded lipid tests, which increased 40% during the quarter.

- Also, allergy testing using ImmunoCAP grew more than 15%.

These tests are examples of current growth drivers and we continue to build a pipeline of new tests for future growth.

We introduced Leumeta plasma-based testing for leukemia and lymphoma early this year. We see tremendous interest in this technology from doctors and hospitals looking for alternatives to painful bone marrow biopsies.

Other recently introduced tests include:

- CellSearch, which identifies circulating tumor cells in patients with metastatic breast cancer;
- The CUP test for the detection of cancers of unknown primary origin; and

- A rapid test for the detection of staph infections in hospitals.

Flawless execution is the key to successful acquisitions and realizing synergies.

- Our integration of LabOne is progressing well and remains on track.
  - We are in the process of consolidating our laboratories in St Louis and Lexington into former LabOne facilities in Kansas City and Cincinnati.
- We are also completing our consolidation in southern California. The new West Hills facility is open, and by this fall will process testing that previously had been performed in three separate locations.

Now, let's look at what we are doing to drive continuous improvements in our operations.

- Our focus on enhancing service to patients and customers is driving results. We have seen steady improvement in physician satisfaction, which is up more than 10% over the past two years.
- In addition, we continue to enhance the patient experience with new features like appointment scheduling and cash collection at patient service centers and first-time problem resolution at our billing call centers.
- We are using Six Sigma and Lean techniques in our operations to improve quality and efficiency. We are working on improving specimen tracking. We are piloting the use of mobile scanners to track specimens and establish an electronic chain of custody.

We have further strengthened our relationships with managed care organizations. For example, we are partnering with health plans to reduce costs and improve patient outcomes through several pilots to promote diagnostic tests and enable e-prescribing.

We have created a significant competitive advantage with our Care360 physician portal.

- We are proud of the adoption rate of this powerful portal and how it is helping doctors to improve their workflow and take care of patients. More than 90,000 physicians are using Care360. And we are installing 200 to 300 new systems each week.
- During June, doctors wrote more than 65,000 electronic prescriptions online, up from approximately 50,000 in March. Also in June, we received more than 5 million lab orders and sent more than 10 million test reports over the internet.
- According to our survey, doctors report that the Care360 portal:
  - Makes lab results easier to access, anywhere anytime;
  - Reduces errors; and saves time.

In closing:

- Our business is strong and growing.
- We continue to differentiate ourselves by focusing on:
  - Enhancing the patient experience
  - Broadening access and distribution
  - Improving quality and efficiency using Lean Six Sigma; and
  - Developing innovative tests and advanced IT services.
- We are on track to meet our goals for 2006.
- And I'm excited about our future.

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