Quest Diagnostics Incorporated
Third Quarter 2004 Conference Call
October 25, 2004, 8:30 am ET

Laure Park: Good morning. I am here with Surya Mohapatra, our president 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 2003 Form 10-K and subsequent filings.

As we have previously indicated, this is the last quarter in which we will provide quarterly guidance. To keep everyone's focus on the longer term, beginning in 2005 we will provide financial guidance for the full-year only.

A copy of our earnings press release, together with any information that would be required under Regulation G, and the text of our prepared remarks will be available in the "quarterly updates" section of our website later today at www.questdiagnostics.com.

Now, here is Surya Mohapatra.

Surya Mohapatra: Thank you, Laure. We reported strong financial results during the third quarter.

Earnings per share grew by 13%. Revenues grew nearly 6%. We generated substantial amounts of cash during the quarter -- $217 million. So far this year, we have returned in excess of $400 million to shareholders in the form of share buybacks and dividends.

We continue to differentiate ourselves in the marketplace. We do this by providing patients and physicians with innovative science and medicine, advanced information technology, unparalleled access and distribution, and the benefits of our long-standing commitment to Six Sigma quality.

Now, Bob will discuss the quarterly results and provide you with guidance for the fourth quarter and full-year 2004. I will then discuss some of the investments we are making to generate growth.

Bob Hagemann: Thanks, Surya.

Overall, we reported strong results for the third quarter. We generated solid gains in revenues, earnings and cash flows, despite the impact of hurricanes on our business in the southeastern part of the United States.

Revenues grew 5.6%. Volume increased 3.3%, and reflects a reduction of just over half a point due to the hurricanes. This represents the fourth consecutive quarter of underlying volume improvement.

Revenue per requisition grew 1.9% for the quarter. The benefits of changes in test mix and tests per requisition continue to be the principal drivers of the improvement, with modest increases in pure price. The 1.9% improvement is a slower rate of growth than reported in the first half of the year and reflects about a half a percent reduction from a shift in payer mix associated with certain new business. We continue to expect revenue per requisition to contribute about 2% to revenue growth in a given year, principally driven by improvements in test mix and the number of tests per requisition.

The rest of the revenue growth in the quarter was attributable to our non-clinical testing businesses.

For the quarter, operating income as a percentage of revenues was 18%. This reflects a reduction of about 60 basis points, contributed equally by the hurricane impact and an increase in bad debt expense compared to the second quarter. The increase in bad debt expense was driven by two of our business units, which we are currently addressing. We expect lower bad debt and improved margin expansion in the fourth quarter.

We are committed to expanding operating margins through a combination of profitable growth and efficiencies from our Six Sigma efforts at the same time we invest to further strengthen our value proposition.

Cash from operations was strong, totaling $217 million during the quarter, an increase of $44 million compared to the prior year. Days sales outstanding were 48 days, unchanged from the level at the start of the year. Our goals call for further reducing this level by several days.

During the quarter we repurchased 1.3 million shares of common stock for $110 million at an average price of $81.64. We have now repurchased a total of 8.5 million shares for $639 million at an average price of $74.82 since initiating our share repurchase program in May, 2003. Currently, $261 million of the share repurchase authorization remains available.

We continue to view growth opportunities as the first priority for our excess cash flow, with share repurchases the alternative when growth opportunities are not available on appropriate terms.

Turning to our outlook for the fourth quarter:

- We expect revenues to grow approximately 6%.
- Earnings per diluted share are expected to be between $1.18 and $1.23 before the required change in accounting for our convertible debentures, which will reduce earnings by 3 cents; and
- We expect operating income as a percentage of revenues to be between 17% and 18%.

The resulting 2004 full year outlook is for:

- Revenues to grow approximately 8%;
- Earnings per diluted share to be between $4.82 and $4.87, before the special charges recorded in the second quarter and the change in accounting for the convertible debentures. We have narrowed the range since our previous guidance with the mid-point of the range unchanged. A reconciliation of the EPS guidance is included in Footnote 7 of our earnings release.
- We expect full year operating income to approach 18% of revenues and capital expenditures to be between $180-190 million. Cash from operations is expected to exceed $700 million.

Now, I'll turn it over to Surya.

Surya Mohapatra: Thanks, Bob.

We continue to make progress in driving organic revenue growth. The primary driver of this growth is our strong market differentiation. Here are a few examples of how we are investing to further differentiate Quest Diagnostics from our competitors:

> Our focus on Six Sigma is producing benefits for physicians and patients. For example, in our Nichols Institute esoteric lab in Chantilly, we improved the turnaround time for cystic fibrosis testing by 70% using Lean Six Sigma. We did it by linking value added-steps and eliminating unnecessary work throughout the process. As a result, turnaround time improved while specimen volumes continued to grow for this extremely important test. In addition to reducing our turnaround time, we also reduced what I call the "anxiety time" for patients and doctors waiting for the test results.
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> We have continued to expand our access for patients, and it is producing results. Managed care organizations choose Quest Diagnostics for the clear benefits we offer their members and physicians. We offer patients access to almost 2,000 conveniently located patient service centers for collecting their blood samples. Each day, our professional drivers make 85,000 stops and our dedicated pilots fly 82 flights to 42 cities – all to ensure that we get the patients' samples to our labs quickly and safely for quality testing.
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> Another significant differentiator for us is our science and medicine, which provides patients and doctors with the broadest test menu. We continue to seek out new and innovative tests to help physicians diagnose and treat patients. Our main areas of focus are cardiovascular disease, cancer and genetic testing.
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> Recently we announced the availability of an innovative new cancer test called CellSearch, from Johnson & Johnson's Veridex unit. This test identifies and counts circulating tumor cells from metastatic breast cancer patients. Clinical studies have shown that measuring the number of circulating tumor

cells in the blood sample can help oncologists monitor the response to therapy. There are an estimated 80,000 or more patients with metastatic breast cancer in the United States.

We are the only national commercial reference laboratory to offer this test, which has been cleared by the FDA. We launched the test roughly one month following its August publication in the New England Journal of Medicine. This demonstrates our commitment to science and medicine, as well as our focus on bringing important new tests to market quickly.

Another way we differentiate ourselves is through healthcare information technology. Increasingly, the government and private payers are interested in clinical integration, pay-for-performance, electronic health records and e-prescribing to improve patient care and reduce healthcare costs.

Quest Diagnostics has unique expertise in the application of information technology to healthcare. For example, our patient-centric Care360 eMaxx portal enables doctors to aggregate lab and pharmacy data and other clinical information to improve patient care. In addition, it allows doctors to verify insurance eligibility and write prescriptions electronically, reducing errors and improving efficiency.

Doctors continue to expand their use of our online services. By the end of the third quarter, we were receiving nearly 40% of all test orders and transmitting more than 50% of all test results to doctors via the Internet. That equates to approximately two-and-a-half million transactions per week.

All of these investments continue to differentiate us from the competition, as well as drive growth and expand operating margins.

Increasingly, we are being recognized for our accomplishments. During the quarter, we were named as one of the nation's Top 100 Innovators by the prestigious InformationWeek 500 ranking. Also, Business Week magazine included questdiagnostics.com on its short list of the best websites in healthcare for its extensive and useful library of health information.

We are the leader in a vital and growing industry, and are well positioned for sustainable growth. Last month, Quest Diagnostics was added to the Dow Jones Sustainability World Index. The Index contains more than 300 companies from around the world identified as "sustainability leaders," ranked according to objective benchmarks linked to financial, environmental and social criteria.

We had a strong third quarter and I am excited about the prospects for our company.

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