Quest Diagnostics Incorporated
Q4 2004 Conference Call Prepared Comments

Thursday, January 27, 2005, 8:30 am

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 2003 Form 10-K and subsequent filings.

As we have previously indicated, beginning this quarter we are no longer providing quarterly guidance and will provide financial guidance for the full-year only.

A copy of our earnings press release, together with any information that is required under Regulation G, are 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 is also available on the website.

Now, here is Surya Mohapatra.

Surya Mohapatra: Thank you, Laure.

We reported strong financial results for the fourth quarter and the full year.

- For the fourth quarter, revenues grew 6.6% and earnings per share grew 21%;
- For the full year, revenues grew more than 8% and earnings per share grew 18%;
- And, in 2004, cash from operations was $800 million dollars.

We have made significant progress in many areas and I am pleased with the direction in which our company is heading:

- We have demonstrated that we can drive strong organic growth, 6.7% in 2004.
- Six Sigma is playing an important role in driving growth by improving the overall experience of patients and customers, while helping us become more efficient.
- Our focus on innovation is giving us a competitive edge in science, medicine and information technology.
- We have increased the value we return to our shareholders. In 2004 we returned $800 million dollars to our shareholders through share repurchases and dividends while continuing to invest to drive growth for our company.

We expect 2005 to be another strong year with earnings per share increasing 14 to 16 %.

Now Bob will share with you the analysis of our 2004 financial performance and 2005 guidance.

Bob Hagemann: Thanks, Surya. We reported strong results for the fourth quarter, with improvement in all of our key financial metrics.

Revenues grew 6.6%. Volume increased 4.1%, the fifth consecutive quarterly increase. The investments we've been making in sales, service quality, innovation, and access for customers are differentiating us and driving growth.

For the quarter, revenue per requisition grew 1.9% over the prior year, an increase consistent with the third quarter. Improvements in test mix and the number of tests per requisition remain the principal drivers of the increase. We continue to expect that these factors, in addition to modest price increases, will drive further improvements in revenue per requisition and contribute about 2% to revenue growth in a given year.

The rest of the revenue growth for the quarter, about half a point, was contributed by our non-clinical testing businesses.

For the quarter, operating income was 17.2% of revenues, an improvement of 80 basis points from the prior year. Half of that improvement was due to a lower bad debt rate, which improved to 4.2% of revenues in the quarter. We reported a modest increase in our cost of sales percentage compared to the prior year. However, our overall profitability, which is what we focus on, showed strong improvement due to our Six Sigma efforts and continued profitable growth.

Two factors principally impacted the cost of sales percentage in the quarter. The larger of the two, which has to do with incentive payments, is one of timing and not something we see as continuing. We incent essentially all our employees based on a balanced scorecard, which includes financial, operating, customer service and quality metrics. In the fourth quarter we accelerated progress in a number of these areas, which required us to accrue additional incentive payments. The other factor has to do with growth in clinical trials testing. This operation, which carries a higher cost of sales than our core business, experienced strong growth in certain business, which, while profitable, raised its cost of sales percentage even further.

Profitable growth, Six Sigma, and increasing use of electronic connectivity by our customers, will drive further margin expansion at the same time we continue investing to further differentiate our company.

Our strong operating performance translated into strong earnings growth. During the quarter we grew diluted earnings per share 21% from the prior year level. EPS growth benefited modestly (about 2%) from a lower tax rate in the fourth quarter, which brought our full year effective tax rate to 40.2%, and is consistent with the effective tax rate we expect going forward. The reduction in the rate is principally related to state taxes.

Cash from operations was outstanding, totaling $264 million for the quarter. Days sales outstanding improved to 47 days, one day lower than last quarter and a year ago. Capital expenditures during the quarter were $42 million and totaled $176 million for the year.

During the quarter we repurchased 3.8 million common shares for $353 million, at an average price of $93.47. Included in these totals is 2.7 million shares purchased from GlaxoSmithKline in December. Our strong cash flow enabled us to complete the fourth quarter repurchases with no incremental borrowings at quarter end. For the year, we repurchased a total of 8.3 million common shares for $735 million. We have now repurchased 12.3 million shares for a total of $1 billion, at an average price of $80.54, since initiating our share repurchase program in May 2003.

This morning we increased our dividend and expanded the share repurchase authorization, reflecting confidence in our ability to continue generating strong cash flows.

We continue to view growth opportunities as our first priority for deploying excess cash flow, and are excited about the longer-term prospects in this area. However, as we've previously demonstrated, we will continue to use share repurchases as an alternative use of cash when growth opportunities are not available on appropriate terms.

As you know, in December we called for redemption, our $250 million in convertible debentures. Essentially all of the holders elected to convert their debentures into common shares, and as a result, approximately 2.9 million shares were issued in connection with the call.

Turning to 2005 guidance, we expect:

- Revenues to grow between 5 and 6%, essentially all from organic growth.
- Operating income as a percentage of revenues to expand to between 18 and 19%.
- Cash from operations to approach $800 million, and capital expenditures of $210 and $230 million.
- And, we expect earnings per diluted share to be between $5.45 and $5.55. This reflects an increase of 14-16% compared to 2004 earnings per share of $4.77, before special charges.
- Estimates for 2005 earnings per diluted share, operating income and cash from operations are before the impact of the accounting change for equity-based compensation, which takes effect in July.

We have not finalized what, if any, changes may be made to our equity compensation plans in light of the accounting change, and therefore are not yet in a position to quantify its impact. We expect to share the impact with you in connection with reporting our second quarter financial results.

Now, I'll turn it over to Surya.

Surya Mohapatra: Thanks, Bob. I'm excited about our 2004 financial performance. What we accomplished goes well beyond the numbers. We have built a strong foundation for future growth.

It all starts with patients. Increasingly, patients and their doctors have a choice when it comes to selecting a health care provider, and we are giving them new and compelling reasons to put their trust in Quest Diagnostics every day.

We want to ensure that our patients and doctors have an excellent experience whenever they interact with us – from beginning to end. That includes everything – not just ordering tests and getting results. It also covers our:

- Couriers picking up samples;
- Phlebotomists drawing blood;
- Medical staff performing the tests and providing consultations;
- And interactions during the billing cycle.

Further, we are focused on reducing anxiety time for patients by assuring that their results are delivered to their physicians even faster.

We are investing, and focusing Six Sigma resources to improve the overall patient experience. After all, we pursued Six Sigma in the first place because one hundred forty million patients and their families rely on us each year to determine whether they are ill or well.

While acquisitions will always play an important role in our growth strategy, we are successfully transitioning to organic growth as a more significant contributor. We continue to expand our sales force, particularly in high-growth specialty areas. We are giving them better tools and training, as well as new products to sell. Our sales reps' knowledge of new and innovative products serves as a valuable source of information for doctors to improve patient care.

- Our campaigns to inform doctors about the benefits of various tests – such as HPV testing for primary cervical cancer screening; the use of ImmunoCAP for allergy testing; and tests to determine cardiovascular risk – are improving patients' health and driving growth.
- Recently, two studies and an editorial in the Annals of Internal Medicine exposed the inaccuracy of fecal occult blood tests using digital rectal exams. In contrast, our InSure colorectal screening test is more patient-friendly than the conventional test, has higher sensitivity and is included in the American Cancer Society guidelines for recommended screening.
- We are making specimen collection more convenient for patients and reducing wait times by adding phlebotomists and expanding the hours of operation of our patient service centers.
- We are improving customer satisfaction and loyalty by continuously improving service levels and their consistency using Six Sigma.

Our focus on innovation continues, and will benefit patients, doctors and payers. Each year we add around one hundred tests developed by our scientists at Nichols Institute to our comprehensive menu of more than 3,000 tests. We also work with academic and research institutions and biotechnology companies to bring new tests and technology to market quickly. For example:

- Earlier this week we announced a collaboration with the University of Texas M. D. Anderson Cancer Center to develop a series of new blood tests to replace the need for painful bone marrow biopsies for patients with a range of leukemias and lymphomas.

- We have accelerated our ability to bring products to market. We recently introduced the Cell Search test to help oncologists better care for patients with metastatic breast cancer – and we were able to do so within one month following publication in the New England Journal of Medicine.

- The investments we have made in healthcare information technology are also contributing to growth. Our connectivity solutions help doctors spend more time with patients and less time searching for test results. Usage of our Internet services continue to grow and has enhanced customer loyalty. We are currently transmitting 60% of all test results to doctors and receiving 40% of all test orders via the Internet.

- And we are starting to see usage grow for our new premium services, such as e-prescribing.

- Additionally, physicians value the new anatomic pathology reports that we are introducing. These reports include images and organ maps, in addition to the diagnosis, to aid specialists, particularly in communicating about cancers with their patients and referring physicians.

- Increasingly, payers recognize the value of early detection and prevention. For example, HEDIS health plan quality metrics and pay-for-performance programs include measurements related to the appropriate use of screening tests.

To summarize:

- We are playing an increasingly important role in improving the health of patients;
- 2004 was a strong year, and we anticipate another strong year in 2005;
- And, we are well positioned to continue providing superior returns to our shareholders.

We will now take your questions. Operator?