

loyalty by providing more convenient ordering and reporting of clinical tests and better access to patient-centric information.

We develop and integrate clinical connectivity and data management solutions for healthcare organizations, physicians and clinicians primarily through our Care360 suite of products and the ChartMaxx® electronic document management system for hospitals. The Care360 products, including our Care360 Physician Portal, enable physicians to order diagnostic tests and review test results from Quest Diagnostics online. In addition, the Care360 Physician Portal enables physicians to electronically prescribe medication, view clinical and administrative information in a patient-centric record maintained in our repository and share confidential information with medical colleagues in a HIPAA-compliant manner. Demand has been growing for our information technology solutions as physicians have expanded their usage of the Internet. By the end of 2007, approximately 125,000 physicians were using our Care360 products and, excluding our recently acquired AmeriPath business, approximately 65% of our test orders and approximately 75% of our test results were being transmitted electronically. In December 2007, approximately 140,000 e-prescribing scripts were processed through Care360.

Additionally, we have recently acquired the capabilities to deploy a health information exchange system comprised of proprietary technologies that enable healthcare providers to access and manage a range of patient data from multiple sources at the point-of-care. These capabilities will enable us to provide solutions to the many health information exchanges that are being developed.

THE UNITED STATES CLINICAL TESTING MARKET

Most clinical tests are performed by one of three types of laboratories: commercial clinical laboratories; hospital-affiliated laboratories; and physician-office laboratories. We believe that hospital-affiliated laboratories account for approximately 60% of the market, commercial clinical laboratories approximately one-third and physician-office laboratories the balance.

Key Trends. There are a number of key trends that we expect to have a significant impact on the clinical testing business in the U.S. and on our business. These trends present both opportunities and risks. We believe that the industry will continue to grow over the long term and that we are well positioned to benefit from the long-term growth expected in the industry.

Demographics. The growing and aging population is increasing the demand for clinical testing.

Increased testing. We believe that we are entering the decade of diagnostics, moving to preventative care from curative care. Physicians increasingly are relying on testing to aid in the identification of risk factors and symptoms of disease, the choice of therapeutic regimen and the evaluation of treatment results. Physicians, consumers and payers increasingly recognize the value of testing as a means to improve health and reduce the overall cost of healthcare through early detection and prevention.

Science and technology advances. Medical advancements allow for more accurate and earlier diagnosis and treatment of diseases. Continuing research and development in the area of genomics is expected to yield new, more sophisticated and specialized diagnostic tests.

Health information technologies. Demand is growing toward comprehensive care management solutions that serve patients, payers and practitioners by improving access to patient data, increasing patient participation in care management, reducing medical errors and improving clinical outcomes. There is an increasing focus on interconnectivity and desire for real time data aggregation. Electronic medical records and patient health records continue to grow.

Customer consolidation. Our customers, including health insurance plans, employers, pharmaceutical companies and other intermediaries, have been consolidating. We expect that this trend will continue. Consolidation is increasing customer bargaining power and enhancing their purchasing sophistication.

Highly competitive. The clinical testing industry remains fragmented, is highly competitive and is subject to new competition. Competition is growing from non-traditional competitors. New market entrants with extensive resources may make acquisitions or expand into our traditional areas of operations. We also are expanding into new diagnostic testing areas that are highly competitive.

Regulatory and policy environment. Government oversight of and attention to the healthcare industry in the United States is significant and may increase.

Globalization. There is a growing demand for healthcare services in emerging market countries. Opportunities are arising to participate in the restructuring or growth of the healthcare systems in these countries.

Additionally, our customers are establishing positions outside the United States. Demographic changes globally may also create opportunities.

Customers and Payers. We provide testing services to a broad range of customers, with orders for clinical testing generally generated by physician offices, hospitals and employers. In most cases, the customer that orders the testing is not responsible for the payments of services. We consider a party that refers a test to us a “customer” and a party that reimburses us a “payer.” Depending on the billing arrangement and applicable law, the payer may be (1) a third party responsible for providing health insurance coverage to patients, such as a health insurance plan, self-insured employer benefit fund, or the traditional Medicare or Medicaid program, (2) the patient or (3) the physician or other party (such as a hospital, another laboratory or an employer) who referred the testing to us.

The following table shows current estimates of the breakdown of the percentage of our total volume of requisitions and net revenues associated with our clinical testing business during 2007 applicable to each payer group:

	Requisition Volume as % of Total Volume	Net Revenues as % of Total Clinical Laboratory Testing Net Revenues
Traditional Medicare and Medicaid Programs	15% - 20%	15% - 20%
Physicians, Hospitals, Employers and Other Monthly-Billed Clients.....	30% - 35%	20% - 25%
Health Insurance Plans: Fee-for-Service.....	30% - 35%	40% - 45%
Health Insurance Plans: Capitated.....	15% - 20%	5% - 10%
Patients	2% - 5%	5% - 10%

Health insurers, including managed care organizations and other health insurance providers, which typically reimburse us as a contracted provider on behalf of their members for clinical testing services performed, represent approximately one-half of our net revenues from clinical testing. Reimbursement from our two largest health insurer payers totaled approximately 11% of our net revenues in 2007. Aetna, which accounted for over 6% of our consolidated net revenues for 2007, was our largest health insurer payer.

Physicians. Physicians requiring testing for patients are the primary referral source of our clinical testing volume. Physicians determine which laboratory to recommend or use, based on a variety of factors, including service; patient access and convenience, including inclusion in a health plan network; price; and depth and breadth of test and service offering.

Most of our clinical testing is referred by primary care physicians. We historically have provided a strong value proposition in routine and esoteric clinical testing. During 2007, we acquired AmeriPath, expanding our service capabilities. This will enable us to leverage our capabilities and to more effectively compete in several physician sub-specialties, including dermatology, urology, gastroenterology, hematology and oncology, where historically we had a smaller market share. We plan to continue to enhance our test menu and service capabilities.

Health Insurance Plans. Health insurance plans, including fully insured and self-funded employers, typically negotiate directly or indirectly with a number of clinical laboratories, and represent approximately one-half of our total clinical testing volumes and one-half of our net revenues from clinical testing. In certain markets, such as California, health insurance plans may delegate to independent physician associations (“IPAs”) the ability to negotiate for clinical testing services on behalf of certain members. The trend of consolidation among health insurance plans has continued.

Health insurance plans and IPAs often demand that clinical test service providers accept discounted fee structures or assume all or a portion of the financial risk associated with providing testing services through capitated payment arrangements and discounted fee-for-service arrangements. Under capitated payment arrangements, we provide services at a predetermined monthly reimbursement rate for each covered member, generally regardless of the number or cost of services provided by us. Average reimbursement rates under capitated payment arrangements are typically less than our overall average reimbursement rate. Health insurance plans continue to focus product offerings on point-of-service (“POS”) plans, and consumer driven health plans (“CDHPs”) that offer a greater choice of healthcare providers. Pricing for these programs is typically negotiated on a fee-for-service basis, which generally results in higher revenue per requisition than under capitation arrangements. Increased patients in CDHPs and high deductible plans involve greater patient cost-sharing; this could negatively impact patient collection experience.

Most of our agreements with major health insurance plans are non-exclusive arrangements. Certain health insurance plans, however, have been increasingly willing to limit the laboratory network to only a single national laboratory to obtain improved pricing. In cases where members choose to use a non-contracted provider due to service, quality or convenience, the non-contracted provider is generally reimbursed at rates considered “reasonable and customary.” Contracted rates are generally lower than “reasonable and customary” rates because of the potential for greater volume as a contracted provider. A non-contracted clinical test service provider with quality and service preferred by physicians and patients to that of contracted providers could potentially realize greater profits than if it was a contracted provider, provided that physicians and patients continue to have choice in selecting their clinical test provider and any potential additional cost to the patient of using a non-contracted provider is not considered prohibitive.

We also may be a member of a “complementary network.” A complementary network is generally a set of contractual arrangements that a third party will maintain with various providers that allow for discounted fees for the benefit of members of the customers that arrange access through the third party. A member of a health insurance plan may choose to access a non-contracted provider that is a member of a complementary network; if so, the provider will be reimbursed at a rate negotiated by the complementary network.

We offer QuestNet™, a service in which we develop and administer customized networks of clinical test providers for health insurers. QuestNet™ networks provide physicians and patients multiple choices for clinical testing. Health insurance plans that use these networks realize cost reductions by reducing testing performed by non-contracted providers and from simplified payment administration for clinical testing services.

Hospitals and Other Laboratories. Hospitals generally maintain an on-site laboratory to perform testing on patients and refer less frequently needed and highly specialized procedures to outside laboratories, which typically charge the hospitals on a negotiated fee-for-service basis. Fee schedules for hospital reference testing are typically negotiated on behalf of the hospitals by group purchasing organizations. We believe that most hospital laboratories perform approximately 90% to 95% of their patients’ clinical tests. We provide services to hospitals throughout the United States that vary from esoteric testing, to helping manage their laboratories, to serving as the medical directors of the hospital’s histology or clinical laboratory. We believe that we are the industry’s market leader in servicing hospitals. Hospitals generally continue to look for ways to fully utilize their existing laboratory capacity: they perform tests needed by their patients and compete with commercial laboratories for outreach (non-hospital patients) testing. Continuing to obtain referrals from hospitals depends on our ability to provide high quality services that are more cost-effective than if the hospitals were to perform the services themselves. We believe that our combination of full-service, bi-coastal esoteric testing capabilities, medical and scientific professionals for consultation, innovative connectivity products, focus on Six Sigma quality and dedicated sales and service professionals has positioned us to be an attractive partner for hospital customers.

Most physicians have admitting privileges or other relationships with hospitals as part of their medical practice. Many hospitals leverage their relationships with community physicians and encourage the physicians to send their outreach testing to the hospital’s laboratory. In addition, hospitals that own physician practices generally require the physicians to refer tests to the hospital’s affiliated laboratory. Hospitals can have greater leverage with health insurers than do commercial clinical laboratories, particularly hospitals that have a significant market share; hospitals thus are frequently able to negotiate higher reimbursement rates with health insurance plans than commercial clinical laboratories for comparable clinical testing services.

We also have joint venture arrangements with leading integrated healthcare delivery networks in several metropolitan areas. These joint venture arrangements, which provide testing for affiliated hospitals as well as for unaffiliated physicians and other healthcare providers in their geographic areas, serve as our principal laboratory facilities in their service areas. Typically, we have either a majority ownership interest in, or day-to-day management responsibilities for, our hospital joint venture relationships.

We also provide testing services to federal, state and local governmental agencies, and perform esoteric testing services for other commercial clinical laboratories that do not have a full range of testing capabilities. These customers are charged on a fee-for-service basis.

Insurers and Employers. We provide services to life insurance companies and employers. Life insurance companies use clinical tests and other services we provide to assist in making policy issuance and premium rating decisions. Factors such as the number of applications for fully-underwritten life insurance policies can affect the utilization of clinical testing and other services we provide to our insurance customers. We seek to grow our insurance revenues by increasing our market share and by offering new and innovative clinical tests and other services. Our life insurance customers have been consolidating, which has resulted in increased individual customer purchasing power. We expect that this trend will continue. We charge our life insurance customers on a fee-for-service basis, typically under multi-year agreements.

Employers use clinical tests for drugs-of-abuse to determine an individual's employability and his or her "fitness for duty." Companies with high turnover and safety conscious environments provide the highest volumes of testing. Factors such as the general economy and job market can impact the utilization of clinical testing. We seek to grow our employer volumes through offering new and innovative programs to help companies with their goal in maintaining a safe and productive workplace. One of these innovations is our Blueprint for Wellness program where we provide wellness screenings to employers and their employees.

GENERAL

Sales and Marketing. Our sales force is organized to focus on customer groups and service types. The majority of representatives focus on marketing clinical laboratory testing, anatomic pathology and related services to physicians, including physician specialists. Supporting our physician sales teams are genomics and esoteric testing specialists, who are specially trained and focused on educating our clients on new and more complex tests. In addition, we have a health plan sales organization that focuses on regional and national insurance and healthcare organizations. We also have a hospital sales organization that focuses on meeting the unique clinical testing needs of hospitals and promotes the specialized capabilities of our Nichols Institute esoteric testing laboratories and our Focus Diagnostics infectious and immunologic disease testing laboratory. A smaller portion of our sales force focuses on selling substance-of-abuse and wellness testing to employers. We also have a sales force that focuses on selling risk assessment testing services to life insurance companies. In addition, we have a sales organization that focuses on selling diagnostic products to hospitals, commercial clinical laboratories, physician office laboratories, blood banks and clinics. We also have a sales force that focuses on our clinical trials services to drug developers. We focus our sales efforts on obtaining and retaining profitable accounts. We have an active customer management process to evaluate the growth potential and profitability of all accounts.

Information Technology. Information systems are used extensively in virtually all aspects of our business, including clinical laboratory testing, test reporting, billing, customer service, logistics and management of medical data. We endeavor to establish systems that create value and efficiencies for our patients and customers. The successful delivery of our services depends, in part, on the continued and uninterrupted performance of our information technology systems.

We have made substantial investments in our healthcare information technology systems, and believe that they help differentiate us. Innovations in our healthcare information technology have the potential to improve patient care, promote efficiency and reduce expense. Both at the federal and state levels, there are public and private efforts to bring together healthcare providers, information technology vendors and other stakeholders to facilitate the creation of standards for the exchange and use of electronic healthcare data, including standard clinical code sets. If certain healthcare data and information technology standards were adopted, we could be required to make substantial investments in our systems to comply with such standards or systems.

Our systems may be vulnerable to damage from a variety of causes, including telecommunications or network failures, human acts and natural disasters. Moreover, despite the security measures we have implemented, our systems may be subject to physical or electronic break-in attempts, computer viruses and similar disruptive problems. We also have taken precautionary measures to prevent unanticipated problems that could affect our systems. Nonetheless, system failures, such as those that interrupt our ability to process test orders, deliver test results or perform tests in a timely manner, could adversely affect our reputation and result in a loss of customers and net revenues.

Some of our historic growth has come through acquisitions and we continue to use non-standardized billing, laboratory or other core information systems. We have standardized some of our systems and are implementing standard laboratory information and billing systems across our operations, including those from our most recent acquisitions. We expect implementation will take several more years to complete, and will result in significantly more centralized systems, improve operating efficiency, provide management with more timely and comprehensive information and enhance control over our operational environment. Failure to properly implement the new systems could materially adversely affect our business. During system conversions of this magnitude, workflow is re-engineered to take advantage of best practices and enhanced system capabilities, which may cause temporary disruptions in service.

Quality Assurance. In our clinical testing business, our goal is to continually improve the processes for collection, storage and transportation of patient specimens, as well as the precision and accuracy of analysis and result reporting. Our quality assurance efforts focus on positive patient identification of specimens and reports, proficiency testing, process audits, statistical process control and personnel training for all of our laboratories and patient service centers. We continue to implement our Six Sigma and standardization initiatives to help achieve our goal of becoming recognized as the undisputed quality leader in the healthcare services industry. In 1998, our