Quest Diagnostics Incorporated
Conference Call Prepared comments
For the Quarter Ended December 31, 2012

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Kathleen Valentine: Thank you and good morning. I am here with Steve Rusckowski, our president and chief executive officer, and Bob Hagemann, our chief financial officer. Before we begin, I'd like to share that as part of the new organization structure announced in October, I am moving into a new role in the company, supporting our new Value Creation organization. Now I'd like to introduce our new executive director of investor relations. Dan Haemmerle. Dan?

Dan Haemmerle: Thanks, Kathleen. During this call, we may make forward-looking statements. Actual results may differ materially from those projected. Risks and uncertainties that may affect Quest Diagnostics' future results include, but are not limited to, those described in Quest Diagnostics' 2011 Annual Report on Form 10-K, 2012 Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.

A copy of our earnings press release is available, and the text of our prepared remarks will be available later today, in the Investor Relations "quarterly updates" section of our website at www.questdiagnostics.com.

A PowerPoint presentation and spreadsheet with our results and supplemental analysis are also available on the website.

Now, here is Steve Rusckowski.

Steve Rusckowski: Thanks, Dan. And thanks, everyone, for joining us today.

In 2012, we generated $1.2 billion in cash, a record for the company.

For the year, we expanded operating margin 30 basis points to 17.8%, driven by continued strong progress in our Invigorate cost-reduction initiative.

We began laying the groundwork for restoring growth.

In a few moments, Bob will review the Fourth quarter with you.

I'd like to start by giving an update on progress we're making to execute the five point business strategy we shared with you at Investor Day in November.

The first element of our strategy is to refocus on diagnostic information services. We conducted a thorough business review of our assets to ensure strategic alignment, and began to pursue strategic options for several of them, including HemoCue and OralDNA.

Last year, we sold OralDNA, and last week we announced our plan to sell HemoCue. As a result, we reported the results for these businesses as discontinued operations.

The second strategic element is to drive operational excellence. I'd like to share that we are making excellent progress.

We delivered annual realized savings in 2012 of $160 million, with a run rate exiting the year of approximately $200 million. This exceeds our goal entering the year for run-rate savings of $150 million.

We are on track to achieve our revised commitment to exit 2014 with run rate savings of $600 million and realized savings of $500 million.

As I've mentioned in past calls, I have been very involved in this program, which is essential to building long-term value. The program is now being managed within our newly created Operations organization. And I will continue to be very engaged in driving progress.

The third strategic element is to restore growth. We now have a single, unified sales team under a strong, collaborative leader, with new regional sales leaders in place across the organization. We will have our first ever national sales force together in two weeks. This is where we will kick off the year, train our sales reps and motivate them to restore growth in 2013. In addition, we are executing on our seven key growth initiatives with short term focus on building sales excellence, growing esoteric testing and establishing a hospital professional services business.

Fourth, we are simplifying our organization. When we reported on third quarter results in October, we had just launched our new organization structure and I had identified the senior management team. Since then, we have been deploying the new organization deep into the business, which includes reducing the number of management layers from 10 to seven. This is on track to be concluded in the second quarter.

The fifth point of our strategy is to deliver disciplined capital deployment. In 2012 we reduced debt by $654 million, significantly increased our dividend, repurchased $200 million of our shares, and announced the UMass transaction, which we completed on January 2nd.

Our UMass Memorial relationship and planned 'lab of the future' in Marlborough, Massachusetts represent a new model for delivering diagnostic information services for our nation's increasingly cost-pressured healthcare system. We have begun integrating this business into our company, and the new facility is being prepared for the build out to start in the spring. Our management team is actively engaged in this integration to ensure we deliver the value we envisioned. We are seeing a lot of interest in this acquisition by integrated delivery networks throughout the country.

We have made progress launching to employees in November what we are calling “Our New Quest”. We have engaged our employees in a conversation about our company’s new vision of “Empowering better health with diagnostic insights,” and our five point business strategy.

I’d like to share that this has generated enthusiasm and excitement inside the company. It also has confirmed our initial view that by eliminating complexity and empowering our employees, we can be more effective and create an inspiring place to work.

There is a strong management commitment to driving operational excellence and restoring growth, starting with me. I have been personally involved in the Invigorate initiative since I arrived at Quest in May.

Another top priority for me is ensuring that we focus more intensely on our customers. I have already met a variety of customers in health plans, integrated delivery networks, and large physician practices, and I look forward to meeting many more of our customers during 2013 with our new Commercial team, as we progress in restoring growth.

The revenue guidance we provided this morning is consistent with the commitment we shared at our Investor Day in November to grow revenues in the low single digits through 2015, beginning with slower growth in the near term, and accelerating through the period.

We see 2013 as a building year, as we improve operations and begin to restore growth.

In 2013 our focus will continue to be driving operational excellence and restoring growth. We will build on the positive momentum of our 2012 Invigorate performance in 2013. We expect results from our efforts to restore growth to gradually build throughout 2013, and anticipate continued revenue softness in the first half, with improvement thereafter. Our efforts to drive sales excellence, grow esoteric testing and build a hospital professional services business will gain momentum through the year. This, coupled with more favorable year-over-year comparisons in the back half of 2013, is what we expect to lead to improvement in the second half.

We believe the Affordable Care Act will provide volume lift in 2014 as more people gain access to health insurance. The diagnostic information services industry continues to deliver significant value to healthcare, given it represents a large portion of the information that is used every day to make healthcare decisions, while it represents only a small portion of the healthcare dollar. In the future, with the evolving healthcare system that will place more emphasis on evidence-based decision making, we believe this industry, and specifically our company, is very well positioned.

Despite this longer term view, we are prudently planning for reimbursement pressure averaging 1-2% through 2015.

In the short term, we are projecting that the combination of commercial pricing pressures, coupled with Medicare cuts, including the most recent pathology service reimbursement reduction, will approximate a 3% reimbursement decline in 2013.

We expect to be able to achieve double digit earnings per share growth by the time we get to 2014, with that growth contributed by not only improvements in operating earnings but continued share repurchases as well.

Our management team and I are focused on driving improvements in return on invested capital. We expect that executing our strategy will result in value for our shareholders by driving return on invested capital over the long term and restoring growth.

Now I'll turn it over to Bob for detailed analysis of the numbers.

***Bob Hagemann*:** Thanks, Steve.

I'll start by trying to simplify some of the analysis of the results. Given the movement of HemoCue and OralDNA into discontinued operations, explaining the performance for Q4 and full-year 2012 has become more complex. To assist in understanding the impact of that change, we have presented a series of tables in Footnote 4 to the earnings release which reconcile the reported results for what is now continuing operations, to pro forma results from continuing operations on an adjusted basis, had we not treated HemoCue and OralDNA as discontinued operations. Those pro forma results are comparable with how we had been reporting through the first three quarters and how we presented our financial guidance provided in October. The tables presented cover Q4 and full-year performance for 2012.

As the pro forma results show, we fell short of our full-year revenue guidance by ≈ 50 basis points. About half of the shortfall is due to the estimated impact of Hurricane Sandy, with the other half softer volume performance than we expected in the underlying business.

Despite the softer top line performance, the full-year pro forma adjusted EPS of $4.47, which was reduced by an estimated $.06 for Hurricane Sandy, was within our EPS guidance range. Our success in driving our Invigorate initiative was a key contributor to delivering the EPS performance.

For the balance of the discussion, I will speak to principally the adjusted results which present HemoCue and OralDNA as discontinued operations, and is consistent with how we will report going forward.

In discussing the results, I'll refer to Diagnostic Information Services (or DIS) and Diagnostic Solutions (or DS). DIS is made up of the same businesses we previously called Clinical Testing, and was essentially unaffected by the movement of HemoCue and OralDNA into discontinued operations. What we previously called our "non-clinical testing businesses" will now be referred to as DS. HemoCue was previously included in "non-clinical testing."

Starting with revenues…

Q4 consolidated revenues of $1.8 billion reflect a decrease of 4% from the prior year, with an estimated 1.2% of the decrease due to the impact of Hurricane Sandy.

Our DIS revenues, which account for over 90% of total revenues, were 4.4% below the prior year, with 1.3% of the decrease due to the impact of Hurricane Sandy. Volume was 2.4% below the prior year, with 1% due to the hurricane. Revenue per requisition was 2% below the prior year level, but essentially unchanged from Q3.
Favorable test mix and an increased number of tests per requisition continue to have positive impacts, but have been more than offset by reimbursement pressures, and business and payor mix changes.

Q4 revenues in our DS businesses, which include risk assessment, clinical trials testing, healthcare IT, and our remaining products businesses, were comparable to the prior year.

Q4 adjusted operating income at 17% was 90 basis points below the prior year, with the decrease due principally to the impact of Hurricane Sandy. Adjusted EPS of $1.01 was $0.19 below the prior year, with each of the following contributing approximately a third of the decline: Sandy, underlying revenue softness, and the year-over-year impact of non-recurring tax items.

Restructuring and integration costs totaling $36 million reduced reported operating income as a percentage of revenues by 2.1% and reported EPS by 14 cents. Last year's fourth quarter included $11 million of costs associated with CEO succession and restructuring and integration, which reduced reported operating income as a percentage of revenues by about 60 basis points and reported EPS by 4 cents.

In response to the softer volume we've seen in the most recent quarters, we have taken action to accelerate savings associated with our Invigorate program. We estimate that Invigorate delivered approximately $160 million in realized savings in 2012, with a run-rate savings as we exited the year at about $200 million.
This represents about one-third of our updated goal of $600 million in run-rate savings as we exit 2014. In addition, as you heard at our November Investor Day, we are evaluating additional opportunities which can bring that amount to $1 billion over time.

Bad debt expense as a percentage of revenues improved 10 basis points from the prior year to 3.4% in the quarter. DSOs were 47 days, up one day from last quarter.

Cash from operations was $380 million in the quarter compared to $338 million in the prior year. Cash flow in the quarter benefited by a deferral of just over $90 million of income tax payments into the first quarter of 2013. The tax deferral was offered to companies headquartered in states most affected by Hurricane Sandy. While this deferral helped cash flows in 2012, it will reduce cash flows in 2013, with the year-over-year impact being ≈ $180 million. This deferral, plus the roughly $72 million of cash flow benefit we realized from cashing out certain interest rate swaps in 2012, will adversely impact the comparison of 2013 cash flow to that of 2012 by a total of roughly $250 million.

Capital expenditures were $60 million in the quarter, compared to $44 million a year ago.

During the quarter we repurchased 869 thousand common shares at an average price of $57.55 for a total of $50 million dollars, bringing the annual total to $200 million. We also reduced outstanding debt by $147 million in the quarter, bringing the full-year total to $654 million in connection with our stated objective to de-lever by $500 – $700 million.

Turning to 2013 guidance:

We expect results from continuing operations, before special items, as follows:

- Revenue growth of between 0 and 1% ;
- Earnings per diluted share to be between $4.35 and $4.55
- Cash provided by operations to approximate $1 billion
- And capital expenditures to approximate $250 million, with the increase from the prior year primarily associated with our Invigorate initiative.

Now I'll turn it back to Steve.

Steve Rusckowski: Thanks, Bob.

In closing, this quarter, we aggressively drove operational excellence and delivered strong Invigorate savings.

We are actively working to regain market share and grow our business.

We have taken tangible actions to increase shareholder returns and improve ROIC.

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