Quest Diagnostics Incorporated
Conference Call Prepared Comments
For the Quarter Ended March 31, 2014

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Dan Haemmerle: Thank you and good morning. I am here with Steve Rusckowski, our president and chief executive officer, and Mark Guinan, our Chief Financial Officer.

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' 2013 Annual Report on Form 10-K 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.

This morning, I'll walk you through the industry dynamics; talk about the impact of the harsh winter on the quarter; and review progress against our five-point strategy. Then Mark will provide more detail on the results and walk you through guidance.

- **Let's start with the industry dynamics and the legislative dynamics in particular.**
  - Our industry has been facing unprecedented reimbursement challenges from the government, following a long history of reimbursement cuts.
  - The new provisions of the "Doc Fix" legislation that relate to the Clinical Lab Fee Schedule remove a dark cloud that was hanging over our industry.
  - This legislation gives us an outcome that is much preferable to earlier government proposals.
    - It delays adjustments to the Clinical Lab Fee Schedule until 2017.
    - It provides for a rulemaking process to define new rates based on a market weighted median of commercial rates from a broad range of labs.

        - And, importantly, it restricts the authority of CMS to make discretionary cuts.
        - I look forward to working closely on this issue with our trade association in my new role as its chairman.
    - There have been questions about the pricing mechanisms in the legislation. Now let me provide clarity to that.
        - First, this needs to be defined through a rulemaking process, but it is designed to be representative of the entire commercial laboratory market.
        - The legislation includes hospital outreach laboratories and independent laboratories. The laboratory industry agrees that everyone benefits from including a broad spectrum of providers in the network.

- **Now beyond the recent legislation, we continue to believe the Affordable Care Act will be net positive for the industry.**
    - In the near term, we expect it to be neutral to slightly positive for Quest in 2014.
    - The enrollment process was in line with our expectations; that is, a bumpy rollout followed by a late surge near the deadline.
    - And we believe that going into the second half we'll see some impact but again neutral to slightly positive.

- **As we all know, this was an unusually harsh winter in many parts of the country, and this had a significant impact on many businesses.**
    - During the quarter, we estimate that the harsh winter reduced our revenues by 2% and EPS by 11 cents.
    - Had this winter been more like last year, revenues would have been essentially flat to the prior year and EPS would have been favorable to 2013.
    - We saw signs of continued stabilization in the underlying trends. Sequential year-over-year trends improved for revenue, volume and revenue per requisition.

- **As we said in January, we want to deliver guidance that is both realistic and achievable. While the slow start to this year clearly is a challenge, we are confident that progress we have made on growth initiatives, particularly as a result of acquisition activities, will enable us to meet our commitments.**
    - Given this environment and actions we are taking, we now expect to show revenue growth, beginning in the second quarter. In a few minutes, Mark will share color on our 2014 guidance.
    - We have been dealing with dynamic market forces and are in the process of updating our longer term view, which we expect to share with you later in the year at an Investor Day presentation. In the meantime, we continue to be bullish on longer term growth drivers for this industry:
        - First the market will benefit from continued population growth and favorable demographics as Baby Boomers move into Medicare and live longer;
        - Also advanced esoteric testing will grow as precision medicine drives demand for advanced diagnostic insights;
        - Despite the initial slow uptake from the Affordable Care Act, more insured lives will gradually begin to enter the market each year;
        - And then, finally, medical guideline changes do influence physician behavior, and we expect to see increases in some tests, such as Hepatitis C, Non-Invasive Prenatal Testing, Lynch Syndrome and lipid testing.

Over the long term, we see significant opportunity in being a high quality, low cost provider of diagnostic information services, which are essential to healthcare delivery.

We remain committed to executing our five-point strategy, and what I'd like to do now is give you an update on progress.

Our top priority for 2014 is to restore growth.

- **We are making solid progress on our growth priorities.**
    - On the business development front, we have completed 7 acquisitions since the beginning of 2013, including 3 this year.
    - Prior to our January call, we announced the agreement to acquire Solstas and I am happy to say that the integration is now well underway. I have been impressed with the professionalism and quality of the Solstas team that I have met. Solstas will help us improve top line performance and strengthen our presence in an important region of the country.
    - We also recently completed the acquisition of Summit Health a few days ago.
        - Summit solidifies our leadership position in the fast-growing wellness business. In this business we partner with employers and health plans to provide an overall health assessment, including biometric screening as well as a comprehensive laboratory analysis.
        - It is complementary to Quest's own wellness offering, whose customers tend to be large employers. Both businesses have been growing organically in the double digits.
        - Summit offers wellness services largely through third parties, including through large health plans and employers.
        - Both Summit and our Wellness business also work closely to help retailers and urgent care centers meet their needs as they explore new business models.
        - Our specimen collection is based largely on venipuncture; Summit relies largely on finger sticks.
        - This positions us well in the major wellness segments, including screening, immunizations, coaching and disease management.

At Investor Day in November 2012 we indicated that we are targeting 1-2% of revenue growth through strategically aligned acquisitions. As we have shared, Solstas will add about 5% to revenues on an annualized basis. In addition, other acquisitions, including Summit and Steward, will add an additional 1 to 2% to revenue growth in 2014.

- Beyond acquired growth, we have been highlighting the opportunity to partner with hospital systems and integrated delivery networks. At our Investor Day in November 2012, we spoke about the challenges that integrated delivery networks would begin to have as a result of intensifying reimbursement pressure and falling utilization. There are many ways that Quest Diagnostics can help, from performing reference testing to various forms of laboratory management partnerships, all the way to purchasing a hospital's outreach business, such as our recent agreement with Steward Health System. What we've seen over the past year is increased interest from the c-suite of IDNs interested in learning more about our broad experience across this spectrum of service offerings.

- During our last call, we announced that we had reached agreement with 3 community based hospitals. And we indicated we would soon have more to share. I am pleased that during the quarter, our lab professional services team reached agreement with a significant regional integrated delivery network.
    - This is a multi-million dollar opportunity involving several sites. We have taken on hundreds of this client's former employees to operate this lab network, and we began to generate revenues earlier this month. These are all exciting opportunities for us.
    - This last win is further evidence that hospital leaders are open to new ideas to help them manage the emerging challenges of reimbursement pressure and lower utilization. We have the expertise and the experience to help tailor solutions for the needs of hospitals of all shapes and sizes.
- Finally, we are seeing results from our focus on specific disease states and conditions.
    - We talked about the strong growth in the wellness business. Combining with Summit Health will strengthen this business.
    - We have also seen solid growth in our toxicology and prescription drug monitoring offerings, as well as improvements in Hepatitis C, BRCAvantage and non-invasive prenatal testing.
    - In Oncology and women's health, we launched a test to assess the risk of Lynch syndrome, a genetic disorder associated with higher incidence of colorectal and other cancers.
- While we are making progress, we need to keep our focus on this top priority of restoring growth.

We continue to make progress driving operational excellence.

Our Invigorate cost-reduction initiative is expected to approach $700 million in run-rate savings by the end of this year, compared to 2011. And we also continue to be committed to our longer-term goal of $1 billion in savings beyond 2014.

As we have said, the operational excellence program, which we call Drive, is improving our quality and efficiency and will enable us to improve our overall customer experience.

Driving operational excellence is really all about creating a superior customer experience.

- Toward that end, we recently launched our MyQuest by Care360 Patient Portal to allow patients to take ownership of their own results and manage their conditions more effectively.
- A new federal rule that took effect earlier this month gives patients in all 50 states the right to view their test results directly without first being authorized by a physician.

We made great progress on our Simplifying the organization strategy last year. So in 2014, our attention has shifted toward building a high performing culture, focusing on our behaviors and delivering results.

We have also made some important organizational changes.

First, I am pleased that Lidia Fonseca, an industry veteran, has joined Quest as our new chief information officer. I worked with Lidia years ago at Philips in my old role. Lidia is now fully engaged and is part of our plan to strengthen our IT capabilities, which includes improving the customer experience and driving efficiencies that will help us reach our $1 billion Invigorate goal.

Also, as previously announced, John Haydon, formerly SVP Operations, has moved into a key role to oversee our equity joint ventures. He is succeeded in the operations role by Jim Davis, who has deep operational experience and had led our employer, insurance and products businesses.

We continue to review our portfolio for opportunities to refocus on diagnostic information services, and enable us to continue to deliver disciplined capital deployment.

We remain committed to our plan to return the majority of our free cash flow to our shareholders through a combination of dividends and share repurchases.

The harsh winter made this a particularly tough quarter. But we are seeing signs of continued stabilization in the business, and closed the quarter strong in March. We are making progress, and recognize that there is much more to be done.

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

Mark Guinan: Thanks, Steve.

Starting with revenues…

Consolidated revenues of $1.75 billion were 2.3% below the prior year.

Our Diagnostic Information Services revenues, which account for over 90% of total revenues, were 2.1% below the prior year. Volume was 0.7% favorable to the prior year. Recent acquisitions added approximately 3.5% to volumes.

The unseasonably harsh winter depressed volumes by approximately 2% compared to the prior year.

You've heard us talk about the impact of weather on our business in the past. Given the severity of this past winter, let me take a minute to give you some color on how we calculate the impact of weather on our business. Our analysis is based on specific declines in volume, versus trend, for specific geographies related to specific weather events.

Adjusting for acquisitions and weather, we are estimating our organic volumes declined less than 1% compared to Q1 2013. This year over year comparison is essentially in line with our exit run rate from Q4 2013 and is an improvement in the comparison from the earlier periods of 2013.

Revenue per requisition in Q1 was down 2.8% compared to the prior year. The recent acquisitions and price erosion each accounted for about 100 basis points of the change; while changes in business mix accounted for the remainder.

However, we expect this metric to improve as we move through the year as certain items will anniversary, including Sequestration and certain commercial rates that were renegotiated during 2013.

Consistent with what we shared with you in the fall of 2012, we continue to plan for average reimbursement pressure of 1-2% through 2015.

Q1 revenues in our Diagnostic Solutions businesses, which include risk assessment, clinical trials testing, healthcare IT, and our remaining products businesses, were down 4.3% compared to the prior year, with approximately half of that impact related to the divestiture of Enterix last year.

Adjusted operating income at 13.5% of revenues was about 1.7% below the prior year, with the decrease due principally to lower margins associated with reimbursement pressure and limited flexibility in our ability to remove costs in response to short-term weather events. Despite these challenges, we continue to make progress on our Invigorate program, which helped offset wage bill inflation and the lower margins on our more recent acquisitions. As we indicated on our last call, we expect to achieve approximately $200 million in realized savings during 2014 and approach approximately $700 million in run rate savings as we exit 2014, with a longer term goal of $1 billion over time.

Adjusted EPS of $.84 was $0.05 below the prior year, with an 11 cent headwind resulting from the impact of the unfavorable weather in the quarter.

Special items totaling $28 million, principally restructuring and integration costs, reduced reported operating income as a percentage of revenues by 1.6% and reported EPS by 13 cents. Last year's first quarter included $45 million of costs associated with restructuring and integration charges which reduced reported operating income as a percentage of revenues by 2.5% and reported EPS by 17 cents.

Bad debt expense as a percentage of revenues increased 30 basis points from the prior year to 4.3%. Two issues to keep in mind on our bad debt. First, as you think about the year, our bad debt expense is typically the highest in the first quarter due to increased patient responsibility associated with unmet deductible amounts. Second, from a benefit design perspective, as we shared on our last call, we expected that employers would shift more costs to individuals and we see a continued increase in the prevalence of high deductible plans. Despite this trend, we believe we are managing the change in operating environment and continue to see improvement in our collection rates across our various payor categories as a result of our efforts to Drive Operational Excellence.

DSOs were 49 days, a 2 day increase from last quarter principally as a result of the Solstas transaction. That is, our results include all of the Solstas accounts receivable balance, but only revenues since the early March close date.

Cash from operations was $84 million in the quarter compared to $47 million in the prior year. Cash flow for Q1 is seasonally the weakest of the year, and as we explained last year, our Q1 2013 cash flow was reduced due to a tax payment that had previously been deferred.

Capital expenditures were $68 million in the quarter, compared to $49 million a year ago.

During the quarter we repurchased $32 million dollars of our common shares at an average price of $52.80. We plan to meet our capital deployment commitments by returning the majority of our free cash flow to shareholders through a combination of dividends and share repurchases.

We also acquired Solstas and recently went to the capital markets and ran a very successful $600 million bond offering last month at attractive rates, while maintaining our investment grade credit ratings. We remain committed to maintaining our investment grade credit rating and also remain committed to paying down the majority of the debt associated with the Solstas transaction over the next 18 months.

Turning to guidance:

Our guidance remains unchanged from what we shared last month. We expect results from continuing operations, before special items, as follows:

- Revenues to increase 2 to 4% compared to a year ago.
- Earnings per diluted share to be between $3.95 and $4.15;
- Cash provided by operations to approximate $900 million;
- And capital expenditures to approximate $300 million.

While the first quarter was negatively impacted by the weather, we continue to believe that this guidance is realistic and achievable and will benefit from our recently completed acquisitions and our efforts to restore growth.

Finally, I'd like to remind you of some data points to help put our guidance into perspective.

- Regarding reimbursement, keep in mind some items will anniversary this year, including sequestration and certain commercial contracts;
- Regarding acquisitions, you should dial 6-7% revenue growth into your models for the remainder of the year – 5% from Solstas and an additional 1-2% from other acquisitions in the year;
- And, we expect acquisitions to benefit EPS gradually through the year as integration plans unfold. Both Solstas and Summit will be dilutive to second quarter earnings but accretive for the full year.

As a result of these items, we now expect second quarter EPS to approximate the prior year level and to show growth in adjusted EPS in the back half of the year.

Now I'll turn it back to Steve.

Steve Rusckowski: Thanks, Mark.

To summarize:

- **The harsh winter hurt us in the quarter, but we are seeing positive signs in underlying trends.**
- **Fortunately, Congress lifted a cloud from our industry with the recent legislation that affects the Clinical Lab Fee Schedule**
- **Our top priority for 2014 is restoring growth. We are pleased with progress we are making on our growth priorities and particularly the recent acquisitions.**
- **As we said in January, we believe our 2014 guidance is both realistic and achievable.**