Quest Diagnostics Incorporated
Conference Call Prepared Comments
For the Quarter Ended March 31, 2015

Conference operator: Welcome to the Quest Diagnostics Fourth Quarter and Full Year 2014 conference call. At the request of the company, this call is being recorded. The entire contents of the call, including the presentation and question and answer session that will follow, are the copyrighted property of Quest Diagnostics with all rights reserved. Any redistribution, retransmission or rebroadcast of this call in any form without the express written consent of Quest Diagnostics is strictly prohibited. Now I'd like to introduce Dan Haemmerle, Executive Director of Investor Relations for Quest Diagnostics. Go ahead, please.

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 and also discuss non-GAAP measures. 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' 2014 Annual Report on Form 10-K, quarterly reports on Form 10-Q and Current Reports on Form 8-K.

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 provide you with highlights of the quarter, share industry trends, and also review progress we are making executing on our five-point strategy. Then Mark will provide more detail on the results and take you through guidance.

Before we get to our performance, I want to highlight the joint venture we announced last month with Quintiles in clinical trials testing.

Together, our two companies will create a new business that will be one of the leading global providers of central laboratory services to support drug development through clinical trials. The creation of a joint venture allows Quest and Quintiles to bring together the complementary capabilities and scale of our two organizations in an agile way with a laser-like focus on serving customers.

The new company will enable biopharmaceutical customers to enhance their drug development process; support precision medicine through companion diagnostics and biomarker discovery; and build value by creating a more efficient and effective organization through leveraging the scale, scientific expertise and operational excellence of the parent organizations. We expect that over time the JV will have an accelerated growth rate, achieve cost synergies and be accretive to what our clinical trials testing business would have been on a standalone basis.

The JV structure addresses three of our five strategic points. First, it will help us accelerate growth in the near term for our clinical trials business and explore opportunities related to our longer term strategies on precision medicine, companion diagnostics and creating value from our data. Second, it enables us to refocus on our core diagnostic information services business without distraction. And third, with minimal capital it enables us to participate in expected synergies in a way that lets us deliver disciplined capital deployment. Mark will provide some more color on this exciting partnership.

For now, both entities will continue to operate separately until the closing of the transaction, which is anticipated to be no later than the third quarter of 2015.

Turning to our first quarter results, we continued to make progress on our path forward, delivering solid revenue, EPS and operating income growth.

- Revenues grew 5.3% to $1.84 billion;
- On an organic basis, consolidated revenues grew almost 1%;
- Adjusted cash EPS increased 13% to $1.05; and
- Adjusted operating income increased 14%.

Our performance reflects improved execution in a stable business environment. And we were able to grow despite a harsh winter that, while somewhat less severe than a year ago, was still particularly difficult in the northeast portion of the U.S., where we have a strong presence.
Before I get to our strategy update, I'd like to talk about industry dynamics for utilization, reimbursement and regulation.

During the first quarter, we continued to see stability in test volumes on a "same-provider" basis.

We're encouraged by the progress in adding more insured lives to the healthcare system as a result of the Affordable Care Act.

- More states have been expanding their Medicaid programs, including Pennsylvania, during the quarter.
- We continue to see growth in our Medicaid volumes.
- Medicaid expansion will bring new people into the healthcare system with the goal of identifying issues earlier to improve outcomes and reduce overall costs.
- We saw this ourselves in our recent Quest Diagnostics Health Trends study. This peer-reviewed publication in *Diabetes Care* found a significant double digit increase in diabetes diagnoses in states that expanded Medicaid coverage and no increase in states that did not.

On reimbursement, we see less government pressure on the Clinical Lab Fee Schedule in 2015 than we've seen in the previous two years.

I'll start with the Doc Fix. Last week the President signed historic legislation titled "The Medicare Access and CHIP Reauthorization Act" to permanently reform the Medicare physician payment methodology. We are pleased that cuts to laboratory payments under Medicare were not included as part of the package.

This legislation also encourages payments based on quality and encourages us to make the healthcare system smarter without denying service.

This legislation is also directionally aligned with the HHS goals announced in January to tie traditional Medicare payments to quality or value through alternative payment models. Both the legislation and HHS have outlined specific, measurable goals and timelines for these value based reimbursement models. We believe these emerging payment models will favor providers with scale that are more effective and efficient, like us.

Next, I'd like to provide a status update on the Protecting Access to Medicare Act of 2014, or PAMA, which calls for an orderly review of the Clinical Lab Fee Schedule.

Our industry continues to work constructively with CMS on effectively implementing PAMA legislation.

A few weeks ago I met with leaders at CMS and a delegation from our industry trade association to discuss the rulemaking process that will govern any reimbursement changes.

During that meeting, we reviewed our view of the industry and its participants. We also discussed our shared goal of delivering an accurate, complete and efficient data collection process. We remain hopeful the rulemaking process will be defined in 2015 and will establish an approach to building a representative view of the market.

As this industry continues to evolve and mature, we have the right strategy and team and are well positioned continue to lead.

We continue to execute the company's five-point strategy.

As a reminder, our strategy is to:

- Restore growth;
- Drive operational excellence;
- Simplify the organization;
- Refocus on the core diagnostic information services business; and
- Deliver disciplined capital deployment.

Now I'd like to share a few comments on each element of our strategy. Let's review our progress, starting with growth.

This was the second consecutive quarter of organic revenue growth on a consolidated basis. We continue to focus on our key growth opportunities:

- First, we continue to focus on sales effectiveness;
- Second, we are getting traction on the professional laboratory services agreements we signed last year; and

- Third, gene-based and esoteric testing revenues grew during the quarter at the fastest rate in more than a year.

We continued to grow BRCA revenues, which clearly benefited from Angelina Jolie's ongoing public advocacy.
One way we are differentiating ourselves is by advocating for open access to BRCA data for patients and clinicians.

In collaboration with the French research institute INSERM, we led the creation of BRCAshare, an open-data-sharing initiative. Its goal is to accelerate research on BRCA gene mutations, particularly variants of uncertain significance, to improve the ability to predict which individuals are at risk of developing inherited breast, ovarian and other cancers.

The INSERM collaboration is an example of how we are using our unmatched data and informatics assets to deliver insights to customers that demonstrate the value that Quest provides.

Last quarter we told you about new population health, data analytics and decision support tools we were developing.

We have been piloting our population health tool with several physicians, ACOs and health plans to evaluate disease states for their patient populations, monitor compliance with specific testing protocols and identify gaps in care. In this pilot, our customers are now engaging with patients and health care professionals proactively to encourage the appropriate use of screening and monitoring tests to drive better health.

In addition to population health tools, we're making progress delivering what we call "interactive insights" to providers and patients.

Our Interactive Insights offers providers trending data; interactive features, such as customizable reports; and additional content, such as videos and articles, related to specific conditions and diseases.

Many of our hospitals, integrated delivery networks and physician practices are using IntelliTest Analytics, a web-based secure portal that provides data-driven insights about test utilization patterns, so they can adhere to clinically appropriate testing norms.

Care360 Revenue Cycle Management helps customers manage denials of billing claims with a focus on improving patient and payer collections.

In November, 2012, we established a new vision that spoke to the impact we have on people's lives: Empowering Better Health with Diagnostics Insights. Our vision was an essential part of becoming more external and customer focused, and since then we've made tremendous progress bringing the vision to life.

We're not just a lab– we're more than a lab, we're a trusted partner and we provide deep clinical insights.

Our vision was the first step. Next, we needed to turn it into a compelling customer-facing brand. A simple, consistent way to talk about Quest -- who we are, the value we bring; in short, what is the Quest difference?

Our new core brand idea is powerful one – it is "Action from Insight".

Our brand strategy is based on three pillars – the idea that <u>we inspire action</u> through the work we do; that <u>we illuminate answers</u> for patients and healthcare providers; and that <u>we advocate better health</u> for patients and communities.

This is a powerful idea, the notion that: *<u>From data comes insight; from insight comes action –action that transforms lives.</u>*

I am very excited about what our new corporate positioning means for Quest – it translates our vision into a concise, clear and actionable brand that gives us the opportunity to reshape our place in the industry, allowing us to continue to differentiate ourselves and not compete solely on price.

Brand is more than a logo or a tagline. To bring our brand to life, we'll have to change the way we think and talk about what we do. Additionally, we are engaging all our 45,000 people with their direct impact on delivering this brand promise. You'll start to see the new brand in action in the coming weeks and months.

Next is our strategy for Driving Operational Excellence. We are well underway with planning the next phase of Invigorate, which will extend our cost savings to $1.3 billion by the end of 2017. As in the past, we will continue to update you on our progress.

The third element of our strategy is to simplify and strengthen our organization. We have been focusing on execution and building a performance-oriented culture. We were very pleased to be included recently as one of Fortune Magazine's World's Most Admired Companies.

Over the past year we have introduced a number of new management tools as part of the Quest Management System and we are rolling out a new leadership development initiative this month. As I have visited more than a dozen of our major facilities in conjunction with our new brand rollout, I've found employees at all levels to be highly engaged and excited about the challenges ahead.

The fourth element of the strategy is to refocus on our core Diagnostic Information Services business. We continue to make good progress, and the joint venture with Quintiles is the most recent example of this. After considering a broad range of options for our clinical trials business, we found the joint venture was the best option to enable us to focus on the core while unlocking the value of this important business.

We continue to review our portfolio and look at options for non-core assets, and always strive to build value for our shareholders.

And, finally, we remain focused on the fifth element of our strategy, delivering disciplined capital deployment.

During April, we completed the refinancing of more than $1.2 billion of our debt that will lower interest expense for years to come; we paid our dividend at the increased rate; and, as noted earlier, we think the joint venture with Quintiles will enable us to share in future value creation without requiring significant capital outlays.

Now, Mark will provide an overview on our first quarter financial performance and walk you through the details of our 2015 outlook which is based on our strengthening operational performance and an improving business environment.

Mark Guinan: Thanks, Steve.

Starting with revenues…

Consolidated revenues of $1.84 billion increased by 5.3% versus the prior year, and grew organically by 70 basis points.

Revenues for Diagnostic Information Services, or DIS for short, grew by 4.9% compared to the prior year.

Volume, measured by the number of requisitions, increased 5.6% versus the prior year while revenue per requisition was lower than the prior year by 0.7%.

For DIS, acquisitions contributed nearly 5% to revenues.

Excluding acquisitions, DIS revenues, volumes and revenue per requisition were all essentially flat for the quarter.

I would like to share some additional context on these underlying volume and revenue per requisition metrics:

- First, let me touch on the impact of the harsh winter. As we have shared in the past, our analysis is based on changes in volume versus trend for given geographies related to specific weather events.
- Additionally, we provide guidance based on historical weather patterns. For the past two years, we've experienced unusually severe winters. However, in 2012, we had a mild winter, which resulted in upside to our expectations.
- This year, volumes were negatively impacted in the quarter by a harsh winter throughout much of the country, and in particular, the northeast. While the impact was not as severe as a year ago, it was worse than we anticipated. We believe the impact of weather on the quarter was approximately 8 cents. As a result, while we are pleased with the quarter, we were planning on better performance.
- Turning to underlying revenue per requisition, we saw modest reimbursement pressure in the quarter that was in line with our expectations. That reimbursement pressure was offset by favorable test and business mix shifts.

Moving to our Diagnostic Solutions business, which includes risk assessment, clinical trials testing, healthcare IT, and our remaining products businesses, revenues grew by 11% compared to the prior year. We enjoyed strong growth during the quarter from our Clinical Trials, Products and Risk Assessment businesses.

Adjusted operating income for the quarter was $269 million, or 14.6% of revenues, compared to $236 million, or 13.5% of revenues, a year ago. With comparable volumes essentially flat, the improvement can be primarily attributed to the benefits of our business mix, Invigorate program and M&A related impacts, including synergies. These factors enabled us to improve gross margins and further leverage SG&A. As a result, our adjusted operating income and earnings grew faster than revenues.
For the quarter, adjusted EPS, excluding amortization, was $1.05, 13% better than a year ago. Amortization was $0.09 in both 2014 and 2015.

The company recorded after-tax charges totaling $80 million in the quarter, primarily associated with the debt refinanced in the first quarter. The charges also included restructuring and integration costs associated with our Invigorate program and recent acquisitions, and combined to reduce reported EPS by 54 cents. Last year's first quarter included after-tax charges of $18 million primarily associated with restructuring and integration charges, which reduced reported EPS by 13 cents.

Let me share a few comments on special items. As you think about special items, because of their nature, they do fluctuate from period to period.

- This quarter, we incurred a charge related to the first tranche of debt retired.
- A second tranche of debt was redeemed in April, which will result in a similar charge in the second quarter.
- We expect to incur total pretax charges of nearly $150 million related to our debt refinancing.

In addition to charges, our special items also include benefits.

- For example, we anticipate recognizing a gain related to the joint venture with Quintiles.
- This gain will occur when we contribute our clinical trials business into the joint venture, which is expected to close no later than the third quarter.
- This gain is expected to be of similar magnitude to the total charges associated with the debt retirement.
- We will adjust this one-time gain out of our earnings.

To put this in perspective, since the beginning of 2012, the benefits adjusted out of earnings have been approximately the same amount as the charges adjusted out of earnings.

Bad debt expense as a percentage of revenues was 4.3%, flat to a year ago. As a reminder, bad debt expense is typically highest in the first quarter due to increased patient responsibility associated with coinsurance and deductible requirements. Our DSOs were 45 days, 3 days lower than last quarter and 4 days lower than a year ago. This is a testament to our operational excellence continuously demonstrated by our billing, operations and patient service centers teams that continue to effectively engage with patients and payers to ensure that we get paid for the work we do.

Reported cash provided by operations was $52 million in the quarter. However, excluding the $78 million of cash charges associated with the retirement of debt, cash provided by operations would have been $130 million in the quarter, versus $84 million a year ago.

Capital expenditures were $56 million in the quarter, compared to $68 million a year ago.

Moving to guidance, we expect full year 2015 results from continuing operations, before special items, as follows:

- Revenues to increase between 2% to 3% compared to 2014;
- Adjusted diluted EPS excluding amortization expense to be between $4.70 and $4.85;
- Adjusted cash provided by operations to approximate $850 million;
- And capital expenditures to approximate $300 million.

We have not included in our guidance the impact of contributing our clinical trials business to the JV with Quintiles, largely because the impact will depend on the timing of the deal's closing. To help frame it, our clinical trials testing revenue was in the range of approximately 2% of our consolidated revenues in 2014. With respect to the impact on adjusted EPS, we believe the JV will be essentially neutral in 2015. We will provide more details when the deal closes later this year.
And, as we noted on the investor call to announce the transaction, once it closes we will no longer report the revenues and operating income from the clinical trials business in our income statement.

We will, however, reflect our share of the joint venture's earnings on the "equity earnings" line on our income statement. This is where we report our current share of earnings in our three unconsolidated diagnostic information services joint ventures which are with leading regional integrated delivery networks.

Now, let me turn it back to Steve.

Steve Rusckowski: Thanks, Mark.

To summarize:

- **We delivered solid top and bottom line growth and improved profitability in the first quarter.**
- **It was our second consecutive quarter of reported organic consolidated revenue growth.**
- **We continue to make good progress executing our strategy.**
- **And, we are excited to share more details on the joint venture with Quintiles when we close.**
- **Thanks for your support.**

Steve: Thanks again for joining our call today.
- We are making good progress executing our strategy.
- We're excited about the clinical trials opportunity.
- We appreciate your support.
- Goodbye.