CLFS IMPACT
CONFERENCE CALL SCRIPT
Tuesday, November 21, 2017, 8:30 am ET

Conference operator*:* Welcome to the Quest Diagnostics conference call to provide an update on impact of final 2018 Medicare payment rates for clinical laboratory tests. 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 written consent of Quest Diagnostics is strictly prohibited. Now I'd like to introduce Shawn Bevec, Executive Director of Investor Relations for Quest Diagnostics. Go ahead, please.

Shawn Bevec: Thank you and good morning. I am here with Steve Rusckowski, our Chairman, President and Chief Executive Officer, and Mark Guinan, our Chief Financial Officer. During this call, we may make forward-looking statements and will discuss non-GAAP measures. For this call, references to reported EPS refers to reported diluted EPS and references to adjusted EPS refer to adjusted diluted EPS excluding amortization. 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 our most recent Annual Report on Form 10-K and subsequently filed quarterly reports on Form 10-Q and Current Reports on Form 8-K.

Now, here is Steve Rusckowski.

Steve Rusckowski: Thanks, Shawn, and thanks, everyone, for joining us today on short notice to discuss an important topic to this industry.

This morning we will provide an update on the impact of final 2018 Medicare payment rates for clinical laboratory tests issued on Friday, November 17th. We issued a press release on this subject last night. In a few minutes Mark will provide more detail and take you through the financial impact beginning in 2018.

We are deeply disappointed that CMS did not take into account much of the feedback received from across the healthcare ecosystem.

While we acknowledge adjustments by CMS to a few of the most egregious elements of the proposed fee schedule, the final fee schedule remains deeply flawed and plagued by a distorted market data collection process that excluded key components of the lab market.

As an example, less than 1 percent of all laboratories submitted data, and over 99 percent of hospital and physician office laboratories were prohibited from reporting their rates.

Also, based on the data submitted to CMS, Quest alone represented nearly 40 percent of all the market data CMS collected. As you're aware, our estimated share of the Medicare market is less than 15 percent.

We continue to urge CMS to delay the implementation of PAMA to take the time to get it right. These final rates that CMS released are not "market based" rates as Congress intended, and we support the efforts of our trade association to continue its advocacy before all branches of government, including the courts if necessary, to ensure the best outcome for clinical laboratories and the Medicare beneficiaries we serve.

Now let's talk about the impact of the new rates.

The final CLFS rates have huge impacts on both the industry and our company. While these cuts will hurt Quest, they will have a disproportionate impact on many other providers whose cost to serve is much higher than ours. Most competitors do not enjoy the cost structure benefits of our scale and geographic footprint. Mark will take you through the numbers shortly.

We have begun to plan for the worst case, and, as we have said, despite the flawed implementation of PAMA, we remain confident in our ability to meet the long-term commitments outlined at our 2016 Investor Day.

Now Mark will provide you with a financial update.

Mark Guinan: Thanks, Steve.

As we highlighted on our third quarter earnings call in October, we had been waiting for more clarity from CMS on how the new 2018 payment methodology would impact reimbursement through the CLFS. We also highlighted that the impact could vary materially based on further clarification by CMS.

First and foremost, let me reiterate Steve's earlier comments that the final fee schedule remains plagued by a flawed market data collection process and that the data CMS used to calculate the volume weighted median reimbursement across the fee schedule is NOT market based.

Another major flaw in PAMA is that it included managed Medicaid rates. As you are aware, these rates reflect the traditional Medicaid rates which are significantly below market.

We were awaiting clarification on several topics. One had to do with codes that had no 2017 NLA amount – particularly the Lipid Panel. A second issue was whether CMS would continue to require labs to bill under bundled Automated Test Payment, or ATP codes.

In the information provided by CMS on Friday, we learned that CMS would phase in the reductions for codes that previously had no 2017 NLA amount, consistent with the 10% cap dictated by PAMA legislation. As many of you know, CMS had proposed immediately implementing a roughly 40% cut to Lipid Panels in 2018. This is the fourth largest code reimbursed by CMS in terms of total 2016 CLFS payments.

Additionally, we learned on Friday that CMS would no longer use ATP codes beginning in 2018 and that labs will instead bill at the individual code level. For these commonly bundled chemistry panels, today we are currently paid far below the aggregate individual code amounts, so this change by CMS means we will generally see a meaningful increase for these tests in 2018, followed by subsequent reductions as the NLA moves down to the PAMA market survey volume weighted median.

After reviewing the final 2018 CLFS payment rates and changes announced by CMS on Friday, we believe the impact to be as follows:

- In 2018, we estimate the impact of the final rates to be approximately 4%.

- Because any increases are largely limited to 2018, we estimate the impact of the new rates could be approximately 10% in both 2019 and 2020.

Before turning to your questions, I'd like to make a few brief comments on 2018. While we are not prepared to provide detailed 2018 guidance at this time, I'd like to remind you of our comments from our third quarter earnings call:

- Recall, our 2017 adjusted EPS has benefited from recent accounting changes around the excess tax benefits associated with stock based compensation. Specifically, as you think about 2018, we would encourage you to focus on our 2017 EPS guidance of $5.62 to $5.67 excluding the 20 cent year over year increase of these excess tax benefits as the jump off point for 2018.

Furthermore, we have once again reaffirmed our long term 2020 outlook which includes an adjusted earnings CAGR in the mid-to-high single-digit range. This earnings outlook contemplated a starting point of $5.15 in adjusted EPS in 2016 and as we shared in October, this outlook implies adjusted EPS in the range of $6 to $7 by 2020 excluding the impact of excess tax benefits associated with SBC.

While we expect to grow earnings in each of the next three years, given that much of the PAMA cuts remain largely intact, particularly in 2019 and 2020, we continue to believe our earnings outlook is more likely to be towards the lower end of that $6 to $7 range in 2020. But again, M&A activity beyond our 1-2% growth target represents upside to this outlook.

Now let me turn it back to Steve.

Steve Rusckowski: Thanks, Mark.

To summarize:

- **We're deeply disappointed that CMS did not take into account much of the feedback received from across the industry.**

- **While we acknowledge corrections to a few of the most egregious elements of the proposed fee schedule, the final fee schedule remains plagued by a flawed market data collection process that excluded key components of the lab market.**

- **Finally, these cuts will hurt our company and our industry. Quest has been preparing for the worst case and, despite the flawed implementation of PAMA, we remain confident in our ability to meet the long-term commitments outlined at our 2016 Investor Day.**

Now we'd be happy to take your questions.

STEVE: Thanks again for joining our call today and for your continued support.

Goodbye.