Q4 and Full Year 2021
CONFERENCE CALL SCRIPT
Thursday, February 3, 2022, 8:30 am ET

Conference operator: Welcome to the Quest Diagnostics Fourth Quarter and Full Year 2021 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 written consent of Quest Diagnostics is strictly prohibited. Now I'd like to introduce Shawn Bevec, Vice President of Investor Relations for Quest Diagnostics. Go ahead, please.

Shawn Bevec: Thank you and good morning. I am joined by Steve Rusckowski, our Chairman, Chief Executive Officer and President, and Mark Guinan, our Chief Financial Officer. During this call, we may make forward-looking statements and will discuss non-GAAP measures. We provide a reconciliation of non-GAAP measures to comparable GAAP measures in the tables to our earnings press release. Actual results may differ materially from those projected. Risks and uncertainties, including the impact of the COVID-19 pandemic, 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. The company continues to believe that the impact of the COVID-19 pandemic on future operating results, cash flows and/or its financial condition will be primarily driven by: the pandemic's severity and duration; healthcare insurer, government, and client payer reimbursement rates for COVID-19 molecular tests; the pandemic's impact on the U.S. healthcare system and the U.S. economy; and the timing, scope and effectiveness of federal, state and local governmental responses to the pandemic including the impact of vaccination efforts which are drivers beyond the company's knowledge and control.

For this call, references to reported EPS refer to reported diluted EPS and references to adjusted EPS refer to adjusted diluted EPS. Any references to base business, testing, revenues, or volumes refer to the performance of our business excluding COVID-19 testing. Growth rates associated with our long-term outlook projections – including total revenue growth, revenue growth from acquisitions, organic revenue growth, and adjusted earnings growth - are Compound Annual Growth Rates. Finally, revenue growth rates from acquisitions will be measured against our base business.

Now, here is Steve Rusckowski.

Steve Rusckowski: Thanks Shawn.

And thanks everyone for joining us today.

Over the past two years our 50,000 Quest employees have risen to the challenge of COVID-19, innovating, persevering, and remaining committed to the patients and customers we serve. While doing so, they have also managed to grow our base business by more than 19 percent in 2021, achieving record levels. I am extremely proud of what we have accomplished as a team.

This morning, I'll discuss our performance for the fourth quarter and full year 2021 and share our thoughts on the impact of COVID-19 on our business moving forward. I will also update you on the progress we are making in our base business. Then Mark will provide more detail on our financial results and talk about our financial outlook for 2022.

Turning to our results, we closed out 2021 with another year of record revenue, earnings, and cash from operations. Our base business recovered throughout the year, and we experienced continued strong demand for COVID-19 testing services.

For the full year 2021:

- Total revenues grew by more than 14% to $10.8 billion.
- Earnings per share increased by nearly 49% on a reported basis to $15.55 and more than 27% on an adjusted basis to $14.24.
- Cash provided by operations increased more than 11% to $2.2 billion.

For the fourth quarter:

- Total revenues were $2.7 billion, a decrease of roughly nine percent versus 2020 when COVID-19 volumes were surging.
- Earnings per share were $3.12 on a reported basis and $3.33 on an adjusted basis, both down approximately 26% versus the prior year.

I'd like to share our perspective on the role of COVID-19 testing moving forward. A lot of progress has been made in the battle against COVID-19, but we believe it's not going away anytime soon.

Our molecular volumes began this year strong, with volumes peaking in the middle of January.

Testing will continue to play an important role in managing COVID-19 and we believe that molecular testing remains the gold standard. We continue to perform well through this latest surge, maintaining average turnaround times of 2 days or less for our COVID molecular test.

We will continue to maintain appropriate testing capacities and staffing levels to be prepared for any additional surges this year if they emerge. We also continue to believe there could be a larger role for serology testing and how we measure COVID-19 protection going forward.

Ultimately, we expect COVID-19 testing to eventually become more flu-like and become a permanent part of our portfolio going forward.

Turning to our base business, we continue to make progress executing our 2-point strategy to accelerate growth and drive operational excellence.

We delivered 2% revenue growth on our base business from acquisitions last year.

- In the fourth quarter, we acquired assets of Labtech Diagnostics, a regional independent lab serving physicians and patients primarily in South and North Carolina, Georgia, and Florida. This is the first full-service laboratory owned by Quest in South Carolina.
- We also recently announced our acquisition of Pack Health, a patient engagement company that helps individuals adopt healthier behaviors to improve outcomes, which bolsters our extended care capabilities.
- Since 2012, we have completed more than 40 acquisitions including outreach labs, regional independent labs, and capability enhancing deals, and over the last four years we have achieved our target of greater than an average of two percent revenue growth on our base business each year from acquisitions.
- Our M&A funnel remains strong.

In 2021 we took full advantage of our strong health plan access, which is approximately 90 percent of all commercially insured lives in the U.S.

We also made good progress working together with health plans to help companies and their employees save money by reducing denials and out-of-network leakage.

Health plans also recognize the value of working with us, and we have grown our health plan revenue faster than our overall revenue to the best levels we've ever seen.

Hospital health systems revenue has grown more than 20% compared to 2019 levels excluding COVID-19 testing, driven largely by the strength of our Professional Laboratory Services contracts.

- Our performance in 2021 benefitted from our two largest PLS contracts to date: Hackensack Meridian Health and Memorial Hermann.
- Altogether our PLS business without COVID-19 exceeded a record $500 million in annual revenue last year.
- Hospitals have continuously faced pressure throughout the pandemic, but post-pandemic, we believe the same will be true. We believe there will be continued consolidation and ongoing challenges that afford Quest an opportunity to implement our flexible solutions to help hospitals become more effective and productive.

Advanced diagnostics is critical to the future of healthcare.

We are building strong momentum in our key growth drivers which include consumer and hereditary genetics, oncology, and pharma services. In 2021 these test categories accounted for several hundred million dollars of our advanced diagnostics portfolio, growing more than 25% versus 2020 and nearly 33% versus 2019.

We are aggressively investing in areas with potential to further differentiate and grow our advanced diagnostics value proposition, including automated next gen sequencing, bioinformatics, the sales force, and customer service.

We are leveraging our scale and expertise to give patients and providers greater access to important innovations, such as liquid biopsy and digital pathology.

Advanced diagnostics is one of the faster growing areas of our portfolio. Our strategy and investments in this area will enable us to achieve high single digit growth going forward.

We are equally excited about the opportunities we see in direct-to-consumer testing. Revenues for QuestDirect services nearly doubled to more than $70 million in 2021, driven by both base and COVID-19 testing.

We expect the non-COVID consumer diagnostics market will experience double digit growth over the next several years, and we're on track to build a $250M direct-to-consumer business by 2025.

- We're ramping up our investments in the business, launching a new and improved digital experience later this year. We are also investing in enhancements to the in-person customer experience at our Patient Service Centers.

- We're off to a good start in 2022.
  - We are building on our long-standing relationship with Walmart by recently launching consumer-initiated laboratory testing on Walmart.com through a solution powered by QuestDirect™.
  - Finally, the MyQuest platform now has nearly 23 million users, up more than 3 million in the past quarter.

We are excited about our longer-term growth opportunities in Advanced diagnostics and direct-to-consumer testing and are increasing the investments we made in 2021 to strengthen our business and accelerate growth beyond the

pandemic. These investments were made possible with the record cash and earnings we've generated over the last two years

The second part of our two-point strategy is to drive operational excellence.

We remain laser focused on improving both operational quality and efficiency, which go hand in hand.

During 2021, the Invigorate program exceeded our goal of 3% productivity improvements and savings. We made good progress last year in procurement supply savings as well as reducing health plan denials and improving patient collections at the time of service.

While we faced modest inflationary wage pressure in 2021, on the supply cost side, we have more than offset any increases with cost savings from our suppliers. Historically our Invigorate productivity savings have been net of any inflationary increases.

Beyond that, we continue to drive additional productivity improvements with platform consolidation and greater use of automation and artificial intelligence.

Turning to our workforce, Quest employees are highly engaged, based on results of our quarterly surveys. In a challenging labor market, we are focused on further improving engagement and retention.

Our team has done a lot to create an inspiring workplace, and we will continue to do everything we can to attract, recruit and retain talent.

We are entering 2022 in a strong position within the lab industry and more broadly throughout health care.

- Our base business is poised to build off the record revenues we achieved last year, and we are investing to accelerate growth.
- We expect to see continued demand for COVID-19 testing services albeit at lower levels than the last two years.
- The delay of the 2022 PAMA cuts announced late last year was a good outcome for our industry and Medicare beneficiaries. However, we will continue to be hard at work in 2022 with our trade association and members of Congress with a goal of arriving at a permanent fix to PAMA.
- We remain committed to our capital deployment strategy of returning the majority of our free cash flow to our shareholders.
- This morning we raised our dividend for the eleventh time since 2011.
- We expect to have more than $1 billion in cash available this year for M&A and share repurchases.

Putting it all together, our 2022 guidance reflects strong momentum and investment in our base business balanced with the inevitable but expected decline in COVID-19 testing revenues.

Before turning it over to Mark, I'd like to recognize and thank again all of our employees who really have been on the front lines of the pandemic and continue to serve the health care needs of patients who depend on Quest every day.

Now Mark will provide more details on our performance and our 2022 guidance. Mark?

Mark Guinan: **Thanks, Steve.**

In the fourth quarter, consolidated revenues were $2.74 billion, down 8.6% versus the prior year.

Revenues for Diagnostic Information Services declined 8.5% compared to the prior year. The decline reflected lower revenue from COVID-19 testing services versus the fourth quarter of 2020, partially offset by continued growth in our base testing revenue.

Compared to 2019, our base DIS revenue grew approximately 6% in the fourth quarter, and it was up more than 1% excluding acquisitions.

Volume, measured by the number of requisitions, increased 1.3% versus the prior year with acquisitions contributing 1.1%.

Compared to our fourth quarter 2019 baseline, total base testing volumes increased more than 10%. Excluding acquisitions total base testing volumes grew approximately 5% versus 2019 and benefited from new PLS contracts that have ramped over the last year.

The progress we made in our base business throughout 2021 continued in the fourth quarter and base testing volumes remained consistent with our prior outlook.

As many of you know, COVID-19 testing volumes moderated early in the fourth quarter following the peak of the Delta wave in September but then surged again in early December as the Omicron variant spread across the U.S. Together with our JV partner Sonora Quest, we resulted approximately 7.9 million molecular tests. Quest alone resulted roughly 7.3 million molecular tests and nearly 730 thousand serology tests in the fourth quarter. In January, our COVID-19 molecular volumes averaged approximately 120 thousand tests per day and over 139 thousand per day including Sonora Quest, with volumes peaking in the middle of the month.

Revenue per requisition declined 9.8% versus the prior year, driven primarily by lower COVID-19 molecular volume.

In the fourth quarter, increases in our base revenue per req were more than offset by the impact of recent PLS wins.

Modest unit price headwinds remained consistent with our expectations.

Reported operating income in the fourth quarter was $536 million, or 19.5% of revenues, compared to $795 million, or 26.5% of revenues last year.

On an adjusted basis, operating income in Q4 was $579 million, or 21.1% of revenues, compared to $860 million, or 28.6% of revenues last year.

As you may recall, the updated 2021 guidance we shared in October contemplated a lower adjusted operating margin both year-over-year and versus 3Q. The year over year decline was primarily driven by lower COVID-19 testing revenue and higher COVID-19 testing costs; headcount and wage increases; and ramping strategic growth investments. It's also important to note that over time a growing portion of our COVID-19 molecular testing volumes have come from non-traditional channels which carry additional expenses and logistics costs.

Also, spiking COVID-19 positivity rates across the country in December eliminated our pooling capability which further increased COVID-19 testing costs late in the quarter.

In addition, we also experienced higher than anticipated employee health care costs in the fourth quarter primarily related to COVID-19.

Reported EPS was $3.12 in the quarter compared to $4.21 a year ago. Adjusted EPS was $3.33, compared to $4.48 last year.

Cash provided by operations was $2.23 billion in 2021 versus $2.01 billion in the prior year. We completed our $1.5 billion ASR in November and repurchased an additional $310 million in stock in the fourth quarter. This brings total share repurchases to more than $2.2 billion dollars in 2021 and we ended the year with $872 million dollars on the balance sheet.

Before turning to guidance, I'd like to comment on recent trends we've seen in our labor costs.

As Steve noted, we've been managing through a challenging labor environment.

While wage inflation, including our annual merit increase, is expected to be between 3-4% this year, the increase in our total salaries, wages, and benefits is expected to be below 3% in 2022 given the reset of our annual performance compensation and lower expected overtime. As a reminder, all of our employees are eligible for annual performance comp.

Now turning to guidance, we estimate full year 2022 results as follows:

- Revenues expected to be between $9.0 and $9.5 billion, a decline of approximately 12 to 17% versus the prior year.
- Base business revenues are expected to be between $8.3 and $8.5 billion, an increase of approximately 3.5% to 6%.
- COVID-19 testing revenues are expected to be between $0.7 and $1 billion, a decline of approximately 64% to 75%.
- Reported EPS expected to be in a range of $7.63 and $8.33, and adjusted EPS to be in a range of $8.65 and $9.35.
- Cash provided by operations is expected to be at least $1.6 billion; and
- Capital expenditures are expected to be approximately $400 million.

Before concluding, I'll touch on some assumptions embedded in our 2022 guidance. As Steve said, we're entering 2022 in a strong position.

- Our guidance assumes COVID-19 molecular volumes to average between 65 to 80 thousand tests per day in Q1, representing a decline from January levels, and approximately 20-35 thousand tests per day for the full year. For COVID-19 serology volumes, the guidance assumes approximately 3 thousand tests per day for the full year. While our guidance does not currently anticipate another COVID wave, we'll remain ready from an operational standpoint to handle any future surges.
- Last month the public health emergency was again extended another 90 days through April. We assume average reimbursement for COVID-19 molecular testing to hold relatively steady through this period. While the public health emergency could continue to get renewed beyond April, additional extensions are not captured in our guidance.
- The earnings we've generated from COVID-19 testing have afforded us an opportunity to continue to increase investment in our business.
    - As Steve noted earlier, we continue to ramp investment in our growth pillars, particularly the advanced diagnostics and direct-to-consumer testing opportunities. We are planning to invest approximately $160 million in our growth initiatives this year which represents an additional $90 million in investments in 2022.
- We also continue to incur higher costs to manage our business through the pandemic including expenses to comply with CDC guidelines, address ongoing supply chain challenges, and maintain adequate staffing levels. We currently forecast these expenses to be approximately $50 million in 2022.

- As a reminder, we originally expected PAMA cuts of approximately $80 million in 2022. These cuts were delayed one year until 2023.
- Finally, we ended 2021 with approximately 124 million diluted shares outstanding. Our guidance assumes no change in our share count in 2022 and only enough share repurchases to offset our employee equity programs.

Steve Rusckowski: Thanks, Mark.

To summarize:

- **We had another record year, providing critical COVID-19 testing to our country, and delivered unprecedented record revenues, earnings, and cash from operations**
- **We also grew our base business to a record level, up 19 percent year over year.**
- **Quest is well positioned in 2022 to deliver on our commitments.**
- **I am proud of the incredible accomplishments of our 50,000 Quest employees throughout the pandemic.**
- **And finally, our team is strong, the business has good momentum, and Quest's future is bright.**

Now we'd be happy to take your questions.
Operator?

OPERATOR: Thank you. We will now open it up to questions. At the request of the
Company, we ask that you please limit yourself to one question. If you have additional questions, we ask that you please fall back in the queue.

STEVE: Thanks again for joining our call today. We appreciate your continued support.
Have a good day, everybody.