Q1 2022
CONFERENCE CALL SCRIPT
Thursday, April 21, 2022, 8:30 am ET

Conference operator: Welcome to the Quest Diagnostics First Quarter 2022 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, Jim Davis, CEO-elect, 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.

We're off to a good start in 2022.

We drove strong year-over-year growth in our base business, which excludes COVID-19 testing. COVID-19 volumes remained strong early in the quarter and decreased in February and March, in line with the market. We continue to make investments to further accelerate growth in the base business, and our efforts to improve productivity are helping us to offset inflationary pressures. Based on the strength of our business we are raising our 2022 guidance.

This morning, I'll discuss our performance for the first quarter of 2022. Then Mark will provide more detail on financial results and talk about our updated financial outlook for 2022.

But first, I'd like to ask Jim Davis to give you an update on the leadership transition. Jim?

Jim Davis: Thanks Steve.

We are making good progress on the transition. Yesterday we announced a series of organizational changes and leadership appointments of seasoned executives, designed to help us accelerate growth and drive operational excellence:

- First, Cathy Doherty has been named Senior Vice President, Regional Businesses. Cathy has deep knowledge of our business, gained through 3 decades of leadership at Quest. She will oversee regional and enterprise operations, the commercial organization, and marketing. She will also be responsible for driving operational excellence, including Program Drive, the company's quality and productivity initiative.
- Next, Carrie Eglinton Manner is taking on an expanded role as Senior Vice President, Advanced & General Diagnostics Clinical Solutions. For more than 5 years, Carrie has been responsible for bringing innovative solutions to market through Quest's clinical franchises. Before joining Quest, Carrie had nearly two decades of leadership experience in healthcare and medical technology.
- Patrick Plewman, who had led our West region and has been with Quest for more than 9 years, is named Senior Vice President, Diagnostic Services, a portfolio of data driven analytics and services businesses which enable employers, providers, pharma companies and others to deliver health care more effectively and efficiently. This portfolio includes Employer Population Health, Employer Solutions, ExamOne, Healthcare Analytic Solutions, and Quest HealthConnect. Before joining Quest, Patrick had 20 years of leadership experience in biotech and molecular diagnostics.
- Mark Delaney has joined Quest as Senior Vice President and Chief Commercial Officer. Mark has responsibility for the commercial team, including sales operations. Previously, he held senior sales and marketing leadership roles over his 30-year career at GE Healthcare and Hillrom.
- And, finally, Richard Adams has joined Quest as Vice President and General Manager, Consumer Initiated Testing, a new role. Richard has two decades of varied leadership experience in e-commerce, digital marketing and customer experience, and will lead our rapidly-growing direct-to-consumer testing business.

These appointments demonstrate the depth and strength of Quest's management team, and we're excited about the leadership and expertise that Mark Delaney and Richard Adams bring to us.

Additionally, we are making good progress on our CFO selection process, and are on track to name a leader in the next several months.

The management transition is going very well, and the changes announced yesterday are an important step in positioning us well for the future.

I'll now turn it back over to Steve.

Steve Rusckowski: Thanks Jim, and I agree the transition is going well.

Turning to our results, our base business continued its strong recovery, up more than 6% from the prior year.

- Total revenues were $2.6 billion.
- Earnings per share was $2.92 on a reported basis and $3.22 on an adjusted basis.
- Cash provided by operations was $480 million.

COVID-19 testing revenues were approximately $600 million in the first quarter, down approximately 28 percent from 2021. Nearly 60 percent of the COVID-19 revenue came during the Omicron peak in January. We project continued demand for PCR testing through the end of the year and into 2023, albeit at lower levels.

The Public Health Emergency was extended into July, maintaining our current level of reimbursement.

Based on these factors, we raised our COVID-19 revenue guidance for full year 2022 to between $850 million and $1 billion.

Turning to our base business, in the first quarter we continued to make progress executing our 2-point strategy to accelerate growth and drive operational excellence. Here are some highlights from the quarter.

- We continued to make inroads with health plans, gaining share and increasing revenues faster than the market.
    - Our health plan revenue without COVID-19 grew faster than our overall base business did in the quarter.
    - We also deepened relationships with payers through value-based contracting.
    - Currently, about 30% of our health plan revenues are tied to value-based elements, such as patient health outcomes, quality or shared savings. We think that we can grow this to about 50% over the next few years. Through these value-based contracts we are achieving better alignment with the health plans, which we believe will allow us to continue to gain share.
- We are working with hospital health system leaders to help them execute their lab strategy. Our large partnerships such as Hackensack Meridian Health in New Jersey, Memorial Hermann in Texas and those with Community Health Network and Ascension St. Vincent in Indiana are performing well. Hospitals look to us for help with their laboratory design, staffing and management, and we can enable them to monetize outreach lab assets to free up needed capital.

We have continued to make important investments to strengthen our Advanced Diagnostics capabilities, and are already seeing results. We continue to make investments to accelerate growth in: Oncology and Hematology; Hereditary Genetics; Genomic Sequencing Services, and Pharma Services. Since we ramped up investments in our Advanced Diagnostics portfolio, we've already accelerated growth by several hundred basis points, and expect to deliver 8 percent growth earlier than 2024, which we committed to at our 2021 Investor Day.

We remain excited about the opportunities we see in direct-to-consumer testing. As you know, we are ramping up investments in our consumer business and it's having an impact.

- In the quarter our direct-to-consumer revenue more than doubled compared to the prior year, driven by strong growth in both our COVID-19 testing offerings as well as base business testing. We're seeing continued solid demand for tests like comprehensive metabolic panels and complete blood counts. Also, our new and improved digital experience is on track to launch later this year.
- Finally, we have been expanding our Diagnostic Services portfolio. We are collaborating with a small digital imaging software firm to deliver diabetic retinal imaging services through designated Quest Diagnostics patient service centers across the United States. This will aid in screening patients as part of a diabetes management program.

The second part of our two-point strategy is to drive operational excellence.
We remain focused on improving our operational quality, service and cost, thereby driving productivity gains.

We are not immune to the current inflationary environment, but we are tightly managing our operations and are expecting another good year of Invigorate savings and productivity improvements to help offset these pressures. By way of example:

- Our procurement team continues to work with our strategic suppliers to mitigate potential price increases and improve productivity through long term relationships. Also, to date, the team has effectively managed challenges in our global supply chain.

- We also look for our suppliers to deliver innovation that allow us to lower the overall cost of testing and improve quality. The most recent example is the rollout of a new urinalysis platform that is being deployed across our laboratory network.
    - Our lab in Clifton, New Jersey has been operational for a year and we are seeing incremental productivity gains from the investments we made in automation and artificial intelligence.
- Our new "Schedule at Check In" initiative encourages patients to make appointments, allowing us to better manage demand and phlebotomy productivity while enhancing the patient experience. The system has been successfully deployed to over 700 Patient Service Centers.

Our continued investment in operations is producing results. We are well on our way to achieving our targeted productivity gains of 3 percent of our cost structure in 2022.

Now Mark will provide more details on our performance and share more insights on our updated guidance for the remainder of 2022.

Mark Guinan: Thanks, Steve.

In the first quarter, consolidated revenues were $2.61 billion, down 4.0% versus the prior year. Base business revenues grew 6.3% to more than $2 billion, while COVID-19 testing revenues declined 27.6% to approximately $600 million.

Revenues for Diagnostic Information Services declined 3.9% compared to the prior year. The decline reflected lower revenue from COVID-19 testing services versus the first quarter of 2021, partially offset by strong growth in our base testing revenue.

Total volume, measured by the number of requisitions, increased 1.3% versus the prior year and was roughly flat on an organic basis.

Total base testing volumes increased more than 6% versus the prior year. Excluding acquisitions total base testing volumes grew nearly 5%. We experienced some modest softening of base testing volumes in January during the peak of the Omicron surge, but volumes rebounded in February and March.

COVID-19 testing volumes surged during the spread of the Omicron variant during the winter with volumes peaking in mid-January but declined through the month of February and into March. Together with our JV partner Sonora Quest, we resulted approximately 7.2 million molecular tests. Quest alone resulted roughly 6.3 million molecular tests, down approximately 2 million tests and one million tests versus the prior year and fourth quarter respectively. We also resulted nearly 450 thousand serology tests in the first quarter. Our COVID-19 molecular volumes have generally stabilized between an average of roughly 30 thousand tests per day over the last 4 weeks excluding Sonora Quest.
Revenue per requisition declined 5.2% versus the prior year, driven primarily by lower COVID-19 molecular volume. Base business revenue per req was up modestly. Importantly, we continue to see an improving price environment. Unit price reimbursement pressure was less than 100 basis points.

Reported operating income in the first quarter was $513 million, or 19.7% of revenues, compared to $660 million, or 24.3% of revenues last year.

On an adjusted basis, operating income was $554 million, or 21.2% of revenues, compared to $708 million, or 26.0% of revenues last year.

The year-over-year decline in adjusted operating income is primarily related to lower COVID-19 testing volume; a higher portion of COVID-19 molecular testing volume from non-traditional channels which carry additional expenses and logistics costs; investments to accelerate growth in our base business; and lower average reimbursement for COVID-19 molecular tests. These headwinds were partially offset by strong growth in our base business.

As many of you probably heard, the Health Resources and Services Administration, or HRSA, stopped accepting claims to test and treat uninsured patients on March 22 due to insufficient funding. HRSA runs the program to provide funding for COVID-19 testing, vaccination, and treatment for uninsured patients. Approximately 14% of our COVID-19 molecular testing volume has come from uninsured patients which is much higher than the 1 to 2% we typically see in our base business. As a result, we were unable to bill HRSA for roughly $20 million in COVID-19 testing work that was performed just prior to the March 23 HRSA cutoff date.

Moving forward, we are now billing uninsured patients for COVID-19 testing directly up front. As a result, we've seen a decline in our uninsured COVID-19 molecular testing volumes in late March and into April and this is reflected in trends I shared earlier.

Reported EPS was $2.92 in the quarter compared to $3.46 a year ago. Adjusted EPS was $3.22, compared to $3.76 last year.

Cash provided by operations was $480 million in Q1 versus $731 million in the prior year period and we repurchased $350 million in stock during the first quarter.

Now turning to our updated guidance:

- Revenues are now expected to be between $9.2 and $9.5 billion, a decline of approximately 12 to 15% versus the prior year.
- Base business revenues are expected to be between $8.35 and $8.5 billion, an increase of approximately 4% to 6%.
- COVID-19 testing revenues are expected to be between $850 million and $1 billion, a decline of approximately 64% to 69%.
- Reported EPS expected to be in a range of $7.88 and $8.38, and adjusted EPS to be in a range of $9.00 and $9.50.
- 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 updated 2022 guidance as well as some additional considerations.

- Our guidance assumes COVID-19 molecular volumes to average approximately 10-20 thousand tests per day for the rest of the year. This reflects modest continued declines in Q2 from the roughly 30 thousand tests per day we are seeing in April and some degree of stabilization during the second half of the year.
- As we look toward 2023, our expectation for COVID-19 molecular and serology testing volumes assumes that the COVID-19 testing run rate in the second half of 2022 continues into next year.
- Last week the public health emergency was again extended another 90 days through mid-July. We assume average reimbursement for COVID-19 molecular testing to hold relatively steady through this period. While the public health emergency could be renewed beyond July, additional extensions are not captured in our guidance.

- We remain prepared for additional future surges, collecting COVID-19 testing volume from a range of customers. While the PHE is in effect, we continue to incur incremental costs from non-traditional channels for supplies, special logistics routes and channel expenses for this volume which can represent roughly $30 in incremental costs per test. Therefore, you should not assume the higher reimbursement due to the PHE extension drops right to the bottom line.
- As Steve highlighted earlier, we're already seeing some returns on our investments to accelerate growth, particularly in the areas of Advanced Diagnostics and Direct-to-Consumer testing and would expect a margin tailwind on these investments in 2023. As a reminder, we are planning to spend approximately $160 million on these investments this year. We spent approximately $30 million in the first quarter and we expect these investments to ramp in Q2 to support the launch of our new consumer site later this year. A portion of these stand-up IT costs are temporary but variable marketing costs will increase following the launch of the new site. We'll also be adding additional headcount this year to support our consumer offering as well as bioinformatics capabilities within Advanced Diagnostics.
- Finally, we know there's a lot of focus on expectations for 2023. While it is clearly too early to provide specific guidance for next year, based on everything we know and see today, we expect to deliver top line and earnings consistent with our long term outlook at our 2021 Investor Day.

I will now turn it back to Steve.

Steve Rusckowski: Thanks, Mark.

To summarize:

- We're off to a good start in 2022, driving strong year-over-year growth in the base business.
- We continued to make important investments to accelerate growth and we are seeing the results.
- Based on the strength of our base business we have raised our outlook for the remainder of the year.

Now we'd be happy to take your questions.

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.