Quest Diagnostics Reports Strong Revenue and Earnings Growth in Second Quarter 2000

July 24, 2000

TETERBORO, N.J., July 24, 2000 —

Quest Diagnostics Incorporated (NYSE: DGX), the nation's leading provider of diagnostic testing, information and services, announced that for the second quarter ended June 30, 2000, net income increased to $30.2 million, or $0.64 per diluted share, after net special charges of $2.1 million pretax, or $0.03 per diluted share. Net income for the second quarter of 1999 was $13.1 million, or $0.43 per diluted share. Cash earnings, or earnings before amortization of intangible assets and net special charges, rose to $0.90 per diluted share from $0.57 per diluted share for the 1999 period.

Second quarter revenues increased to $877 million compared to $394 million in 1999. Earnings before interest, taxes, depreciation and amortization, adjusted to exclude net special charges and integration related costs (adjusted EBITDA), were $128 million compared to $46 million for the prior year period. The increases in revenues and adjusted EBITDA were due primarily to the acquisition of SmithKline Beecham Clinical Laboratories (SBCL) and improved operating performance.

"We are encouraged by the improvement in our performance and the progress made in integrating operations of Quest Diagnostics and the former SmithKline Beecham Clinical Laboratories," said Kenneth W. Freeman, Chairman and Chief Executive Officer. "We have completed about one-third of the planned integration activities. A major portion of the integration is planned for the second half of the year. At this time, we anticipate reporting full year earnings for 2000 of between $2.10 and $2.20 per diluted share before special charges. Contributing to this estimate is an increase in the synergies anticipated from the SBCL integration to $50 million for this year. We have raised our estimate of the total annual synergies anticipated from $100 million to $150 million."

Days sales outstanding were 52 days, compared to 51 days in the first quarter. The company ended the quarter with $99 million in cash and no borrowings outstanding under its $250 million revolving credit facility. Capital expenditures totaled $23 million for the quarter.

For the first half of 2000, net income increased to $48.0 million from $20.5 million for the prior year. Revenues increased to $1.7 billion compared to $776 million in 1999. Diluted earnings per share were $1.03, compared to $0.67 for the prior year. Adjusted EBITDA for the six-month period was $227 million, compared to $84 million a year ago. Capital expenditures for the first half totaled $41 million.

PRO FORMA COMPARISONS

Revenues in the second quarter of 2000 increased 4.7% compared to pro forma revenues in 1999, assuming that SBCL had been part of Quest Diagnostics in 1999. Clinical testing volume, measured by the number of requisitions, increased 5%, and average revenue per requisition increased 6%. Revenue growth was partially offset by accounting for a contract as a loss contract beginning in the second half of 1999 and by eliminating the gross-up of revenues and expenses associated with certain managed care contracts modified during the quarter. Adjusted for these changes, pro forma revenue growth was 10.5%.

Bad debt expense was 7.1% of revenues during the second quarter, compared to 7.5% in the second quarter of 1999 and 7.6% in the first quarter of 2000, excluding the impact of the company's laboratory network management business and the loss contract. Net income was $30.2 million in the second quarter of 2000, compared to a pro forma net loss of $8.9 million in the prior year. Adjusted EBITDA was $128 million for the second quarter of 2000, compared to pro forma adjusted EBITDA of $85 million last year. In 1999, the pro forma net loss reflects $35 million of non-recurring pretax charges. These charges were excluded for purposes of calculating 1999 pro forma adjusted EBITDA.

For the first half of 2000, revenues increased 4.4% compared to pro forma revenues in 1999. Clinical testing volume, measured by the number of requisitions, increased 5%, and average revenue per requisition increased 4%. Revenue growth was partially offset by accounting for a contract as a loss contract beginning in the second half of 1999 and by eliminating the gross-up of revenues and expenses associated with certain managed care contracts modified during the period. Adjusted for these changes, pro forma revenue rose 9.2%.

Net income was $48.0 million in the first half of 2000, compared to a pro forma net loss of $0.6 million in the prior year. Adjusted EBITDA was $227 million, compared to pro forma adjusted EBITDA of $166 million. In 1999, the pro forma net loss reflects $37 million of non-recurring pretax charges. These charges were excluded for purposes of calculating 1999 pro forma adjusted EBITDA.

Quest Diagnostics will discuss results for the second quarter during a conference call on July 25 at 8:00 a.m. (Eastern Time). To hear a simulcast of the call over the Internet, or a replay, registered analysts may access StreetEvents at: www.streetevents.com and all others may access the Quest Diagnostics website at: www.questdiagnostics.com. The on-line replay will be available 24 hours a day beginning at noon on July 25. In addition, the replay of the call will also be available from 10 A.M. on July 25 through 5 P.M. on July 27 by dialing 800-337-6871.

Quest Diagnostics is the nation's leading provider of diagnostic testing, information and services with annualized revenues of more than $3 billion. The testing performed on human specimens helps doctors diagnose, treat and monitor disease; enables employers to detect workplace drug abuse; and supports pharmaceutical and biotechnology companies in clinical trials of new therapeutics worldwide. Quest Informatics analyzes laboratory and other medical data to help health care providers improve the care of patients. Additional company information can be found on the Internet at: www.questdiagnostics.com.

The statements in this press release which are not historical facts or information may be forward-looking statements. These forward-looking statements involve risks and uncertainties that could cause the outcome to be materially different. Certain of these risks and uncertainties are listed in the Quest Diagnostics Incorporated 1999 Form 10-K and subsequent filings.

-- Table follows --

Quest Diagnostics Incorporated and Subsidiaries

Consolidated Statements of Operations

For the Three and Six Months Ended June 30, 2000 and 1999

(in millions, except per share data)

	Three Months Ended June 30			Six Months Ended June 30		
	Historical		Pro forma	Historical		Pro forma
	2000	1999	1999	2000	1999	1999
Net revenues	$ 877.1	$ 394.0	$ 837.5	$ 1,734.6	$ 775.9	$ 1,661.0
Costs and expenses:						
Cost of services	520.5	236.1	550.7	1,049.5	473.5	1,087.8
Selling, general and administrative	252.9	121.2	239.2	502.7	237.8	464.7
Interest expense, net	30.2	5.0	29.7	60.0	12.4	61.4
Amortization of intangible assets	12.0	5.2	11.0	23.9	10.3	21.8
Provision for special charges	2.1	-	15.8	2.1	-	15.8
Minority share of income	3.3	1.5	1.5	5.4	2.6	2.6
Other, net	(2.1)	0.5	-	(2.4)	0.8	0.2
Total	818.9	369.5	847.9	1,641.2	737.4	1,654.3
Income (loss) before taxes	58.2	24.5	(10.4)	93.4	38.5	6.7
Income tax expense (benefit)	28.0	11.4	(1.5)	45.4	18.0	7.3
Net income (loss)	$ 30.2	$ 13.1	$ (8.9)	$ 48.0	$ 20.5	$ (0.6)
Basic net income (loss) per common share	$ 0.68	$ 0.44	$ (0.21)	$ 1.08	$ 0.69	$ (0.02)
Diluted net income (loss) per common share	$ 0.64	$ 0.43	$ (0.21)	$ 1.03	$ 0.67	$ (0.02)
Cash earnings per diluted common share	$ 0.90	$ 0.57	$ 0.24	$ 1.53	$ 0.95	$ 0.65
Weighted average common shares outstanding – basic	44.6	29.9	43.2	44.4	29.8	43.1
Weighted average common shares outstanding – diluted	47.0	30.7	43.9	46.3	30.5	43.7
Adjusted EBITDA	$ 127.8	$ 46.2	$ 85.0	$ 227.4	$ 84.1	$ 165.7

Quest Diagnostics Incorporated and Subsidiaries

Selected Balance Sheet Information

June 30, 2000 and December 31, 1999

(in millions)

	June 30, 2000	December 31, 1999
	(unaudited)	
Assets		
Cash and cash equivalents	$ 99	$ 27
Accounts receivable, net	505	539
Intangible assets, net	1,414	1,436
Other assets	919	876
Total assets	$ 2,937	$ 2,878
Liabilities and Stockholders' Equity		
Short-term debt	$ 50	$ 45
Long-term debt	1,144	1,171
Other liabilities	803	800
Common stockholders' equity	940	862
Total liabilities and stockholder's equity	$ 2,937	$ 2,878

Notes to Financial Tables

Acquisition of SmithKline Beecham Clinical Laboratories

On August 16, 1999, Quest Diagnostics Incorporated (the "Company") completed the acquisition of the clinical laboratory business of SmithKline Beecham plc ("SmithKline Beecham") for approximately $1.3 billion. The acquisition was accounted for under the purchase method of accounting. As such, the cost to acquire SmithKline Beecham's clinical laboratory business ("SBCL") has been allocated on a preliminary basis to the assets and liabilities acquired based on estimated fair values as of the closing date.

The SBCL acquisition agreements include a provision for a purchase price adjustment based on an audit of the August 16, 1999 combined balance sheet of SBCL and certain affiliates. Adjustments resulting from this audit, which are subject to resolution as set forth in the SBCL acquisition agreements, and are the subject of on-going discussions between the parties, have already been recorded. However, amounts due from SmithKline Beecham, as a result of the purchase price adjustment, have not been reflected in the consolidated balance sheets of Quest Diagnostics.

The purchase price allocation will be finalized after completion of the valuation of certain assets and liabilities, and the final resolution of the purchase price adjustment. The historical consolidated financial statements include the results of operations of SBCL subsequent to the closing of the acquisition.

Note to Selected Balance Sheet Information

1. The Company maintains zero-balance bank accounts for the majority of its cash disbursements. Prior to the second quarter of 2000, the largest disbursement accounts were at the same financial institution that the Company maintained its primary concentration account, thus giving the institution the legal right of offset. As such, book overdrafts related to the disbursement accounts were netted against cash balances in the concentration accounts for reporting purposes. During the second quarter of 2000, the Company moved its primary concentration account to another financial institution such that no offset existed at June 30, 2000. As a result, book overdrafts in the amount of $46.4 million at June 30, 2000, representing outstanding checks, have been classified as liabilities and not reflected as a reduction of cash at June 30, 2000.

Notes to Consolidated Statements of Operations - Historical

1. During the second quarter of 2000, the Company recorded a net special charge of $2.1 million. Of the special charge, $13.4 million represented the costs to terminate certain contracts that management believed were not economically viable as a result of the SBCL acquisition. These costs were principally associated with the termination of a co-marketing agreement for clinical trials testing services. These charges were partially offset by a reduction in reserves attributable to a favorable resolution of outstanding claims for reimbursements associated with billings of certain tests.
2. During the fourth quarter of 1999, the Company reclassified certain expense items, primarily related to a portion of occupancy costs and professional liability insurance expense, from selling, general and administrative expenses to cost of services, to better reflect the cost of performing testing. The amount reclassified from selling, general and administrative expenses for the three and six months ended June 30, 1999 was $10.4 million and $20.8 million, respectively.
3. Net income for the three and six months ended June 30, 1999 includes a $1.9 million interest refund ($1.2 million, net of tax, or $0.04 per basic and diluted share) associated with a favorable tax settlement.
4. Results for the three and six months ended June 30, 2000 and 1999 included the effects of testing performed by third parties under the Company's laboratory network management arrangements. As laboratory network manager, Quest Diagnostics included in its consolidated revenues and expenses the cost of testing performed by third parties. This treatment added $14.4 million and $15.4 million to both reported revenues and cost of services for the three months ended June 30, 2000 and 1999, respectively, and $46.8 million and $32.8 million for the six months ended June 30, 2000 and 1999, respectively. This treatment also serves to increase cost of services as a percentage of net revenues and decrease selling, general and administrative expenses as a percentage of net revenues. During the first quarter of 2000, the Company and Aetna terminated a laboratory network arrangement, and entered into a new non-exclusive contract, effective April 1, 2000, under which the Company will no longer be responsible for the cost of testing performed by third parties.
5. Depreciation expense totaled $22.2 million and $11.4 million for the three months ended June 30, 2000 and 1999, respectively, and $43.5 million and $22.8 million for the six months ended June 30, 2000 and 1999, respectively.
6. Net income per common share is computed by dividing net income less dividends on preferred stock (approximately $30 thousand per quarter) by the weighted average number of common shares outstanding. Potentially dilutive common shares primarily represent stock options.
7. Cash earnings per common share is calculated as cash earnings less preferred dividends, divided by the diluted weighted average common shares outstanding. Cash earnings represents income before special charges and amortization of all intangible assets, net of applicable taxes.
8. Adjusted EBITDA represents income before income taxes, net interest expense, depreciation and amortization and special items. For the three and six months ended June 30, 2000, special items included $3.1 million and $4.5 million, respectively, of costs related to the integration of SBCL which were incurred and expensed in 2000 and the provision for special charges of $2.1 million.

Notes to the Pro Forma Combined Statement of Operations

Basis of Presentation

The pro forma combined statement of operations assumes that the SBCL acquisition and borrowings under the Company's credit facility were effected on January 1, 1999. The SBCL acquisition agreements include a provision for a purchase price adjustment based on an audit of the August 16, 1999 combined balance sheet of SBCL and certain affiliates. Adjustments resulting from this audit, which are subject to resolution as set forth in the SBCL acquisition agreements and are the subject of on-going discussions between the parties, have been recorded in the pro forma combined financial information to the extent that the Company believes they are applicable. The pro forma combined financial information reflects the preliminary allocation of the purchase price. The allocation will be finalized after completion of the valuation of certain assets and liabilities, and the final resolution of the purchase price adjustment. There can be no assurances that the amounts reflected in the pro forma combined financial information will not be subject to change as a result of changes in the allocation of the purchase price, including the resolution of the purchase price adjustment.

The pro forma combined statement of operations is presented for illustrative purposes only to analyze the financial implications of the SBCL acquisition and borrowings under the credit facility. The pro forma combined statement of operations may not be indicative of the combined financial results of operations that would have been realized had Quest Diagnostics and SBCL been a single entity during the periods presented. In addition, the pro forma combined statement of operations is not necessarily indicative of the future results that the combined company will experience.

Significant pro forma adjustments reflected in the pro forma combined financial information include reductions in employee benefit costs and general corporate overhead allocated to the historical results of SBCL by SmithKline Beecham, offset by an increase in net interest expense to reflect the Company's new credit facility which was used to finance the SBCL acquisition. Amortization of the goodwill, which accounts for a majority of the acquired intangible assets, is calculated on the straight-line basis over forty years. Other, net has been adjusted to remove SBCL's non-recurring gains from the sale and license of certain technology and its physician office-based teleprinter assets and network. Income taxes have been adjusted for the estimated income tax impact of the pro forma adjustments at the incremental tax rate of 40%. A significant portion of the intangible assets acquired in the SBCL acquisition is not deductible for tax purposes, which has the overall impact of increasing the effective tax rate.

Pro Forma Combined Results of Operations

- The special charge in the second quarter of 1999 of $15.8 million was primarily to record (on a pro forma basis) a loss provision to the results of SBCL to reflect a contract as a loss contract as of June 30, 1999.
  In addition, the pro forma combined results for the three and six months ended June 30, 1999 included other expense items recorded in SBCL's historical results which were not separately reflected on the face of the pro forma combined statements of operations, and impacted the overall comparability of pro forma results for 1999. The three and six months ended June 30, 1999 included incremental charges of $19.4 million and $21.1 million, respectively. Approximately $7.3 million of the charges for the three and six months ended June 30, 1999 were associated with two incidents, the costs of which SmithKline Beecham is obligated to indemnify Quest Diagnostics. The most significant of these incidents related to an SBCL employee who allegedly reused certain needles when drawing blood from patients. In addition, for the three and six months ended June 30, 1999 SBCL recorded approximately $5.4 million and $7.1 million, respectively, of incremental charges associated with the loss contract noted above. The remaining incremental charges for the three and six months ended June 30, 1999 primarily resulted from adjustments, recorded by SBCL prior to the acquisition, to accrued liabilities necessary to properly present the closing balance sheet of SBCL.
- Pro forma results for the three and six months ended June 30, 1999 included the effects of testing performed by third parties under the Company's laboratory network management arrangements. As laboratory network manager, Quest Diagnostics included in its pro forma consolidated revenues and expenses the cost of testing performed by third parties. This treatment added $43.1 million and $84.3 million to both pro forma revenues and pro forma cost of services for the three and six months ended June 30, 1999, respectively. This treatment also serves to increase cost of services as a percentage of net revenues and decrease selling, general and administrative expenses as a percentage of net revenues.
- Pro forma depreciation expense totaled $19.6 million and $38.9 million for the three and six months ended June 30, 1999, respectively.
- Pro forma net income per common share is computed by dividing pro forma net income less dividends on preferred stock (approximately $30 thousand per quarter) by the weighted average number of common shares outstanding. Potentially dilutive common shares primarily represent stock options. Both basic and diluted weighted average shares outstanding have been presented on a pro forma basis giving effect to the shares issued to SmithKline Beecham and the shares granted at closing to employees.
- Pro forma cash earnings per common share is calculated as pro forma cash earnings less preferred dividends, divided by pro forma diluted weighted average common shares outstanding. Cash earnings represents income before special charges and amortization of all intangible assets, net of applicable taxes, presented on a pro forma basis.
- Pro forma Adjusted EBITDA represents income before income taxes, net interest expense, depreciation and amortization and special items. For the three and six months ended June 30, 1999, special items included the provision for special charges of $15.8 million noted above, as well as the $19.4 million and $21.1 million, respectively, of incremental charges recorded by SBCL prior to the closing of the acquisition, which are discussed above in Note 1.