Quest Diagnostics Announces Results for Third Quarter 1999

October 26, 1999

QUEST DIAGNOSTICS ANNOUNCES RESULTS FOR THIRD QUARTER 1999

TETERBORO, N.J., OCTOBER 26, 1999 — Quest Diagnostics Incorporated (NYSE: DGX) announced today that for the third quarter ended Septembe 30, 1999, net income before an extraordinary loss and special charges incurred in connection with the acquisition of SmithKline Beecham Clinical Laboratories (SBCL) increased to $10.9 million, or $0.29 per diluted share, from $6.1 million, or $0.20 per diluted share, during the 1998 period. The consolidated results include the operations of SBCL from August 16, 1999, when the transaction was completed. After special charges of $30.3 million and an extraordinary loss, net of taxes, of $2.1 million incurred in connection with the transaction, the company reported a net loss of $9.4 million, or $0.26 per diluted share.

Revenues were $614.8 million compared to $360.7 million for the 1998 third quarter. Earnings before interest, taxes, depreciation and amortization excluding special items (adjusted EBITDA) were $67.8 million compared to $37.6 million for the prior year period. The increase in revenues and adjusted EBITDA was due primarily to the acquisition of SBCL.

Between the closing of the SBCL acquisition and the end of the third quarter, the company generated approximately $95 million of cash, enabling the repayment of $58 million of borrowings incurred in connection with the SBCL transaction. The company ended the quarter with a $37 million cash balance and no borrowings outstanding under its new $250 million revolving credit facility. Capital expenditures totaled $21.5 million for the quarter and $47.2 million for the nine months ended September 30, 1999.

"We are pleased to report solid results in our first quarter as a combined company," said Kenneth W. Freeman, Chairman and Chief Executive Officer. "Cash generation in the third quarter was strong. Quest Diagnostics is well positioned to continue to create value for shareholders, and we remain confident in our ability to grow earnings per share over the next several years by at least 30% annually."

For the nine months ended September 30, 1999, net income before an extraordinary loss and special charges increased to $31.4 million, or $0.95 per diluted share, compared to $21.5 million, or $0.71 per diluted share, for the prior-year period. Revenues increased to $1.39 billion from $1.10 billion. Adjusted EBITDA increased to $151.9 million from $124.7 million last year.

PRO FORMA RESULTS

On a pro forma basis, assuming that SBCL had been part of Quest Diagnostics for the entire quarter in both years, net income before an extraordinary loss and special charges was $8.0 million, or $0.18 per diluted share in the third quarter of 1999, compared to $10.8 million, or $0.25 per diluted share, in 1998. The decline is principally due to $3.2 million of non-recurring, pretax charges incurred by SBCL prior to the acquisition date which have not been classified as special charges.

Pro forma revenues were $819.3 million, up 7% from the prior year. Clinical testing volume, measured by the number of requisitions, increased approximately 3%, and average revenue per requisition improved approximately 2% over the prior-year period. Reflected in the year-to-year comparisons were the company’s laboratory network management business, for which testing performed by third parties is included in the 1999 consolidated revenues and expenses, partially offset by a reduction in revenues associated with a contract which was accounted for as a loss contract in 1999. Adjusted to exclude these items, bad debt expense was 7.6% of revenues during the quarter, compared to 8.8% for the prior year period and 7.5% for the second quarter.

Pro forma adjusted EBITDA was $86.6 million compared to $84.6 million in 1998. Certain items reflected in the SBCL results prior to the acquisition date which are of a non-recurring nature have been excluded for purposes of developing a more meaningful comparison of pro forma EBITDA. As described in more detail in the notes to the financial tables, the items excluded to arrive at adjusted EBITDA are $3.2 million in charges in 1999 and $0.6 million of pre-tax profit in 1998.

For the nine month period ended September 30, 1999, pro forma net income before an extraordinary loss and special charges was $16.9 million, or $0.38 per diluted share, compared to $32.6 million, or $0.75 per diluted share, for the prior-year period. As reflected in the notes to the accompanying financial tables, the year-to-date pro forma results include approximately $24 million of non-recurring expenses in 1999 recorded prior to the acquisition date and $7.2 million in non-recurring gains recorded in 1998, which have not been separately classified as special charges or credits. Excluding the impact of an extraordinary loss, special charges and these items, year-to-date pro forma net income increased to $31.4 million from $28.3 million. Pro forma revenues increased to $2.48 billion from $2.25 billion; and adjusted EBITDA was $252.3 million in 1999 compared to $254.4 million last year.

Quest Diagnostics is the nation's leading provider of diagnostic testing, information and services to physicians, hospitals, managed care organizations, employers and government agencies with annualized revenues of more than $3 billion. The wide variety of tests it performs on human tissue and fluids help doctors and hospitals diagnose, treat and monitor disease. Its Nichols Institute unit conducts research, specializes in esoteric testing using genetic screening and other advanced technologies, and manufactures and distributes diagnostic test kits and instruments. Quest Diagnostics is one of the leading providers of testing to support clinical trials of new pharmaceuticals worldwide. Quest Informatics collects and analyzes laboratory, pharmaceutical and other data to help large health care customers better manage the health of their patients. QuestNet is an innovative new product offering that provides network management services to large buyers of health care services. 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 1998 Form 10-K and subsequent filings.

-- Table follows --

Quest Diagnostics Incorporated and Subsidiaries

Consolidated Statements of Operations

For the Three and Nine Months Ended September 30, 1999 and 1998

(in millions, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1999	1998	1999	1998
Net revenues	$ 614.8	$ 360.7	$ 1,390.7	$ 1,095.3
Costs and expenses:				
Cost of services	369.4	210.9	822.1	646.7
Selling, general and administrative	192.7	122.8	451.3	359.4
Interest expense, net	19.0	8.4	31.4	26.5
Amortization of intangible assets	7.8	5.5	18.1	16.3
Special charges	30.3	-	30.3	-
Other, net	1.1	1.1	4.5	2.5
Total	620.3	348.7	1,357.7	1,051.4
Income (loss) before taxes and extraordinary loss	(5.5)	12.0	33.0	43.9
Income tax expense	1.8	5.9	19.8	22.4
Income (loss) before extraordinary loss	(7.3)	6.1	13.2	21.5
Extraordinary loss, net of taxes	(2.1)	-	(2.1)	-
Net income (loss)	$ (9.4)	$ 6.1	$ 11.1	$ 21.5
Income before extraordinary loss and special charges	$ 10.9	$ 6.1	$ 31.4	$ 21.5
Basic earnings (loss) per common share:				
Net income (loss)	$ (0.26)	$ 0.20	$ 0.34	$ 0.72
Income (loss) before extraordinary loss	$ (0.20)	$ 0.20	$ 0.41	$ 0.72
Income before extraordinary loss and special charges	$ 0.30	$ 0.20	$ 0.98	$ 0.72
Cash earnings before extraordinary loss and special charges	$ 0.49	$ 0.36	$ 1.46	$ 1.17
Weighted average common shares outstanding – basic	36.8	29.7	32.1	29.7

Diluted earnings (loss) per common share:				
Net income (loss)	$ (0.26)	$ 0.20	$ 0.34	$ 0.71
Income (loss) before extraordinary loss	$ (0.20)	$ 0.20	$ 0.40	$ 0.71
Income before extraordinary loss and special charges	$ 0.29	$ 0.20	$ 0.95	$ 0.71
Cash earnings before extraordinary loss and special charges	$ 0.47	$ 0.35	$ 1.43	$ 1.15
Weighted average common shares outstanding – diluted	37.6	30.2	32.9	30.3
Adjusted EBITDA	$ 67.8	$ 37.6	$ 151.9	$ 124.7

Quest Diagnostics Incorporated and Subsidiaries

Selected Balance Sheet Information

September 30, 1999 and December 31, 1998

(in millions)

	September 30, 1999	December 31, 1998
Assets		
Cash and cash equivalents	$ 37	$ 203
Accounts receivable, net	554	221
Intangible assets, net	1,385	495
Other assets	851	441
Total assets	$ 2,827	$ 1,360
Liabilities and Stockholders' Equity		
Short-term debt	$ 37	$ 51
Long-term debt	1,230	413
Other liabilities	705	329

Common stockholders' equity	855	567
Total liabilities and stockholders' equity	$ 2,827	$ 1,360

Quest Diagnostics Incorporated and Subsidiaries

Pro Forma Combined Statements of Operations

For the Three and Nine Months Ended September 30, 1999 and 1998

(in millions, except per share data)

PRO FORMAS	Three Months Ended September 30,		Nine Months Ended September 30,	
	1999	1998	1999	1998
Net revenues	$ 819.3	$ 766.6	$ 2,480.3	$ 2,248.1
Costs and expenses:				
Cost of services	501.2	452.7	1,543.0	1,349.7
Selling, general and administrative	254.4	248.5	765.1	706.3
Interest expense, net	31.2	31.7	92.6	95.1
Amortization of intangible assets	11.2	11.3	33.0	33.6
Special charges	30.3	-	46.1	-
Other, net	.4	.3	3.2	(6.1)
Total	828.7	744.5	2,483.0	2,178.6
Income (loss) before taxes and extraordinary loss	(9.4)	22.1	(2.7)	69.5
Income tax expense	.8	11.3	8.1	36.9
Income (loss) before extraordinary loss	(10.2)	10.8	(10.8)	32.6
Extraordinary loss, net of taxes	(2.1)	-	(2.1)	-
Net income (loss)	$ (12.3)	$ 10.8	$ (12.9)	$ 32.6
Income before extraordinary loss and special charges	$ 8.0	$ 10.8	$ 16.9	$ 32.6
Basic earnings (loss) per common share:				
Net income (loss)	$ (0.28)	$ 0.25	$ (0.30)	$ 0.75
Income (loss) before extraordinary loss	$ (0.23)	$ 0.25	$ (0.25)	$ 0.75
Income before extraordinary loss and special charges	$ 0.18	$ 0.25	$ 0.39	$ 0.75

Cash earnings before extraordinary loss and special charges	$ 0.42	$ 0.49	$ 1.08	$ 1.46
Weighted average common shares outstanding – basic	43.4	43.0	43.2	43.1
Diluted earnings (loss) per common share:				
Net income (loss)	$ (0.28)	$ 0.25	$ (0.30)	$ 0.75
Income (loss) before extraordinary loss	$ (0.23)	$ 0.25	$ (0.25)	$ 0.75
Income before extraordinary loss and special charges	$ 0.18	$ 0.25	$ 0.38	$ 0.75
Cash earnings before extraordinary loss and special charges	$ 0.41	$ 0.48	$ 1.06	$ 1.44
Weighted average common shares outstanding – diluted	44.2	43.4	43.9	43.5
Adjusted EBITDA	$ 86.6	$ 84.6	$ 252.3	$ 254.4

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 purchase price was paid through the issuance of 12,564,336 shares of common stock of the Company, representing approximately 29% of the Company's outstanding common stock, and the payment of $1.025 billion in cash.

The acquisition was accounted for under the purchase method of accounting. As such, the cost to acquire SmithKline Beecham’s clinical laboratory business has been allocated on a preliminary basis to the assets and liabilities acquired based on estimated fair values as of the closing date. The estimated costs associated with severance and other integration-related activities for 1999 and 2000, including the elimination of excess capacity, operational realignment and related workforce reductions are expected to be finalized and recorded during the fourth quarter of 1999.

The Stock and Asset Purchase Agreement includes 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 Stock and Asset Purchase Agreement, have been reflected in the pro forma combined statements of operations to the extent that the Company believes they are applicable. Additionally, these adjustments have been recorded in the September 30, 1999 consolidated balance sheet. However, amounts due from SmithKline Beecham, as a result of the purchase price adjustment, have not been reflected in the September 30, 1999 consolidated balance sheet of Quest Diagnostics.

The financial statements reflect the preliminary allocation of the purchase price. The allocation will be finalized after completion of the valuation of certain assets and liabilities, the recording of the integration costs and the final resolution of the purchase price adjustment. There can be no assurances that the amounts reflected in the pro forma combined statements of operations will not be subject to change as a result of the resolution of the purchase price adjustment.

Liabilities for which the obligation is being retained by SmithKline Beecham through an indemnity to Quest Diagnostics, are recoverable from SmithKline Beecham on an after-tax basis. Quest Diagnostics has recorded an estimate for the indemnified liabilities, which primarily relate to taxes and billing and professional liability claims, in its September 30, 1999 consolidated balance sheet with a net receivable due from SmithKline Beecham.

Notes to Consolidated Statements of Operations - Historical

1. In conjunction with the acquisition of SBCL, Quest Diagnostics repaid the entire amount outstanding under its then existing credit agreement. The extraordinary loss represents $3.6 million ($2.1 million, net of tax) of deferred financing costs which were written off in connection with the extinguishment of the credit agreement.
2. Net income (loss) for the three and nine months ended September 30, 1999 includes special charges totaling $30.3 million ($18.2 million, net of tax), incurred in conjunction with the acquisition of SBCL. Of the total, $19.8

million represents stock based employee compensation related to special one-time grants of the Company's common stock, and accelerated vesting, due to the completion of the SBCL acquisition, of stock grants made in previous years. The remainder of the charge is primarily attributable to professional and consulting fees incurred in connection with integration related planning activities.

3. 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.
4. Cash earnings represents income before extraordinary loss, special charges and amortization of intangible assets, net of applicable taxes. Cash earnings per common share is calculated as cash earnings less preferred dividends, divided by the diluted weighted average common shares outstanding.
5. Depreciation expense totaled $16.3 million and $11.7 million for the three months ended September 30, 1999 and 1998, respectively, and $39.1 million and $35.4 million for the nine months ended September 30, 1999 and 1998, respectively.
6. Net income for the nine months ended September 30, 1998 includes a $2.5 million charge ($1.2 million, net of tax) included in selling, general and administrative expenses related to the Company's consolidation of its laboratory network which was announced in December 1997.
7. Net income for the nine months ended September 30, 1999 includes a $1.9 million interest refund ($1.2 million, net of tax) associated with a favorable tax settlement.
8. Results for the three and nine months ended September 30, 1999 include the effects of the Company's laboratory network management service. As laboratory network manager, Quest Diagnostics includes in its consolidated revenues and expenses the cost of testing performed by third parties. This accounting requirement added $26.2 million and $59.0 million to reported revenues and expenses for the three and nine months ended September 30, 1999, respectively.

Notes to the Pro Forma Combined Statements of Operations

Basis of Presentation

The pro forma combined statements of operations assume that the SBCL acquisition and borrowings under the new credit facility were effected on the earliest period presented. The pro forma combined statements of operations are presented for illustrative purposes only to analyze the financial implications of the SBCL acquisition and borrowings under the new credit facility. The pro forma combined statements 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 statements of operations are not necessarily indicative of the future results that the combined company will experience.

Significant pro forma adjustments 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

- Pro forma net income (loss) for the three and nine months ended September 30, 1999 includes special charges totaling $30.3 million ($18.2 million, net of tax) and $46.1 million ($27.7 million, net of tax), respectively, primarily incurred in conjunction with the acquisition of SBCL. During the three months ended September 30, 1999, the Company recorded special charges of $19.8 million representing stock based compensation related to special one-time grants of the Company's common stock to employees, and the accelerated vesting, due to the completion of the SBCL acquisition, of stock grants made in previous years. The remaining charge in the third quarter of 1999 is primarily attributable to professional and consulting fees incurred in connection with integration planning activities. The nine months ended September 30, 1999 includes an additional charge of $15.8 million in the second quarter, primarily to record (on a pro forma basis) a loss provision to the results of SBCL to reflect a contract as a loss contract.

In addition, the pro forma combined results for the three and nine months ended September 30, 1999 and 1998, include other income and expense items recorded in SBCL's historical results which are not separately disclosed on the face of the pro forma combined statements of operations. These other income and expense items impact the overall comparability of the pro forma results for 1999 and 1998. The three months ended September 30, 1999 includes $3.2 million of charges, principally associated with cumulative adjustments under certain customer contracts. The 1998 period included $.6 million of non-recurring income. The nine months ended September 30, 1999 and 1998 includes incremental expense and pre-tax profits of $24.2 million and $7.2 million, respectively. Approximately $11 million of the incremental expenses resulted from adjustments, recorded by SBCL prior to the close, to accrued liabilities necessary to properly present the closing balance sheet of SBCL. These adjustments impact comparability because they resulted in an overstatement of expenses for the period presented. Additionally, approximately $7 million related to losses incurred under the loss contract noted above, and approximately $6 million related to charges 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 the blood from patients. The pre-tax profit of $7.2 million included in the nine months ended September 30, 1998 primarily represents the favorable settlement of a contract dispute. Excluding the impact of these items in both years would result in income before an extraordinary loss and special charges of $31.4 million for the nine months ended September 30, 1999, and $28.3 million for the nine months ended September 30, 1998.

- 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. 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.
- Cash earnings represents income before extraordinary loss, special charges and amortization of intangible assets, net of applicable taxes. Cash earnings per common share is calculated as cash earnings less preferred dividends, divided by diluted weighted average common shares outstanding.
- Depreciation expense totaled $20.1 million and $20.2 million for the three months ended September 30, 1999 and 1998, respectively, and $59.1 million and $61.0 million for the nine months ended September 30, 1999 and 1998, respectively.
- Results for the three and nine months ended September 30, 1999 include the effects of the Company’s laboratory network management service. As laboratory network manager, Quest Diagnostics includes in its consolidated revenues and expenses the cost of testing performed by third parties. This accounting requirement added $37.5 million and $121.8 million to reported revenues and expenses for the three and nine months ended September 30, 1999, respectively.

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