Quest Diagnostics Announces Record Revenues and Earnings for Full Year 2000

January 29, 2001

TETERBORO, N.J., Jan. 29 /PRNewswire/ -- Quest Diagnostics Incorporated (NYSE: DGX), the nation's leading provider of diagnostic testing, information and services, announced that for the fourth quarter ended December 31, 2000, income before an extraordinary loss and special items increased to $28.3 million, or $0.59 per diluted share, compared to $9.7 million, or $0.22 per diluted share in 1999. Cash earnings, or earnings before amortization of intangible assets and special items, increased to $0.77 per diluted share from $0.45 in 1999. The company prepaid $155 million of bank debt during the fourth quarter and recorded an extraordinary loss, net of taxes, of $2.9 million, or $0.06 per diluted share, associated with the write-off of deferred financing costs, a non-cash charge. After the extraordinary loss, the company reported net income of $25.4 million, or $0.53 per diluted share, in the quarter.

Fourth-quarter revenues were $836 million compared to $815 million in 1999. Excluding the impact of the company's network management business in 1999, fourth quarter revenues grew approximately 7% from the 1999 period. Revenue per requisition during the fourth quarter grew approximately 9% compared to the prior year. Clinical testing volume, measured by the number of requisitions, grew approximately 1% above the prior year period, after adjusting for the impact of severe weather and the contribution of business to unconsolidated joint ventures. Volume was reduced approximately 1.5% due to severe weather in several parts of the country in December. Additionally, reported volume was reduced approximately 1.5% due to the contribution of certain business to unconsolidated joint ventures, as required by existing joint venture agreements. As a result, reported volume during the fourth quarter was approximately 2% below the prior year's level.

Earnings before interest, taxes, depreciation, amortization and special items (adjusted EBITDA) were $112 million, compared to $85 million, for the prior year period. Adjusted EBITDA as a percentage of revenues, improved to 13.4% from 10.4% in 1999. The increase in adjusted EBITDA was due primarily to the company's longstanding strategy of shedding unprofitable business, focusing on higher-value testing services and the realization of synergies associated with the integration of SmithKline Beecham Clinical Laboratories (SBCL).

"We had an excellent year," said Kenneth W. Freeman, Chairman and Chief Executive Officer. "We had strong top line growth and we nearly doubled earnings per share -- all while integrating the largest acquisition in the history of our industry. We are now looking beyond integration to drive performance improvement through three major initiatives: Six Sigma Quality, as we step up our efforts to drive quality improvements; Profitable Growth, as we stand ready to benefit from our leading market position, the genomics revolution and increased interest among consumers in managing their health; and Standardization, as we drive efficiency by moving our laboratory operations to common processes and systems company-wide."

Cash generation remained strong during the quarter. Since the completion of the SBCL acquisition, the company has generated more than $450 million in cash, which was used to reduce debt by almost $300 million, and build a cash balance of more than $170 million at the end of the year. Bad debt expense was 6.3% of revenues during the fourth quarter, compared to 6.8% in the third quarter. Excluding the impact of the company's network management business, bad debt expense was 7.7% in the fourth quarter of 1999. Days sales outstanding at year-end were 56 days compared to 54 days at the end of the third quarter and 57 days a year ago. Capital expenditures totaled $48 million for the quarter and $116 million for the year.

Income before an extraordinary loss and special items for the year ended December 31, 2000, increased to $106.2 million, or $2.25 per diluted share, compared to $41.2 million, or $1.15 per diluted share, in 1999. Cash earnings were $3.12 per diluted share for 2000, compared to $1.87 in 1999. Revenues increased to $3.4 billion from $2.2 billion. Adjusted EBITDA increased to $459 million from $237 million in 1999. After the extraordinary loss and special items, net income was $102.1 million, or $2.16 per diluted share.

PRO FORMA COMPARISONS

Revenues increased 3.8% for the year ended December 31, 2000, compared to pro forma revenues in 1999, assuming that SBCL had been part of Quest Diagnostics for all of 1999. 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 associated with certain managed care contracts modified during 2000. Pro forma revenues rose 8.6%, adjusted for these changes. Average revenue per requisition increased approximately 6% compared to 1999. For the full year, clinical testing volume grew by 3.0%, after adjusting for the contribution of business to unconsolidated joint ventures. Reported volume growth was 2.5% above the 1999 pro forma level.

Income before an extraordinary loss and special items of $106.2 million, or $2.25 per diluted share, compared to a pro forma amount of $12.6 million, or $0.28 per diluted share, in 1999. Adjusted EBITDA was $459 million compared to $337 million on a pro forma basis in the prior year.

Quest Diagnostics will discuss results for the fourth quarter and full year 2000 during a conference call on January 30 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: http://www.streetevents.com and all others may access the Quest Diagnostics website at: http://www.questdiagnostics.com. In addition, a replay of the call will also be available from 10 A.M. on January 30 through 5 P.M. on February 2 by dialing 800-695-4249.

Quest Diagnostics is the nation's leading provider of diagnostic testing, information and services with $3.4 billion in annual revenues. The company's diagnostic testing yields information that enables health care professionals and consumers to make better decisions to improve health. Quest Diagnostics offers patients and physicians the broadest access to diagnostic testing services through its national network of approximately 30 full-service laboratories, 150 rapid response laboratories and more than 1,200 patient service centers, where specimens are collected. Quest Diagnostics is the leading provider of esoteric testing, including gene-based testing, and is the leader in routine medical testing, drugs of abuse testing, and anatomic pathology testing. Through partnerships with pharmaceutical, biotechnology and information technology companies, Quest Diagnostics provides support to help speed the development of health care insights and new therapeutics. Additional company information can be found on the Internet at: http://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.

Quest Diagnostics Incorporated and Subsidiaries

Consolidated Statements of Operations
For the Quarters and Years Ended December 31, 2000 and 1999
(in millions, except per share data)

	Quarter Ended December 31,		Year Ended December 31,		
	Historical		Historical		Pro forma
	2000	1999	2000	1999	1999
Net revenues	$836.4	$814.5	$3,421.2	$2,205.2	$3,294.8
Costs and expenses:					
Cost of services	502.0	520.4	2,056.2	1,380.0	2,132.3
Selling, general and administrative	247.5	229.6	1,001.4	643.4	948.2
Interest expense, net	23.7	30.1	113.1	61.5	122.6
Amortization of intangible assets	10.3	11.7	45.7	29.8	45.2
Provisions for restructuring and other special charges	--	43.1	2.1	73.4	89.2
Minority share of income	1.9	1.6	9.4	5.4	5.4
Other, net	(2.6)	(3.4)	(7.7)	(2.7)	(13.4)
Total	782.8	833.1	3,220.2	2,190.8	3,329.5
Income (loss) before taxes and extraordinary loss	53.6	(18.6)	201.0	14.4	(34.7)
Income tax expense (benefit)	25.3	(4.1)	96.0	15.7	(1.1)
Income (loss) before extraordinary loss	28.3	(14.5)	105.0	(1.3)	(33.6)
Extraordinary loss, net of taxes	(2.9)	--	(2.9)	(2.1)	(2.1)
Net income (loss)	$25.4	$(14.5)	$102.1	$(3.4)	$(35.7)
Income before extraordinary loss and special items	$28.3	$9.7	$106.2	$41.2	$12.6
Basic earnings (loss) per common share:					
Income (loss) before extraordinary loss	$0.62	$(0.33)	$2.34	$(0.04)	$(0.78)
Net income (loss)	0.56	(0.33)	2.28	(0.10)	(0.83)
Income before extraordinary loss and special items	0.62	0.22	2.37	1.17	0.29
Weighted average common shares outstanding - basic	45.4	43.7	44.8	35.0	43.3
Diluted earnings (loss) per common share:					
Income (loss) before extraordinary loss	$0.59	$(0.33)	$2.22	$(0.04)	$(0.78)
Net income (loss)	0.53	(0.33)	2.16	(0.10)	(0.83)
Income before extraordinary loss and special items	0.59	0.22	2.25	1.15	0.28
Cash earnings before extraordinary loss and special items	0.77	0.45	3.12	1.87	1.21
Weighted average common shares outstanding -					

diluted	48.1	44.7	47.2	35.8	44.1
Adjusted EBITDA	$112.4	$85.1	$459.4	$237.0	$337.4

Quest Diagnostics Incorporated and Subsidiaries

Selected Balance Sheet Information
December 31, 2000 and December 31, 1999
(in millions)

	December 31, 2000	December 31, 1999
Assets		
Cash and cash equivalents	$171	$27
Accounts receivable, net	486	539
Intangible assets, net	1,262	1,436
Other assets	946	876
Total assets	$2,865	$2,878
Liabilities and Stockholders' Equity		
Short-term debt	$265	$45
Long-term debt	761	1,171
Other liabilities	808	800
Common stockholders' equity	1,031	862
Total liabilities and stockholders' equity	$2,865	$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 to the assets and liabilities acquired based on estimated fair values as of the closing date. The historical consolidated financial statements include the results of operations of SBCL subsequent to the closing of the acquisition.

The SBCL acquisition agreements included a provision for a reduction in the purchase price paid by Quest Diagnostics in the event that the combined balance sheet of SBCL showed that the net assets acquired, as of the acquisition date, were below a prescribed level. On October 11, 2000, the purchase price adjustment was finalized with the result that SmithKline Beecham owed Quest Diagnostics $98.6 million. This amount was offset by $3.6 million separately owed by Quest Diagnostics to SmithKline Beecham, resulting in a net payment to the Company by SmithKline Beecham of $95.0 million. This payment from SmithKline Beecham was recorded in the Company's historical financial statements in the fourth quarter of 2000 as a reduction in the purchase price of the SBCL acquisition.

The remaining components of the purchase price allocation relating to the SBCL acquisition were completed during the third quarter of 2000, resulting in a reduction in the amount of related goodwill recorded of approximately $35 million.

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 Company maintained its largest disbursement accounts and primary concentration accounts at the same financial institution, giving that financial institution the legal right of offset. As such, book overdrafts related to the disbursement accounts were offset 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 the right of offset no longer exists. As a result, book overdrafts in

the amount of $47.4 million at December 31, 2000, representing outstanding checks, were classified as liabilities and not reflected as a reduction of cash.

Notes to Consolidated Statements of Operations - Historical

(1) For purposes of determining income and cash earnings before extraordinary loss and special items, special items included the provisions for restructuring and other special charges reflected on the face of the statement of operations, and a $3.0 million gain recorded on the sale of an investment in the fourth quarter of 1999.

(2) During the second quarter of 2000, the Company recorded a net special charge of $2.1 million ($1.3 million, net of tax). Of the special charge, $13.4 million represented the costs to cancel certain contracts that management believed were not economically viable as a result of the SBCL acquisition. These costs were principally associated with the cancellation of a co-marketing agreement for clinical trials testing services. These charges were in large part offset by a reduction in reserves attributable to a favorable resolution of outstanding claims for reimbursements associated with billings of certain tests.

During the third and fourth quarters of 1999, the Company recorded provisions for restructuring and other special charges totaling $30.3 million ($18.2 million, net of tax) and $43.1 million ($26.1 million, net of tax), respectively, principally incurred in connection with the acquisition and planned integration of SBCL.

Of the total special charge recorded in the third quarter of 1999, $19.8 million represented stock-based employee compensation related to special one-time grants of the Company's common stock to certain individuals of the combined company and accelerated vesting, due to the completion of the SBCL acquisition, of restricted stock grants made in previous years. In addition, during the third quarter of 1999, the Company incurred $9.2 million of professional and consulting fees related to integration planning activities. The remainder of the third quarter charge was related to costs incurred by the Company in conjunction with its planned offering of new senior subordinated notes, the proceeds of which were expected to be used to repay the Company's existing 10-3/4% senior subordinated notes due 2006. During the third quarter of 1999, the Company decided not to proceed with the offering due to unsatisfactory market conditions.

Of the total special charge recorded in the fourth quarter of 1999, $36.4 million represented costs related to planned integration activities affecting Quest Diagnostics' operations and employees. The majority of these costs related to employee severance, lease obligations for facilities and equipment and the write-off of certain assets that management plans to dispose of in conjunction with the integration of SBCL. The remainder of the fourth quarter special charge was primarily attributable to professional and consulting fees incurred in connection with integration related planning activities and special recognition awards granted in the fourth quarter of 1999 to certain employees involved in the transaction and integration planning processes of the SBCL acquisition.

(3) During the fourth quarter of 2000, the Company prepaid $155.0 million of the term loans under the Company's Credit

Agreement. The extraordinary loss in the fourth quarter of 2000 represented $4.8 million ($2.9 million, net of tax) of deferred financing costs which were written off in connection with the prepayment of the term loans under the Company's Credit Agreement.

During 1999, in conjunction with the acquisition of SBCL, Quest Diagnostics repaid the entire amount outstanding under its then existing credit agreement. The extraordinary loss in the third quarter of 1999 represented $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.

(4) Depreciation expense totaled $23.2 million and $21.9 million for the

quarter ended December 31, 2000 and 1999, respectively, and $88.6 million and $61.0 million for the year ended December 31, 2000 and 1999, respectively.

(5) Net income for the year ended December 31, 1999 included a

$1.9 million interest refund ($1.2 million, net of tax) associated with a favorable tax settlement.

(6) Results for 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 $32.6 million to both reported revenues and cost of services for the quarter ended December 31, 1999 and $48.8 million and $91.6 million for the year ended December 31, 2000 and 1999, respectively. This treatment also served 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 2000, the Company modified certain managed care contracts to remove the financial risk associated with testing performed by third parties. As such, the accounting requirement, to include in consolidated revenues and costs of services the cost of testing performed by third parties under two of the Company's laboratory network management agreements, was eliminated. The impact, as a result of these changes to the laboratory management agreements, serves to reduce reported revenues and costs of services on an annual basis by approximately $150 million.

(7) 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. During periods in which net income available to common stockholders is negative, diluted weighted average common shares outstanding will equal basic weighted average common shares outstanding since, under these circumstances, the incremental shares would have an anti-dilutive effect.

(8) 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 extraordinary loss, special items and amortization of all intangible assets, net of applicable taxes.

(9) Adjusted EBITDA represents income before extraordinary loss, income

taxes, net interest expense, depreciation, amortization and special items. For the quarter and year ended December 31, 2000, special items included the special charges reflected on the face of the statement of operations, and $1.7 million and $8.9 million, respectively, of costs related to the integration of SBCL which were included in operating costs and expensed as incurred. For the quarter and year ended December 31, 1999, special items included the special charges reflected on the face of the statement of operations and a $3.0 million gain on sale of an investment in the fourth quarter of 1999.

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 included a provision for a reduction in the purchase price paid by Quest Diagnostics in the event that the combined balance sheet of SBCL showed that the net assets acquired, as of the acquisition date, were below a prescribed level. On October 11, 2000, the purchase price adjustment was finalized with the result that SmithKline Beecham owed Quest Diagnostics $98.6 million. This amount was offset by $3.6 million separately owed by Quest Diagnostics to SmithKline Beecham, resulting in a net payment to the Company by SmithKline Beecham of $95.0 million. This payment from SmithKline Beecham was recorded in the Company's historical financial statements in the fourth quarter of 2000 as a reduction in the purchase price of the SBCL acquisition.

The remaining components of the purchase price allocation relating to the SBCL acquisition were completed during the third quarter of 2000, resulting in a reduction in the amount of related goodwill recorded of approximately $35 million.

In connection with finalizing the purchase price adjustment with SmithKline Beecham, Quest Diagnostics filed a Form 8-K on October 31, 2000 with the Securities and Exchange Commission to revise and update certain pro forma combined financial information previously reported by the Company. The unaudited pro forma combined financial information included in this press release reflects the revised pro forma combined financial information included in the Form 8-K referred to above.

The unaudited pro forma combined financial information is presented for illustrative purposes only to assist in analyzing the financial implications of the SBCL acquisition and borrowings under the Credit Agreement. The unaudited pro forma combined financial information 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 unaudited pro forma combined financial information is not necessarily indicative of the future results that the combined company will experience.

Significant pro forma adjustments reflected in the unaudited 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. 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

(1) For purposes of determining income and cash earnings before

extraordinary loss and special items, special items for the year ended December 31, 1999 included the special charges reflected on the face of the pro forma statement of operations, a $3.0 million gain recorded on the sale of an investment in the fourth quarter of 1999 and a $9.7 million gain recognized by SBCL on the sale of its physician office-based teleprinter assets and network in the first quarter of 1999 which was recorded in other, net.

(2) During the second, third and fourth quarters of 1999, the Company

recorded provisions for restructuring and other special charges totaling $15.8 million, $30.3 million and $43.1 million, respectively, principally incurred in connection with the acquisition and planned integration of SBCL.

The special charge in the second quarter of 1999 of $15.8 million was primarily to record a provision in the results of SBCL to reflect a customer contract as a loss contract.

Of the total special charge recorded in the third quarter of 1999, $19.8 million represented stock-based employee compensation related to special one-time grants of the Company's common stock to certain individuals of the combined company and accelerated vesting, due to the completion of the SBCL acquisition, of restricted stock grants made in previous years. In addition, during the third quarter of 1999, the Company incurred $9.2 million of professional and consulting fees related to integration planning activities. The remainder of the third quarter charge related to costs incurred by the Company in conjunction with its planned offering of new senior subordinated notes, the proceeds of which were expected to be used to repay the Company's existing 10-3/4% senior subordinated notes due 2006. During the third quarter of 1999, management decided not to proceed with the offering due to unsatisfactory market conditions.

Of the total special charge recorded in the fourth quarter of 1999, $36.4 million represented costs related to planned integration activities affecting Quest Diagnostics' operations and employees. The majority of these costs related to employee severance, lease obligations for facilities and equipment and the write-off of certain assets that management plans to dispose of in conjunction with the integration of SBCL. The remainder of the fourth quarter special charge was primarily attributable to professional and consulting fees incurred in connection with integration related planning activities and special recognition awards granted in the fourth quarter of 1999 to certain employees involved in the transaction and integration planning processes of the SBCL acquisition.

A special review of the SBCL pre-closing financial statements, called for in the SBCL acquisition agreements, was conducted to assess the recoverability of assets and the adequacy of liabilities existing prior to the closing date of the acquisition. This special review resulted in adjustments, primarily related to the recoverability of SBCL receivables and accrued liabilities during various periods prior to the closing of the SBCL acquisition. Management believes that the adjustments resulting from the special review, which have not been reflected on the face of the pro forma combined financial information, are of a non-recurring nature and limit the comparability of results between the periods presented. For the year ended December 31, 1999, pro forma results included $46.6 million of these discrete expense items including: bad debt charges of $22.4 million to reflect the reduced recoverability of SBCL receivables, as a result of the special review of the SBCL financial statements; $11.5 million of expenses recorded by SBCL prior to the acquisition, primarily to record liabilities necessary to properly present the closing balance sheet of SBCL; $7.1 million of losses related to a customer contract accounted for as a loss contract beginning in the third quarter of 1999; and $5.6 million of costs for which SmithKline Beecham is obligated to indemnify the Company, associated with two incidents, the most significant of which related to a SBCL employee who allegedly reused certain needles when drawing blood from patients.

(3) Pro forma results for the year ended December 31, 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 $154.4 million to both pro forma revenues and pro forma cost of services for the year ended December 31, 1999. 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.

(4) Pro forma net income (loss) for the year ended December 31, 1999

included a $9.7 million ($5.8 million, net of tax) non-recurring gain recorded by SBCL related to the sale of its physician office-based teleprinter assets and network in the first quarter of 1999 which was recorded in other, net.

(5) Pro forma depreciation expense totaled $81.0 million for the year

ended December 31, 1999.

(6) 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 shares granted at closing to certain employees.

(7) 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 extraordinary loss, special items, and amortization of all intangible assets, net of applicable taxes, presented on a pro forma basis.

(8) Pro forma Adjusted EBITDA represents income before extraordinary

loss, income taxes, net interest expense, depreciation, amortization and special items. For the year ended December 31, 1999, special items included the provisions for restructuring and other special charges reflected on the face of the pro forma combined financial information; $46.6 million of discrete expense items, which are discussed above in Note 2; a $9.7 million gain recognized by SBCL on the sale of its physician office-based teleprinter assets and network in the first quarter of 1999; and a $ 3.0 million gain on sale of an investment in the fourth quarter of 1999.

SOURCE Quest Diagnostics Incorporated

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