Quest Diagnostics Reports Strong Revenue and Earnings Growth In Third Quarter 2000

October 19, 2000

TETERBORO, N.J., Oct. 19 /PRNewswire/ -- Quest Diagnostics Incorporated (NYSE: DGX), the nation's leading provider of diagnostic testing, information and services, announced that for the third quarter ended September 30, 2000, net income increased to $28.7 million, or $0.60 per diluted share. Net income for the third quarter of 1999 was $10.9 million, or $0.29 per diluted share, before an extraordinary loss and special items. Cash earnings, or earnings before amortization of intangible assets and special items, rose to $0.82 per diluted share from $0.47 per diluted share for the 1999 period.

In the third quarter, revenues increased to $850 million compared to $615 million in 1999. The comparison was impacted for the first time by the inclusion of revenues from SmithKline Beecham Clinical Laboratories (SBCL) for a portion of the prior year period. Quest Diagnostics acquired SBCL on August 16, 1999. In addition, the company amended its network management contract with Oxford Health to remove the financial risk associated with testing performed by third parties. This change eliminated the accounting requirement to gross up revenues and expenses by approximately $14 million during the quarter.

Earnings before interest, taxes, depreciation and amortization, adjusted to exclude net special charges and integration related costs (adjusted EBITDA), were $120 million compared to $68 million for the prior year period. The increases in revenues and adjusted EBITDA were due primarily to the acquisition of SBCL and improved operating performance.

"We made significant progress during the third quarter integrating Quest Diagnostics and SBCL in several critical markets, while growing our revenues," said Kenneth W. Freeman, Chairman and Chief Executive Officer. "We have transitioned approximately 60% of the business affected by integration, and we expect to transition approximately 80% by the end of the year. We continue to focus on providing the highest levels of quality and service to our customers as we complete the integration."

Days sales outstanding were 54 days, compared to 52 days in the second quarter. The company ended the quarter with $162 million in cash and no borrowings outstanding under its $250 million revolving credit facility. Capital expenditures totaled $27 million for the quarter.

For the first nine months of 2000, income before extraordinary loss and special items increased to $78.0 million, or $1.66 per diluted share, compared to $31.4 million, or $0.95 per diluted share, in 1999. Revenues increased to $2.6 billion compared to $1.4 billion in 1999. Adjusted EBITDA for the nine-month period was $347 million, compared to $152 million a year ago. Capital expenditures for the nine-month period totaled $68 million.

PRO FORMA COMPARISONS

Revenues in the third quarter of 2000 increased 3.8% compared to pro forma revenues in 1999, assuming that SBCL had been part of Quest Diagnostics for all of 1999. Clinical testing volume, measured by the number of requisitions, increased 1.2%, and average revenue per requisition increased 6.9%. Adjusted for the elimination of the gross-up of revenues associated with certain managed care contracts, pro forma revenues increased by 8.5%.

Bad debt expense, excluding the impact of the company's laboratory network management business, improved to 6.8% of revenues during the third quarter, compared to 7.6% in the third quarter of 1999, adjusted to exclude special items, and 7.1% in the second quarter of 2000. Net income was $28.7 million in the third quarter of 2000, compared to $3.7 million in the prior year on a pro forma basis before an extraordinary loss and special items. Adjusted EBITDA was $120 million for the third quarter of 2000, compared to pro forma adjusted EBITDA of $87 million last year. In 1999, the pro forma adjusted EBITDA excludes $44 million of non-recurring pretax charges.

For the first nine months of 2000, revenues increased 4.2% compared to pro forma revenues in 1999. Clinical testing volume, measured by the number of requisitions, increased 4%, and average revenue per requisition increased 5%. 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 the period. Pro forma revenues rose 9.3%, adjusted for these changes.

Income before extraordinary loss and special items was $78 million in the first nine months of 2000, compared to a pro forma amount of $0.9 million in the prior year. Adjusted EBITDA was $347 million, compared to pro forma adjusted EBITDA of $252 million. In 1999, pro forma adjusted EBITDA excludes $87 million of net non-recurring pretax charges.

Quest Diagnostics will discuss results for the third quarter during a conference call on October 20 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. The on-line replay will be available 24 hours a day beginning at noon on October 20. In addition, the replay of the call will also be available from 10 A.M. on October 20 through 5 P.M. on October 24 by dialing 800-568-6411.

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: 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 Three and Nine Months Ended September 30, 2000 and 1999
(in millions, except per share data)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	Historical		Pro forma	Historical		Pro forma
	2000	1999	1999	2000	1999	1999
Net revenues	$850.2	$614.8	$819.3	$2,584.8	$1,390.7	$2,480.3
Costs and expenses:						
Cost of services	504.7	386.1	524.4	1,554.2	859.6	1,611.9
Selling, general and administrative	251.2	176.0	238.4	753.9	413.8	718.6
Interest expense, net	29.5	19.0	30.9	89.4	31.4	92.6
Amortization of intangible assets	11.5	7.8	11.5	35.4	18.1	35.7
Special charges	--	30.3	30.3	2.1	30.3	46.1
Minority share of income	2.1	1.1	1.2	7.5	3.8	3.8
Other, net	(2.8)	--	(0.8)	(5.1)	0.7	(10.3)
Total	796.2	620.3	835.9	2,437.4	1,357.7	2,498.4
Income (loss) before taxes and extraordinary loss	54.0	(5.5)	(16.6)	147.4	33.0	(18.1)
Income tax expense (benefit)	25.3	1.8	(2.1)	70.7	19.8	2.9
Net income (loss) before extraordinary loss	28.7	(7.3)	(14.5)	76.7	13.2	(21.0)
Extraordinary loss, net of taxes	--	(2.1)	(2.1)	--	(2.1)	(2.1)
Net income (loss)	$28.7	$(9.4)	$(16.6)	$76.7	$11.1	$(23.1)
Income before extraordinary loss and special items	$28.7	$10.9	$3.7	$78.0	$31.4	$0.9
Basic earnings (loss) per common share:						
Income (loss) before extraordinary loss	$0.64	$(0.20)	$(0.33)	$1.72	$0.41	$(0.49)
Net income (loss)	0.64	(0.26)	(0.38)	1.72	0.34	(0.54)
Income before extraordinary loss and special items	0.64	0.30	0.08	1.75	0.98	0.02
Weighted average common shares outstanding - basic	45.0	36.8	43.4	44.6	32.1	43.2
Diluted earnings (loss) per common share:						
Income (loss) before extraordinary loss	$0.60	$(0.20)	$(0.33)	$1.64	$0.40	$(0.48)
Net income (loss)	0.60	(0.26)	(0.38)	1.64	0.34	(0.54)
Income before extraordinary loss and special items	0.60	0.29	0.08	1.66	0.95	0.02
Cash earnings before extraordinary loss and special items	0.82	0.47	0.32	2.35	1.43	0.76

Weighted average common shares outstanding - diluted	47.9	37.6	44.2	46.8	32.9	43.9
Adjusted EBITDA	$119.6	$67.8	$86.6	$346.9	$151.9	$252.3

Quest Diagnostics Incorporated and Subsidiaries

Selected Balance Sheet Information
September 30, 2000 and December 31, 1999
(in millions)

	September 30, 2000	December 31, 1999
Assets		
Cash and cash equivalents	$162	$27
Accounts receivable, net	513	539
Intangible assets, net	1,369	1,436
Other assets	962	876
Total assets	$3,006	$2,878
Liabilities and Stockholders' Equity		
Short-term debt	$283	$45
Long-term debt	906	1,171
Other liabilities	831	800
Common stockholders' equity	986	862
Total liabilities and stockholders' equity	$3,006	$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. Adjustments to the August 16, 1999 combined balance sheet of SBCL and certain affiliates, which were subject to resolution as set forth in the SBCL acquisition agreements and were the subject of on-going discussions between the parties, had already been recorded in the pro forma combined financial information to the extent the Company believed that they were applicable. On October 11, 2000, the Company received $95 million in cash from SmithKline Beecham to settle certain outstanding items associated with the 1999 acquisition of SBCL. The Company received $98.6 million in connection with finalizing the purchase price adjustment. This amount was reduced by $3.6 million for items separately owed to SmithKline Beecham.

In connection with finalizing the purchase price adjustment, the historical financial statements of SBCL and certain pro forma financial statements for the combined operations of SBCL and Quest Diagnostics will be amended through the filing of a Form 8-K with the Securities and Exchange Commission. The settlement has no impact on any of the actual historical results reported for Quest Diagnostics, either before or after the acquisition. The pro forma combined financial information included in this press release reflects the revised pro forma financial information to be disclosed in the Form 8-K referred to above. The purchase price adjustment will be recorded as a reduction of the cost of the SBCL acquisition in the fourth quarter of 2000. During the third quarter of 2000, the Company finalized the remaining components of the SBCL purchase price allocation.

Note to Selected Balance Sheet Information

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 $48.4 million at September 30, 2000, representing outstanding checks, were classified as liabilities and not reflected as a reduction of cash.

Notes to Consolidated Statements of Operations - Historical

For purposes of determining income and cash earnings before extraordinary loss and special items, special items represented net special charges reflected on the face of the statement of operations.

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 nine months ended September 30, 1999 was $16.7 million and $37.5 million, respectively.

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.

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.

Net income (loss) for the three and nine months ended September 30, 1999 included 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 represented stock based employee compensation related to special one-time grants of the Company's common stock to certain individuals of the combined company of $17.8 million, and accelerated vesting, due to the completion of the SBCL acquisition, of restricted stock grants made in previous years totaling $2.0 million. 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 103/4% senior subordinated notes. During the third quarter of 1999, the Company decided not to proceed with the offering due to unsatisfactory conditions in the high yield market.

Depreciation expense totaled $21.9 million and $16.3 million for the three months ended September 30, 2000 and 1999, respectively, and $65.4 million and $39.1 million for the nine months ended September 30, 2000 and 1999, respectively.

Net income for the nine months ended September 30, 1999 included a $1.9 million interest refund ($1.2 million, net of tax) associated with a favorable tax settlement.

Results for the three and nine months ended September 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 $2.0 million and $26.2 million to both reported revenues and cost of services for the three months ended September 30, 2000 and 1999, respectively, and $48.8 million and $59.0 million for the nine months ended September 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 is no longer responsible for the cost of testing performed by third parties. During the third quarter of 2000, the Company amended its network management contract with Oxford Health such that the Company is no longer responsible for the cost of testing performed by third parties.

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.

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.

Adjusted EBITDA represents income before income taxes, net interest expense, depreciation and amortization, extraordinary item, and special items. For the three and nine months ended September 30, 2000, special items included the special charges reflected on the face of the statement of operations, and $2.7 million and $7.2 million, respectively, of costs related to the integration of SBCL which were included in operating costs and expensed as incurred. For the three and nine months ended September 30, 1999, special items represented special charges reflected on the face of the statement of operations.

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 Company reached a settlement with SmithKline Beecham as to amounts due to the Company as a result of the purchase price adjustment. In connection with finalizing the purchase price adjustment, the historical financial statements of SBCL and certain pro forma financial statements for the combined operations of SBCL and Quest Diagnostics will be amended through the filing of a Form 8-K with the Securities and Exchange Commission. The pro forma combined financial information included in this press release reflects the revised pro forma financial information to be disclosed in the Form 8-K referred to above. The purchase price adjustment will be recorded as a reduction of the cost of the SBCL acquisition in the fourth quarter of 2000. During the third quarter of 2000, the Company finalized the remaining components of the SBCL purchase price allocation.

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. 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

For purposes of determining income and cash earnings before extraordinary loss and special items, special items for the three months ended September 30, 1999 represented special charges reflected on the face of the pro forma statement of operations. For the nine months ended September 30, 1999, special items included the special charges reflected on the face of the pro forma statement of operations 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.

Pro forma net income (loss) for the three and nine months ended September 30, 1999 included 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. Of the $30.3 million 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 of $17.8 million, and accelerated vesting, due to the completion of the SBCL acquisition, of restricted stock grants made in previous years totaling $2.0 million. 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 103/4% senior subordinated notes. During the third quarter of 1999, the Company decided not to proceed with the offering due to unsatisfactory conditions in the high yield market.

The nine months ended September 30, 1999 included an additional charge of $15.8 million in the second quarter, primarily to record a loss provision in the results of SBCL to reflect a contract as a loss contract.

In addition, pro forma results for the three and nine months ended September 30, 1999 included $3.2 million and $24.2 million, respectively, of incremental expenses recorded in SBCL's historical financial statements prior to the closing of the acquisition, which have not been separately reflected on the face of the pro forma combined income statements. Of these expenses, approximately $7.1 million were associated with losses recorded during the nine months ended September 30, 1999 related to a customer contract accounted for as a loss contract beginning in the third quarter of 1999. Approximately $5.6 million of these expenses for the nine months ended September 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. The remaining expenses for the three and nine months ended September 30, 1999 primarily resulted from adjustments, recorded by SBCL prior to the acquisition, to record liabilities necessary to properly present the closing balance sheet of SBCL.

In addition, pro forma results reflect adjustments resulting from finalizing the SBCL purchase price adjustment. Pro forma results for the three and nine months ended September 30, 1999 reflect adjustments to increase the previously reported pro forma operating expenses, primarily bad debt expense, by $7.2 million and $22.4 million, respectively. Management believes that these adjustments are of a non-recurring nature and has excluded them from determining pro forma Adjusted EBITDA.

Pro forma results for the three and nine months ended September 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 $37.5 million and $121.8 million to both pro forma revenues and pro forma cost of services for the three and nine months ended September 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 net income (loss) for the nine months ended September 30, 1999 included $9.7 ($5.8 million, net of tax) of non-recurring gains 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.

Pro forma depreciation expense totaled $20.1 million and $59.1 million for the three and nine months ended September 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 extraordinary loss, special items, 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, extraordinary item, and special items. For the three and nine months ended September 30, 1999, special items included the provision for special charges of $30.3 million and $46.1 million, respectively; $3.2 million and $24.2 million, respectively, of incremental charges recorded to the results of SBCL prior to the closing of the acquisition; and $7.2 million and $22.4 million, respectively, of increased expenses recorded as a result of finalizing the SBCL purchase price adjustment, which is discussed above in Note 2. In addition, special items for the nine months ended September 30, 1999 included 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. SOURCE Quest Diagnostics Incorporated

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