

QUEST DIAGNOSTICS INC

Form 10-Q

July 30, 2015

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2015

Commission file number 001-12215

Quest Diagnostics Incorporated

Three Giralda Farms

Madison, NJ 07940

(973) 520-2700

Delaware

(State of Incorporation)

16-1387862

(I.R.S. Employer Identification Number)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of July 23, 2015, there were outstanding 143,552,998 shares of the registrant's common stock, \$.01 par value.

Table of Contents

PART I - FINANCIAL INFORMATION

	Page
Item 1. Financial Statements	
Index to unaudited consolidated financial statements filed as part of this report:	
<u>Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2015 and 2014</u>	<u>2</u>
<u>Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2015 and 2014</u>	<u>3</u>
<u>Consolidated Balance Sheets as of June 30, 2015 and December 31, 2014</u>	<u>4</u>
<u>Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2015 and 2014</u>	<u>5</u>
<u>Consolidated Statements of Stockholders' Equity for the Six Months Ended June 30, 2015 and 2014</u>	<u>6</u>
<u>Notes to Consolidated Financial Statements</u>	<u>7</u>
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>25</u>
Item 3. Quantitative and Qualitative Disclosures About Market Risk	
<u>See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations"</u>	<u>36</u>
Item 4. Controls and Procedures	
<u>Controls and Procedures</u>	<u>36</u>

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2015 AND 2014
(unaudited)
(in millions, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,		
	2015	2014	2015	2014	
Net revenues	\$1,925	\$1,902	\$3,764	\$3,648	
Operating costs and expenses:					
Cost of services	1,182	1,174	2,345	2,275	
Selling, general and administrative	429	440	848	855	
Amortization of intangible assets	20	25	41	47	
Other operating (income) expense, net	(7	) 1	1	1	
Total operating costs and expenses	1,624	1,640	3,235	3,178	
Operating income	301	262	529	470	
Other income (expense):					
Interest expense, net	(37	) (42	) (82	) (81	)
Equity in earnings of equity method investees	7	6	14	12	
Other (expense) income, net	(64	) 3	(142	) 4	
Total non-operating expenses, net	(94	) (33	) (210	) (65	)
Income before income taxes	207	229	319	405	
Income tax expense	78	87	120	152	
Net income	129	142	199	253	
Less: Net income attributable to noncontrolling interests	11	9	20	16	
Net income attributable to Quest Diagnostics	\$118	\$133	\$179	\$237	
Earnings per share attributable to Quest Diagnostics' common stockholders:					
Basic	\$0.82	\$0.92	\$1.24	\$1.64	
Diluted	\$0.81	\$0.92	\$1.23	\$1.63	
Weighted average common shares outstanding:					
Basic	144	144	144	144	
Diluted	145	145	145	145	
Dividends per common share	\$0.38	\$0.33	\$0.76	\$0.66	

The accompanying notes are an integral part of these statements.

2

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2015 AND 2014

(unaudited)

(in millions)

	Three Months Ended June 30,		Six Months Ended June 30,		
	2015	2014	2015	2014	
Net income	\$129	\$142	\$199	\$253	
Other comprehensive income (loss):					
Currency translation	4	3	(2	) 2	
Market valuation, net of tax	—	3	2	3	
Net deferred loss on cash flow hedges, net of tax	1	(3	) 2	(5	)
Other comprehensive income	5	3	2	—	
Comprehensive income	134	145	201	253	
Less: Comprehensive income attributable to noncontrolling interests	11	9	20	16	
Comprehensive income attributable to Quest Diagnostics	\$123	\$136	\$181	\$237	
The accompanying notes are an integral part of these statements.					

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

JUNE 30, 2015 AND DECEMBER 31, 2014

(unaudited)

(in millions, except per share data)

	June 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 150	\$ 192
Accounts receivable, net of allowance for doubtful accounts of \$265 and \$250 at June 30, 2015 and December 31, 2014, respectively	937	932
Inventories	109	110
Deferred income taxes	161	169
Prepaid expenses and other current assets	173	200
Total current assets	1,530	1,603
Property, plant and equipment, net	906	933
Goodwill	5,987	6,032
Intangible assets, net	1,022	1,071
Other assets	219	218
Non-current assets held for sale	56	—
Total assets	\$9,720	\$9,857
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 1,074	\$ 1,191
Current portion of long-term debt	168	518
Total current liabilities	1,242	1,709
Long-term debt	3,568	3,224
Other liabilities	566	594
Stockholders' equity:		
Quest Diagnostics stockholders' equity:		
Common stock, par value \$0.01 per share; 600 shares authorized at both June 30, 2015 and December 31, 2014; 216 shares and 215 shares issued at June 30, 2015 and December 31, 2014, respectively	2	2
Additional paid-in capital	2,444	2,418
Retained earnings	5,793	5,723
Accumulated other comprehensive loss	(25	) (27
Treasury stock, at cost; 72 shares and 71 shares at June 30, 2015 and December 31, 2014, respectively	(3,900	) (3,815
Total Quest Diagnostics stockholders' equity	4,314	4,301
Noncontrolling interests	30	29
Total stockholders' equity	4,344	4,330

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Total liabilities and stockholders' equity	\$9,720	\$9,857
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The accompanying notes are an integral part of these statements.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2015 AND 2014
(unaudited)
(in millions)

	Six Months Ended June 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$199	\$253
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	153	156
Provision for doubtful accounts	158	148
Deferred income tax benefit	(5	) (26
Stock-based compensation expense	27	25
Excess tax benefits from stock-based compensation arrangements	(3	) —
Other, net	(5	) (2
Changes in operating assets and liabilities:		
Accounts receivable	(163	) (191
Accounts payable and accrued expenses	(49	) (39
Income taxes payable	17	44
Other assets and liabilities, net	(2	) (4
Net cash provided by operating activities	327	364
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(6	) (723
Capital expenditures	(117	) (117
Increase in investments and other assets	—	(1
Net cash used in investing activities	(123	) (841
Cash flows from financing activities:		
Proceeds from borrowings	1,829	1,738
Repayments of debt	(1,821	) (1,159
Purchases of treasury stock	(149	) (57
Exercise of stock options	55	30
Excess tax benefits from stock-based compensation arrangements	3	—
Dividends paid	(103	) (91
Distributions to noncontrolling interests	(19	) (14
Other financing activities, net	(41	) (13
Net cash (used in) provided by financing activities	(246	) 434
Net change in cash and cash equivalents	(42	) (43
Cash and cash equivalents, beginning of period	192	187
Cash and cash equivalents, end of period	\$150	\$144
The accompanying notes are an integral part of these statements.		

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2015 AND 2014

(unaudited)

(in millions)

	Quest Diagnostics Stockholders' Equity							
	Shares of Common Stock Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Compre- hensive Loss	Treasury Stock, at Cost	Non- controlling Interests	Total Stock- holders', Equity
Balance, December 31, 2014	144	\$2	\$2,418	\$5,723	\$ (27)	\$ (3,815)	\$29	\$4,330
Net income				179			20	199
Other comprehensive income, net of tax					2			2
Dividends declared				(109)				(109)
Distributions to noncontrolling interests							(19)	(19)
Issuance of common stock under benefit plans	1		4			7		11
Stock-based compensation expense			25			2		27
Exercise of stock options	1					55		55
Shares to cover employee payroll tax withholdings on stock issued under benefit plans			(6)					(6)
Tax benefits associated with stock-based compensation plans			3					3
Purchases of treasury stock	(2)					(149)		(149)
Balance, June 30, 2015	144	\$2	\$2,444	\$5,793	\$ (25)	\$ (3,900)	\$30	\$4,344

	Quest Diagnostics Stockholders' Equity							
	Shares of Common Stock Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Compre- hensive Loss	Treasury Stock, at Cost	Non- controlling Interests	Total Stock- holders', Equity
Balance, December 31, 2013	144	\$2	\$2,379	\$5,358	\$ (8)	\$ (3,783)	\$25	\$3,973
Net income				237			16	253

Other comprehensive income, net of tax				—				—
Dividends declared			(95	)				(95)
Distributions to noncontrolling interests						(14	)	(14)
Issuance of common stock under benefit plans	1				9			9
Stock-based compensation expense		23			2			25
Exercise of stock options		(3	)		33			30
Shares to cover employee payroll tax withholdings on stock issued under benefit plans		(5	)					(5)
Purchases of treasury stock	(1	)			(57	)		(57)
Balance, June 30, 2014	144	\$2	\$2,394	\$5,500	\$ (8	)	\$(3,796)	\$27
The accompanying notes are an integral part of these statements.								

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(dollars in millions unless otherwise indicated)

1. DESCRIPTION OF BUSINESS

Background

Quest Diagnostics Incorporated and its subsidiaries ("Quest Diagnostics" or the "Company") empower people to take action to improve health outcomes. The Company uses its extensive database of clinical lab results to derive diagnostic insights that reveal new avenues to identify and treat disease, inspire healthy behaviors and improve healthcare management. The Company's diagnostic information services business ("DIS") provides insights through clinical testing and related services to patients, physicians, hospitals, accountable care organizations ("ACOs"), integrated delivery networks ("IDNs"), health plans, employers and others. The Company offers the broadest access in the United States to diagnostic information services through its nationwide network of laboratories, Company-owned patient service centers and phlebotomists in physician offices. The Company is the world's leading provider of diagnostic information services, including routine clinical testing, gene-based and esoteric testing, anatomic pathology services and drugs-of-abuse testing, as well as related services and insights. The Company provides interpretive consultation through the organization, with one of the largest medical and scientific staffs in the industry and hundreds of M.D.s and Ph.D.s, many of whom are recognized leaders in their fields. The Company's Diagnostic Solutions ("DS") businesses offer a variety of solutions for life insurers, healthcare providers and others. The Company is the leading provider of risk assessment services for the life insurance industry as well as a leading provider of central laboratory testing for clinical trials (see Note 6 regarding assets held for sale). The Company's diagnostics products business manufactures and markets diagnostic products. In addition, the Company offers healthcare organizations, clinicians and patients robust information technology solutions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The interim unaudited consolidated financial statements reflect all adjustments which in the opinion of management are necessary for a fair statement of results of operations, comprehensive income, financial condition, cash flows and stockholders' equity for the periods presented. Except as otherwise disclosed, all such adjustments are of a normal recurring nature. Operating results for the interim periods are not necessarily indicative of the results that may be expected for the full year. These interim unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's 2014 Annual Report on Form 10-K. The year-end balance sheet data was derived from the audited financial statements as of December 31, 2014, but does not include all the disclosures required by accounting principles generally accepted in the United States ("GAAP").

As a result of the early adoption of the accounting standard update ("ASU") associated with classification of debt issuance costs, certain reclassifications have been made to the prior period financial statements to conform with the current period presentation. For further details regarding the impact of the ASU, see Adoption of New Accounting Standards.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities

at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Earnings Per Share

The Company's unvested restricted stock units that contain non-forfeitable rights to dividends are participating securities and, therefore, are included in the earnings allocation in computing earnings per share using the two-class method. Basic earnings per common share is calculated by dividing net income, adjusted for earnings allocated to participating securities, by the weighted average number of common shares outstanding. Diluted earnings per common share is calculated by dividing net income, adjusted for earnings allocated to participating securities, by the weighted average number of common shares outstanding after giving effect to all potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include the dilutive effect of outstanding stock options and performance share units granted under the

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

Company's Amended and Restated Employee Long-Term Incentive Plan and its Amended and Restated Non-Employee Director Long-Term Incentive Plan. Earnings allocable to participating securities include the portion of dividends declared as well as the portion of undistributed earnings during the period allocable to participating securities.

Adoption of New Accounting Standards

On January 1, 2015, the Company adopted a new accounting standard issued by the Financial Accounting Standards Board ("FASB") related to the presentation and reporting of discontinued operations, including the disposals of components of an entity. The standard changes the criteria for reporting discontinued operations and requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. The new standard also requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. The impact of this standard on the Company's results of operations, financial position, cash flows and disclosures will be assessed as part of any future disposal activity.

In April 2015, the FASB issued an ASU which requires that debt issuance costs be presented in the balance sheet as a direct reduction to the carrying amount of the associated debt liability, consistent with debt discounts. The Company adopted this standard in the second quarter of 2015, which has been applied retrospectively. Adoption of this standard has resulted in the reclassification of \$20 million of unamortized debt issuance costs from other assets to a reduction of long-term debt on the consolidated balance sheet at December 31, 2014.

New Accounting Pronouncements

In May 2014, the FASB issued an ASU on revenue recognition. This ASU outlines a single comprehensive model to use in accounting for revenue arising from contracts with customers. This standard supersedes existing revenue recognition requirements and eliminates most industry-specific guidance from GAAP. The core principle of the revenue recognition standard is to require an entity to recognize as revenue the amount that reflects the consideration to which it expects to be entitled in exchange for goods or services as it transfers control to its customers. The standard requires additional disclosures including those that are qualitative and quantitative disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In July 2015, the FASB voted to defer the effective date of this ASU to the first quarter of 2018, with early adoption permitted beginning in the first quarter of 2017. The ASU can be applied using a full retrospective method or a modified retrospective method of adoption. The Company is currently assessing the impact of the adoption of this ASU on the Company's results of operations, financial position and cash flows.

In February 2015, the FASB issued an ASU which makes targeted amendments to the current consolidation guidance for variable interest entities and limited partnerships and similar entities. The ASU is effective for the Company in the first quarter of 2016 with the option of using a full retrospective or a modified retrospective method. The Company does not expect the adoption of this standard to have a material impact on its results of operations, financial position, and cash flows.

In April 2015, the FASB issued an ASU which provides guidance in determining whether a cloud computing arrangement includes a software license. If it is determined that a cloud computing arrangement does include a

software license, the software element of the arrangement should be accounted for consistent with the acquisition of other software licenses. If the arrangement does not include a software license, it should be accounted for as a service contract. The ASU is effective for the Company in the first quarter of 2016 and can be applied prospectively to all arrangements entered into or materially modified after the effective date or retrospectively. The Company does not expect the adoption of this ASU to have a material impact on its results of operations, financial position and cash flows.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

3. EARNINGS PER SHARE

The computation of basic and diluted earnings per common share was as follows (in millions, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Amounts attributable to Quest Diagnostics' stockholders:				
Net income attributable to Quest Diagnostics	\$ 118	\$ 133	\$ 179	\$ 237
Less: Earnings allocated to participating securities	1	—	1	1
Earnings available to Quest Diagnostics' common stockholders – basic and diluted	\$ 117	\$ 133	\$ 178	\$ 236
Weighted average common shares outstanding – basic	144	144	144	144
Effect of dilutive securities:				
Stock options and performance share units	1	1	1	1
Weighted average common shares outstanding – diluted	145	145	145	145
Earnings per share attributable to Quest Diagnostics' common stockholders:				
Basic	\$0.82	\$0.92	\$1.24	\$1.64
Diluted	\$0.81	\$0.92	\$1.23	\$1.63

The following securities were not included in the calculation of diluted earnings per share due to their antidilutive effect (shares in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Stock options and performance share units	2	3	2	4

4. RESTRUCTURING ACTIVITIES

Invigorate Program

During 2012, the Company committed to a course of action related to a multi-year program called Invigorate which is designed to reduce its cost structure. Invigorate has consisted of several flagship programs, with structured plans in each, to drive savings and improve performance across the customer value chain. These flagship programs include: organization excellence; information technology excellence; procurement excellence; service excellence; lab excellence; and billing excellence. From 2012 through 2014, the Invigorate program was intended to partially offset reimbursement pressures and labor and benefit cost increases; free up additional resources to invest in science, innovation and other growth initiatives; and enable us to improve service quality and operating profitability.

In January 2015, the Company adopted a course of action related to its multi-year Invigorate program to further reduce its cost structure through 2017. This multi-year course of action continues to focus on the flagship program opportunities and new key opportunities such as: standardizing processes, information technology systems, equipment and data; enhancing electronic enabling services; and enhancing reimbursement for work performed. The estimated pre-tax charges expected to be incurred in 2015 in connection with this course of action are: \$25 million to \$30 million of employee separation costs and \$10 million to \$15 million of facility-related costs and asset impairment charges.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

The following table provides a summary of the Company's pre-tax restructuring charges associated with its Invigorate program and other restructuring activities for the three and six months ended June 30, 2015 and 2014:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Employee separation costs	\$6	\$6	\$21	\$14
Facility-related costs	—	3	—	4
Asset impairment charges	—	1	—	1
 Total restructuring charges	 \$6	 \$10	 \$21	 \$19

Total restructuring charges incurred for the three and six months ended June 30, 2015 are primarily associated with various workforce reduction initiatives as the Company continues to simplify and restructure its organization. Of the total \$6 million in restructuring charges incurred during the three months ended June 30, 2015, \$4 million and \$2 million were recorded in cost of services and selling, general and administrative expenses, respectively. Of the total \$21 million in restructuring charges incurred during the six months ended June 30, 2015, \$17 million and \$4 million were recorded in cost of services and selling, general and administrative expenses, respectively.

Total restructuring charges incurred for the three and six months ended June 30, 2014 are primarily associated with various workforce reduction initiatives as the Company continued to simplify and restructure its organization. Of the total \$10 million in restructuring charges incurred during the three months ended June 30, 2014, \$4 million and \$6 million were recorded in cost of services and selling, general and administrative expenses, respectively. Of the total \$19 million in restructuring charges incurred during the six months ended June 30, 2014, \$12 million and \$7 million were recorded in cost of services and selling, general and administrative expenses, respectively.

Charges for all periods presented were primarily recorded in the Company's DIS business.

The following table summarizes activity in the restructuring liability as of June 30, 2015:

	Employee Separation Costs	Facility-Related Costs	Total
Balance, December 31, 2014	\$18	\$ 11	\$29
Current period charges	21	—	21
Less:			
Cash payments	(19	) (3	) (22
Other / adjustments	—	(3	) (3
Balance, June 30, 2015	\$20	\$ 5	\$25

5. BUSINESS ACQUISITIONS

In the first quarter of 2015, the Company finalized the purchase price allocations associated with the 2014 acquisitions of Solstas Lab Partners Group ("Solstas") and Summit Health, Inc. ("Summit Health"). The purchase price allocation adjustments recorded in 2015 were not material. For further details regarding the Company's 2014 acquisitions, see Note 5 to the consolidated financial statements in the Company's 2014 Annual Report on Form 10-K. For further details regarding the fair value of the estimated contingent consideration associated with the Summit Health and Steward Health Care Systems, LLC ("Steward") acquisitions, see Note 7.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

6. ASSETS HELD FOR SALE

On March 30, 2015, the Company entered into a definitive agreement with Quintiles Transnational Holdings Inc. to form a global clinical trials central laboratory services joint venture, Q² Solutions. The transaction closed on July 1, 2015. In connection with the transaction, the Company contributed certain assets of its clinical trials testing business ("Clinical Trials") to the newly formed joint venture in exchange for a non-controlling, 40% ownership interest.

The assets of Clinical Trials that will be contributed to the joint venture, principally consisting of property, plant and equipment, net and goodwill, are classified as non-current assets held for sale in the consolidated balance sheet at June 30, 2015. The Company expects to recognize a non-cash gain based on the difference between the fair value of the Company's equity interest in the newly formed joint venture over the carrying value of the assets contributed. The non-cash gain, which is currently being determined, will be recorded in the third quarter of 2015 and is expected to be material to the Company's results of operations.

Clinical Trials, which is included in all other operating segments, has not been classified as discontinued operations. For further details regarding business segment information, see Note 14.

7. FAIR VALUE MEASUREMENTS

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table provides a summary of the recognized assets and liabilities that are measured at fair value on a recurring basis:

		Basis of Fair Value Measurements		
		Quoted Prices in Active Markets for Identical Assets / Liabilities	Significant Other Observable Inputs	Significant Unobservable Inputs
June 30, 2015	Total	Level 1	Level 2	Level 3
Assets:				
Trading securities	\$48	\$48	\$—	\$—
Cash surrender value of life insurance policies	30	—	30	—
Interest rate swaps	15	—	15	—
Available-for-sale equity securities	10	10	—	—
Total	\$103	\$58	\$45	\$—
Liabilities:				
Deferred compensation liabilities	\$84	\$—	\$84	\$—
Interest rate swaps	12	—	12	—
Call option	4	—	—	4

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Contingent consideration	3	—	—	3
Total	\$ 103	\$—	\$96	\$7

11

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

		Basis of Fair Value Measurements		
		Quoted Prices in Active Markets for Identical Assets / Liabilities	Significant Other Observable Inputs	Significant Unobservable Inputs
December 31, 2014	Total	Level 1	Level 2	Level 3
Assets:				
Trading securities	\$49	\$49	\$—	\$—
Cash surrender value of life insurance policies	30	—	30	—
Interest rate swaps	17	—	17	—
Available-for-sale equity securities	9	9	—	—
Put option	1	—	—	1
Total	\$106	\$58	\$47	\$1
Liabilities:				
Deferred compensation liabilities	\$85	\$—	\$85	\$—
Contingent consideration	17	—	—	17
Forward starting interest rate swaps	15	—	15	—
Interest rate swaps	13	—	13	—
Call option	5	—	—	5
Total	\$135	\$—	\$113	\$22

A full description regarding the Company's fair value measurements is contained in Note 7 to the consolidated financial statements in the Company's 2014 Annual Report on Form 10-K.

The Company offers certain employees the opportunity to participate in non-qualified supplemental deferred compensation plans. A participant's deferrals, together with Company matching credits, are invested in a variety of participant-directed stock and bond mutual funds that are classified as trading securities. Changes in the fair value of these securities are measured using quoted prices in active markets based on the market price per unit multiplied by the number of units held exclusive of any transaction costs. A corresponding adjustment for changes in fair value of the trading securities is also reflected in the changes in fair value of the deferred compensation obligation. The deferred compensation liabilities are classified within Level 2 because their inputs are derived principally from observable market data by correlation to the trading securities.

The Company offers certain employees the opportunity to participate in a non-qualified deferred compensation program. A participant's deferrals, together with Company matching credits, are “invested” at the direction of the employee in a hypothetical portfolio of investments which are tracked by an administrator. The Company purchases life insurance policies, with the Company named as beneficiary of the policies, for the purpose of funding the program's liability. Changes in the cash surrender value of the life insurance policies are based upon earnings and

changes in the value of the underlying investments. Changes in the fair value of the deferred compensation obligation are derived using quoted prices in active markets based on the market price per unit multiplied by the number of units. The cash surrender value and the deferred compensation obligations are classified within Level 2 because their inputs are derived principally from observable market data by correlation to the hypothetical investments.

The fair value measurements of the Company's interest rate swaps and forward starting swaps are model-derived valuations as of a given date in which all significant inputs are observable in active markets including certain financial information and certain assumptions regarding past, present and future market conditions.

Investment in available-for-sale equity securities represents an investment in registered shares of a publicly-held company listed on the Euronext Paris exchange. The Company's investment in available-for-sale equity securities is classified within Level 1 of the fair value hierarchy because the fair value is obtained from quoted prices in an active market.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

In connection with the acquisition of certain businesses from UMass Memorial Medical Center ("UMass"), the Company granted to UMass a call option and UMass granted to the Company a put option for UMass to acquire an 18.90% equity interest in a newly formed entity. The put and call options are derivative instruments whose fair values have been measured using a combination of discounted cash flows and the Black-Scholes-Merton option pricing model. During the second quarter of 2015, UMass provided notice of its intention to exercise its call option and the transaction closed effective July 1, 2015. The put option expired unexercised. For further details on the exercise of the call option and closing of the transaction, see Note 15.

In April 2014, and as further detailed in Note 5 to the consolidated financial statements in the Company's 2014 Annual Report on Form 10-K, the Company completed the acquisitions of Summit Health and Steward. In connection with these acquisitions the Company initially recorded an aggregate contingent consideration liability of \$26 million. The contingent consideration liability was classified within Level 3 measured at fair value using a probability weighted and discounted cash flow method. These measurements are based on externally obtained inputs and management's probability assessments of the occurrence of triggering events, appropriately discounted considering the uncertainties associated with the obligations, as well as the likelihood of achieving financial targets. The initial probability estimate of the occurrence of such triggering events associated with the amounts the Company could be obligated to pay in future periods for both Summit Health and Steward was between 5% and 95%. The probability-weighted cash flows were then discounted using a discount rate of 1.5% to 2.8%. The estimated fair value of the contingent consideration associated with Summit Health was reduced to \$13 million in the fourth quarter of 2014 and \$0 in the second quarter of 2015. These reductions were a result of updated revenue forecasts for 2015 compared to the earn-out target included in the contingent consideration arrangement. The contingent consideration associated with Summit Health, if earned, would be paid in the first quarter of 2016, with a maximum payment of \$25 million. The remaining contingent consideration associated with Steward is projected to be paid out in three equal annual installments, with a maximum payout of \$4 million in total.

The following table provides a reconciliation of the beginning and ending balances of assets and liabilities using significant unobservable inputs (Level 3):

	Assets Put Option Derivative Asset	Liabilities Contingent Consideration	Call Option Derivative Liability	Total Liabilities
Balance, December 31, 2014	1	\$17	5	\$22
Settlements	—	(1	) —	(1
Total gains/losses - realized/unrealized:				
Included in earnings	(1	) (13	) (1	) (14
Balance, June 30, 2015	\$—	\$3	\$4	\$7

The \$13 million gain included in earnings associated with the change in the fair value of contingent consideration for the three and six months ended June 30, 2015 is reported in other operating (income) expense, net.

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable and accrued expenses approximate fair value based on the short maturities of these instruments. At June 30, 2015, the fair value of the Company's debt was estimated at \$3.8 billion, which exceeded the carrying value by \$84 million. At December 31,

2014, the fair value of the Company's debt was estimated at \$4.2 billion, which exceeded the carrying value by \$416 million. Principally all of the Company's debt is classified within Level 1 of the fair value hierarchy because the fair value of the debt is estimated based on rates currently offered to the Company with identical terms and maturities, using quoted active market prices and yields, taking into account the underlying terms of the debt instruments.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

8. GOODWILL AND INTANGIBLE ASSETS

The changes in goodwill for the six months ended June 30, 2015 and for the year ended December 31, 2014 are as follows:

	June 30, 2015	December 31, 2014
Balance, beginning of period	\$6,032	\$5,649
Goodwill acquired during the period	2	383
Reclassification to assets held for sale	(47	) —
Balance, end of period	\$5,987	\$6,032

Principally all of the Company's goodwill as of June 30, 2015 and December 31, 2014 is associated with its DIS business.

For the six months ended June 30, 2015, reclassification to assets held for sale was principally associated with Clinical Trials. For further details regarding assets held for sale, see Note 6.

For the year ended December 31, 2014, goodwill acquired was principally associated with the Solstas, Summit Health, and Steward acquisitions. Acquisitions during 2014 also resulted in \$270 million of intangible assets, principally comprised of customer-related intangibles and trade names. For further details regarding the Company's 2014 acquisitions, see Note 5 to the consolidated financial statements in the Company's 2014 Annual Report on Form 10-K.

Intangible assets at June 30, 2015 and December 31, 2014 consisted of the following:

	Weighted Average Amortization Period (in years)	June 30, 2015			December 31, 2014		
		Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Amortizing intangible assets:							
Customer-related intangibles	19	\$923	\$(278	) \$645	\$929	\$(259	) \$670
Non-compete agreements	5	6	(3	) 3	43	(37	) 6
Technology	14	117	(43	) 74	118	(38	) 80
Other	8	119	(64	) 55	152	(82	) 70
Total	17	1,165	(388	) 777	1,242	(416	) 826
Intangible assets not subject to amortization:							
Trade names		244	—	244	244	—	244
Other		1	—	1	1	—	1

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Total intangible assets	\$1,410	\$(388	) \$1,022	\$1,487	\$(416	) \$1,071
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As of June 30, 2015, a fully amortized contractual non-compete agreement (cost of \$37 million and accumulated amortization of \$37 million) that expired was written-off.

Amortization expense related to intangible assets was \$20 million and \$25 million for the three months ended June 30, 2015 and 2014, respectively. For the six months ended June 30, 2015 and 2014, amortization expense related to intangible assets was \$41 million and \$47 million, respectively.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

The estimated amortization expense related to amortizable intangible assets for each of the five succeeding fiscal years and thereafter as of June 30, 2015 is as follows:

Year Ending December 31,	
Remainder of 2015	\$39
2016	71
2017	67
2018	63
2019	62
2020	62
Thereafter	413
Total	\$777

9. DEBT

Long-term Debt

Long-term debt at June 30, 2015 and December 31, 2014 consisted of the following:

	June 30, 2015	December 31, 2014
Secured Receivables Credit Facility (0.88% at June 30, 2015)	\$85	\$—
5.45% Senior Notes due November 2015	—	500
3.20% Senior Notes due April 2016	151	304
6.40% Senior Notes due July 2017	—	375
2.70% Senior Notes due April 2019	300	300
4.75% Senior Notes due January 2020	523	524
2.50% Senior Notes due March 2020	299	—
4.70% Senior Notes due April 2021	550	549
4.25% Senior Notes due April 2024	309	311
3.50% Senior Notes due March 2025	597	—
6.95% Senior Notes due July 2037	247	421
5.75% Senior Notes due January 2040	368	439
4.70% Senior Notes due March 2045	300	—
Other	34	39
Debt issuance costs	(27)	(20)
Total long-term debt	3,736	3,742
Less: Current portion of long-term debt	168	518
Total long-term debt, net of current portion	\$3,568	\$3,224

Current Portion of Long-Term Debt

At June 30, 2015, current portion of long-term debt was principally comprised of the 3.20% Senior Notes due April 2016. At December 31, 2014, current portion of long-term debt was principally comprised of the 5.45% Senior Notes due November 2015.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

2015 Senior Notes Offering

In March 2015, the Company completed a \$1.2 billion senior notes offering (the “2015 Senior Notes”) that was sold in three tranches: (a) \$300 million aggregate principal amount of 2.50% senior notes due March 2020, issued at a discount of \$1 million; (b) \$600 million aggregate principal amount of 3.50% senior notes due March 2025; and (c) \$300 million aggregate principal amount of 4.70% senior notes due March 2045. These senior notes are unsecured obligations of the Company and rank equally with the Company's other senior unsecured obligations. None of the Company's senior notes have a sinking fund requirement.

The Company incurred \$11 million of costs associated with the 2015 Senior Notes, which is included as a reduction to the carrying amount of long-term debt and is being amortized over the term of the related debt.

Retirement of Debt

In March 2015, the Company commenced a cash tender offer to purchase up to \$250 million aggregate principal amount of its 6.95% Senior Notes due July 2037 and 5.75% Senior Notes due January 2040 using a portion of the proceeds from the 2015 Senior Notes. The Company repurchased \$176 million of its 6.95% Senior Notes due July 2037 and \$74 million of its 5.75% Senior Notes due January 2040. In April 2015, the Company redeemed all of the 5.45% Senior Notes due November 2015, \$150 million of the 3.2% Senior Notes due April 2016 and all of the 6.4% Senior Notes due July 2017 with the remaining proceeds from the 2015 Senior Notes. For the three and six months ended June 30, 2015, the Company recorded a loss on retirement of debt in other (expense) income, net of \$65 million and \$144 million, respectively, principally comprised of premiums paid in connection with these transactions.

Maturities of Long-Term Debt

As of June 30, 2015, long-term debt matures as follows:

Year Ending December 31,		
Remainder of 2015	\$ 12	
2016	244	
2017	6	
2018	4	
2019	302	
2020	801	
Thereafter	2,375	
Total maturities of long-term debt	3,744	
Unamortized discount	(17	)
Debt issuance costs	(27	)
Fair value basis adjustments attributable to hedged debt	36	
Total long-term debt	3,736	

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Less: Current portion of long-term debt	168
Total long-term debt, net of current portion	\$ 3,568

For further discussion regarding the Company's debt, see Note 13 to the consolidated financial statements in the Company's 2014 Annual Report on Form 10-K.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

10. FINANCIAL INSTRUMENTS

The Company uses derivative financial instruments to manage its exposure to market risks for changes in interest rates and, from time to time, foreign currencies. This strategy includes the use of interest rate swap agreements, forward starting interest rate swap agreements, treasury lock agreements and foreign currency forward contracts to manage its exposure to movements in interest and currency rates. The Company has established policies and procedures for risk assessment and the approval, reporting and monitoring of derivative financial instrument activities. These policies prohibit holding or issuing derivative financial instruments for speculative purposes. The Company does not enter into derivative financial instruments that contain credit-risk-related contingent features or requirements to post collateral.

Interest Rate Risk

The Company is exposed to interest rate risk on its cash and cash equivalents and its debt obligations. Interest income earned on cash and cash equivalents may fluctuate as interest rates change; however, due to their relatively short maturities, the Company does not hedge these assets or their investment cash flows and the impact of interest rate risk is not material. The Company's debt obligations consist of fixed-rate and variable-rate debt instruments. The Company's primary objective is to achieve the lowest overall cost of funding while managing the variability in cash outflows within an acceptable range. In order to achieve this objective, the Company has entered into interest rate swaps. Interest rate swaps involve the periodic exchange of payments without the exchange of underlying principal or notional amounts. Net settlements between the counterparties are recognized as an adjustment to interest expense.

Interest Rate Derivatives – Cash Flow Hedges

From time to time, the Company has entered into various interest rate lock agreements and forward starting interest rate swap agreements to hedge part of the Company's interest rate exposure associated with the variability in future cash flows attributable to changes in interest rates.

During the fourth quarter of 2013 and first quarter of 2014, the Company entered into various forward starting interest rate swap agreements for an aggregate notional amount of \$150 million which were accounted for as cash flow hedges. In connection with the issuance of the 2015 Senior Notes, all of these agreements were settled and the Company paid \$17 million. These losses are deferred in stockholders' equity, net of income taxes, as a component of accumulated other comprehensive loss, and amortized as an adjustment to interest expense over the term of the Senior Notes due 2025.

In March 2015, the Company entered into interest rate lock agreements with several financial institutions for a total notional amount of \$350 million which were accounted for as cash flow hedges. These agreements were entered into to hedge a portion of the Company's interest rate exposure associated with variability in future cash flows attributable to changes in the five-year, ten-year and thirty-year treasury rates related to the planned issuance of the 2015 Senior Notes. In connection with the issuance of the 2015 Senior Notes, these agreements were settled and the Company received \$3 million. These gains are deferred in stockholders' equity, net of income taxes, as a component of accumulated other comprehensive loss, and amortized as an adjustment to interest expense over the term of the respective senior notes.

The total net loss, net of taxes, recognized in accumulated other comprehensive loss, related to the Company's cash flow hedges as of June 30, 2015 and December 31, 2014 was \$13 million and \$15 million, respectively. The loss recognized on the Company's cash flow hedges for the three and six months ended June 30, 2015 and 2014, as a result of ineffectiveness, was not material. The net amount of deferred losses on cash flow hedges that is expected to be reclassified from accumulated other comprehensive loss into interest expense, net within the next twelve months is \$3 million.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

Interest Rate Derivatives – Fair Value Hedges

The Company maintains various fixed-to-variable interest rate swaps to convert a portion of the Company's long-term debt into variable interest rate debt. A summary of the notional amounts of these interest rate swaps as of June 30, 2015 and December 31, 2014 is as follows:

Debt Instrument	Floating Rate Paid by the Company	Notional Amount	
		June 30, 2015	December 31, 2014
3.20% Senior Notes due April 2016	Six-month LIBOR plus a 2.3% spread	\$—	\$200
4.75% Senior Notes due January 2020	One-month LIBOR plus a 3.6% spread	350	350
4.70% Senior Notes due April 2021	One-month LIBOR plus a 2.45% to 3.39% spread	400	400
4.25% Senior Notes due April 2024	One-month LIBOR plus a 1.54% to 1.59% spread	250	250
3.50% Senior Notes due March 2025	One-month LIBOR plus a 1.44% spread	200	—
		\$1,200	\$1,200

In April 2015, the Company terminated the outstanding interest rate swaps associated with the Senior Notes due 2016. The value of these interest rate swaps at the date of termination was not material. The net amount of losses on fair value hedges related to the Senior Notes due 2016 reclassified into earnings upon redemption for the three and six months ended June 30, 2015 was not material.

Since inception, the fair value hedges have been effective or highly effective; therefore, there is no impact on earnings for the three and six months ended June 30, 2015 and 2014 as a result of hedge ineffectiveness.

Interest Rate Derivatives - Economic Hedges

In March 2015, in connection with the cash tender offer and redemption discussed in Note 9, the Company entered into reverse interest rate lock agreements with several financial institutions which were not designated for hedge accounting. The Company entered into these agreements to hedge the variability in cash flows associated with \$280 million of the \$1.3 billion principal amount of debt that was retired in the first and second quarters of 2015. Certain of these agreements were settled during the first quarter of 2015 which resulted in a gain of \$3 million which was recognized in other (expense) income, net. The remaining agreements were settled in the second quarter of 2015 and the gain for the period ended June 30, 2015 was not material.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

A summary of the fair values of derivative instruments in the consolidated balance sheets is stated in the table below:

	June 30, 2015 Balance Sheet Classification	Fair Value	December 31, 2014 Balance Sheet Classification	Fair Value
Derivatives Designated as Hedging Instruments				
Asset Derivatives:				
Interest rate swaps	Other assets	\$ 15	Other assets	\$ 17
Liability Derivatives:				
Interest rate swaps	Other liabilities	12	Other liabilities	13
Forward starting interest rate swaps		—	Other liabilities	15
Total Liability Derivatives		12		28
Derivatives Not Designated as Hedging Instruments				
Asset Derivatives:				
Put option		—	Prepaid expenses and other current assets	1
Liability Derivatives:				
Call option	Accounts payable and accrued expenses	4	Accounts payable and accrued expenses	5
Total Net Derivatives (Liabilities)		\$(1)		\$(15)

A full description regarding the Company's use of derivative financial instruments is contained in Note 14 to the consolidated financial statements in the Company's 2014 Annual Report on Form 10-K.

11. STOCKHOLDERS' EQUITY

Components of Comprehensive Income

The market valuation adjustments represent unrealized holding gains (losses) on available-for-sale securities, net of taxes. The net deferred loss on cash flow hedges represents deferred losses on the Company's interest rate related derivative financial instruments designated as cash flow hedges, net of amounts reclassified to interest expense (see Note 10). For the three and six months ended June 30, 2015 and 2014, the tax effects related to the market valuation adjustments and deferred losses were not material. Foreign currency translation adjustments are not adjusted for income taxes since they relate to indefinite investments in non-U.S. subsidiaries.

Dividend Program

During the first and second quarters of 2015, the Company's Board of Directors declared a quarterly cash dividend of \$0.38 per common share. During each of the quarters of 2014, the Company's Board of Directors declared a quarterly cash dividend of \$0.33 per common share.

Share Repurchase Program

At June 30, 2015, \$547 million remained available under the Company's share repurchase authorizations. The share repurchase authorization has no set expiration or termination date.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

For the three months ended June 30, 2015, the Company repurchased 0.6 million shares of its common stock at an average price of \$72.03 per share for \$39 million. For the six months ended June 30, 2015, the Company repurchased 2.1 million shares of its common stock at an average price of \$71.62 per share for \$149 million. For the three and six months ended June 30, 2015, the Company reissued 0.4 million shares and 1.2 million shares, respectively, for employee benefit plans.

For the three months ended June 30, 2014, the Company repurchased 0.4 million shares of its common stock at an average price of \$57.74 per share for a total of \$25 million. For the six months ended June 30, 2014, the Company repurchased 1.0 million shares of its common stock at an average price of \$54.84 per share for a total of \$57 million. For the three and six months ended June 30, 2014, the Company reissued 0.4 million shares and 0.8 million shares, respectively, for employee benefit plans.

12. SUPPLEMENTAL CASH FLOW & OTHER DATA

Supplemental cash flow and other data for the three and six months ended June 30, 2015 and 2014 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Depreciation expense	\$55	\$56	\$112	\$109
Amortization expense	20	25	41	47
Depreciation and amortization expense	\$75	\$81	\$153	\$156
Interest expense	\$(37)	\$(42)	\$(83)	\$(82)
Interest income	—	—	1	1
Interest expense, net	\$(37)	\$(42)	\$(82)	\$(81)
Interest paid	\$45	\$30	\$99	\$82
Income taxes paid	90	129	109	138
Assets acquired under capital leases	2	8	2	10
Accounts payable associated with capital expenditures	9	14	9	14
Dividends payable	\$55	\$48	\$55	\$48
Businesses acquired:				
Fair value of assets acquired	\$2	\$199	\$2	\$845
Fair value of liabilities assumed	—	12	—	82
Fair value of net assets acquired	2	187	2	763
Merger consideration paid (payable), net	4	(30)	4	(30)
Cash paid for business acquisitions	6	157	6	733

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Less: Cash acquired	—	1	—	10
Business acquisitions, net of cash acquired	\$6	\$156	\$6	\$723

20

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

13. COMMITMENTS AND CONTINGENCIES

The Company has a line of credit with a financial institution totaling \$85 million for the issuance of letters of credit (the “Letter of Credit Line”). The Letter of Credit Line, which is renewed annually, matures on November 17, 2015. The Company can also issue letters of credit under its senior unsecured revolving credit facility. For further discussion regarding the Company's senior unsecured revolving credit facility, see Note 13 to the consolidated financial statements in the Company's 2014 Annual Report on Form 10-K.

In support of its risk management program, to ensure the Company's performance or payment to third parties, \$67 million in letters of credit, principally associated with the Letter of Credit Line, were outstanding at June 30, 2015. The letters of credit primarily represent collateral for current and future automobile liability and workers' compensation loss payments.

Contingent Lease Obligations

The Company remains subject to contingent obligations under certain real estate leases that were entered into by certain predecessor companies of a subsidiary prior to the Company's acquisition of the subsidiary. No liability has been recorded for any of these potential contingent obligations. See Note 17 to the consolidated financial statements contained in the Company's 2014 Annual Report on Form 10-K for further details.

Settlements

In 2010, a purported class action entitled *In re Celera Corp. Securities Litigation* was filed in the United States District Court for the Northern District of California against Celera Corporation and certain of its directors and current and former officers. An amended complaint filed in October 2010 alleges that from April 2008 through July 22, 2009, the defendants made false and misleading statements regarding Celera's business and financial results with an intent to defraud investors. The complaint was further amended in 2011 to add allegations regarding a financial restatement. Celera and the director and officer defendants have reached an agreement to settle this action, which the court has preliminarily approved. The settlement is fully covered by insurance.

Legal Matters

The Company is involved in various legal proceedings. Some of the proceedings against the Company involve claims that could be substantial in amount.

In addition to the matters described below, in the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with the Company's activities as a provider of diagnostic testing, information and services. These legal actions may include lawsuits alleging negligence or other similar legal claims. These actions could involve claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages, and could have an adverse impact on the Company's client base and reputation.

The Company is also involved, from time to time, in other reviews, investigations and proceedings by governmental agencies regarding the Company's business, including, among other matters, operational matters, which may result in

adverse judgments, settlements, fines, penalties, injunctions or other relief. The number of these reviews, investigations and proceedings has increased in recent years with regard to many firms in the healthcare services industry, including the Company.

In August 2011, the Company received a subpoena from the U.S. Attorney for the Northern District of Georgia seeking various business records, including records related to the Company's compliance program, certain marketing materials, certain product offerings, and test ordering and other policies. The Company is cooperating with the request.

In June 2010, the Company received a subpoena from the Florida Attorney General's Office seeking documents relating to the Company's pricing and billing practices as they relate to Florida's Medicaid program. The Company cooperated with the requests. In November 2013, the State of Florida intervened as a plaintiff in a civil lawsuit, Florida ex rel. Hunter Laboratories LLC v. Quest Diagnostics Incorporated, et al., filed in Florida Circuit Court. The suit, originally filed by a

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

competitor laboratory, alleges that the Company overcharged Florida's Medicaid program. The Company's motion to dismiss the state's amended complaint was denied.

In April 2015, a qui tam civil lawsuit entitled United States ex rel. Mayes v. Berkeley HeartLab, Inc., et al., filed in the U.S. District Court for the District of South Carolina, was unsealed. The complaint alleges that certain alleged business practices of the defendants violate the False Claims Act, and seeks monetary relief. The United States has intervened as a plaintiff as to Berkeley HeartLab, Inc., a subsidiary of the Company; the United States did not intervene as a plaintiff as to Quest Diagnostics Incorporated. Before the lawsuit was unsealed, Berkeley HeartLab and Quest Diagnostics Incorporated had received subpoenas, civil investigative demands and interrogatories related to the matter.

The federal or state governments may bring claims based on the Company's current practices, which it believes are lawful. In addition, certain federal and state statutes, including the qui tam provisions of the federal False Claims Act, allow private individuals to bring lawsuits against healthcare companies on behalf of government or private payers. The Company is aware of lawsuits, and from time to time has received subpoenas, related to billing practices based on the qui tam provisions of the Civil False Claims Act or other federal and state statutes, regulations or other laws. The Company understands that there may be other pending qui tam claims brought by former employees or other "whistle blowers" as to which the Company cannot determine the extent of any potential liability.

Management cannot predict the outcome of such matters. Although management does not anticipate that the ultimate outcome of such matters will have a material adverse effect on the Company's financial condition, given the high degree of judgment involved in establishing loss estimates related to these types of matters, the outcome of such matters may be material to the Company's results of operations or cash flows in the period in which the impact of such matters is determined or paid.

These matters are in different stages. Some of these matters are in their early stages. Matters may involve responding to and cooperating with various government investigations and related subpoenas. As of June 30, 2015, the Company does not believe that any losses related to the legal matters described above are probable. While the Company believes that a reasonable possibility exists that losses may have been incurred related to the legal matters described above, based on the nature and status of these matters, potential losses, if any, cannot be estimated.

Reserves for Legal Matters

Reserves for legal matters, other than those described above, totaled \$16 million and \$11 million at June 30, 2015 and December 31, 2014, respectively.

Reserves for General and Professional Liability Claims

As a general matter, providers of clinical testing services may be subject to lawsuits alleging negligence or other similar legal claims. These suits could involve claims for substantial damages. Any professional liability litigation could also have an adverse impact on the Company's client base and reputation. The Company maintains various liability insurance coverages for, among other things, claims that could result from providing, or failing to provide, clinical testing services, including inaccurate testing results, and other exposures. The Company's insurance coverage limits its maximum exposure on individual claims; however, the Company is essentially self-insured for a significant

portion of these claims. Reserves for such matters, including those associated with both asserted and incurred but not reported claims, are established by considering actuarially determined losses based upon the Company's historical and projected loss experience. Such reserves totaled approximately \$116 million and \$113 million at June 30, 2015 and December 31, 2014, respectively. Management believes that established reserves and present insurance coverage are sufficient to cover currently estimated exposures. Management cannot predict the outcome of any claims made against the Company. Although management does not anticipate that the ultimate outcome of any such proceedings or claims will have a material adverse effect on the Company's financial condition, given the high degree of judgment involved in establishing accruals for loss estimates related to these types of matters, the outcome may be material to the Company's results of operations or cash flows in the period in which the impact of such claims is determined or paid.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

14. BUSINESS SEGMENT INFORMATION

The Company's DIS business provides insights through clinical testing and related services to patients, physicians, hospitals, ACOs, IDNs, health plans, employers and others. The Company is the world's leading provider of diagnostic information services, including routine clinical testing, gene-based and esoteric testing, anatomic pathology services and drugs-of-abuse testing, as well as related services and insights. The DIS business accounted for greater than 90% of net revenues in 2015 and 2014.

All other operating segments include the Company's DS businesses, which consists of its risk assessment services, clinical trials testing, diagnostic products and healthcare information technology businesses. The Company's DS business offers a variety of solutions for life insurers, healthcare providers and others. The Company provides risk assessment services, testing for clinical trials, robust information technology solutions and diagnostic products.

During 2015, the Company classified certain assets of Clinical Trials, which is included in all other operating segments, as held for sale. For further details regarding assets held for sale, see Note 6.

During 2014, the Company acquired Solstas, Summit Health and Steward which are included in the Company's DIS business.

At June 30, 2015, substantially all of the Company's services are provided within the United States, and substantially all of the Company's assets are located within the United States.

The following table is a summary of segment information for the three and six months ended June 30, 2015 and 2014. Segment asset information is not presented since it is not used by the chief operating decision maker at the operating segment level. Operating earnings (loss) of each segment represents net revenues less directly identifiable expenses to arrive at operating income for the segment. General corporate activities included in the table below are comprised of general management and administrative corporate expenses, amortization or impairment of intangibles assets, other operating income and expenses net of certain general corporate activity costs that are allocated to the DIS and DS businesses. The accounting policies of the segments are the same as those of the Company as set forth in Note 2 to the consolidated financial statements contained in the Company's 2014 Annual Report on Form 10-K and Note 2 to the interim unaudited consolidated financial statements.

Table of Contents

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

(unaudited)

(dollars in millions unless otherwise indicated)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net revenues:				
DIS business	\$1,771	\$1,763	\$3,463	\$3,377
All other operating segments	154	139	301	271
Total net revenues	\$1,925	\$1,902	\$3,764	\$3,648
Operating earnings (loss):				
DIS business	\$302	\$293	\$544	\$524
All other operating segments	30	22	56	40
General corporate activities	(31)	) (53	) (71	) (94
Total operating income	301	262	529	470
Non-operating expenses, net	(94)	) (33	) (210	) (65
Income before income taxes	207	229	319	405
Income tax expense	78	87	120	152
Net income	129	142	199	253
Less: Net income attributable to noncontrolling interests	11	9	20	16
Net income attributable to Quest Diagnostics	\$118	\$133	\$179	\$237

15. SUBSEQUENT EVENTS

Sale of Noncontrolling Interest in Subsidiary

On July 1, 2015, UMass exercised its call option, acquiring an 18.9% noncontrolling interest in a subsidiary of the Company that performs diagnostic information services in a defined territory within the state of Massachusetts. In connection with the transaction, the Company paid the \$50 million deferred consideration associated with the January 2, 2013 acquisition of the Massachusetts-based clinical outreach and anatomic pathology businesses from UMass and received \$50 million associated with the call option exercise price. The deferred consideration is included in accounts payable and accrued expenses at June 30, 2015.

Clinical Trials Central Laboratory Services Joint Venture

On July 1, 2015, the Company closed a transaction with Quintiles Transnational Holdings Inc. to form a global clinical trials central laboratory services joint venture, Q² Solutions. In connection with the transaction, the Company contributed certain assets of its Clinical Trials business to the newly formed joint venture in exchange for a non-controlling, 40% ownership interest. For further details regarding the transaction, see Note 6.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Our Company

Quest Diagnostics is the world's leading provider of diagnostic information services empowering people to take action to improve health outcomes. We use our extensive database of clinical lab results to derive diagnostic insights that reveal new avenues to identify and treat disease, inspire healthy behaviors and improve healthcare management. Our diagnostic information services business ("DIS") provides insights through clinical testing and related services to patients, physicians, hospitals, accountable care organizations, integrated delivery networks, health plans, employers and others and makes up over 90% of our consolidated net revenues. The balance of our net revenues is derived from our Diagnostic Solutions ("DS") businesses, which consist of our risk assessment services, clinical trials testing (see discussion regarding assets held for sale below), diagnostic products and healthcare information technology businesses. Our business segment information is disclosed in Note 14 to the interim unaudited consolidated financial statements.

Second Quarter Highlights

Our second quarter performance reflects continued execution of our five-point strategy and we are seeing a moderation of government reimbursement pressure relative to the past two years. Our total net revenues of \$1.9 billion were 1.2% above the prior year period. Excluding the impact of acquisitions, total net revenues grew by 0.8%. DIS revenues of \$1.8 billion were 0.4% above the prior year period. DIS volume, measured by the number of requisitions, decreased 0.4% compared to the prior year period. Revenue per requisition increased 0.9% compared to the prior year period, reflecting growth in gene-based and esoteric testing and business mix shifts. This was the first quarter we reported year-over-year revenue per requisition growth since the first quarter of 2012. DS revenues of \$154 million were 11.1% above the prior year period. The increase in DS revenues was primarily driven by our clinical trials testing, diagnostic products and risk assessment services businesses. Net income attributable to Quest Diagnostics' stockholders was \$118 million, or \$0.81 per diluted share, for the three months ended June 30, 2015 and was impacted by net charges of \$0.36 per diluted share, primarily associated with the loss on early retirement of debt and related refinancing charges and restructuring and integration charges.

Five-point Strategy

Progress on the execution of our five-point strategy during the second quarter of 2015 includes:

• We grew total net revenues 1.2% to \$1.9 billion and operating income 14.9% to \$301 million.

We continue to grow revenues from new relationships with hospitals and integrated delivery networks by helping them improve health outcomes and reduce costs. Most recently, we entered into a definitive agreement to acquire MemorialCare Health System's laboratory outreach services business, which provides outreach laboratory testing in southern California. The acquisition is expected to close in August 2015.

• We are enhancing our diagnostic information services to help customers with population health, data analytics and decision support tools which will help to drive growth as well as deliver a superior customer experience.

We closed on our Q² Solutions joint venture with Quintiles Transnational Holdings Inc. ("Quintiles") on July 1, 2015, forming a global clinical trials central laboratory services company into which we contributed our clinical trials testing business in exchange for a 40% ownership interest.

• We completed the refinancing of over \$1.2 billion in outstanding senior notes, resulting in reduced future interest expense and an improved maturity profile.

• We repurchased \$39 million of our common stock as part of our Common Stock repurchase program.

Invigorate Program

We are engaged in a multi-year program called Invigorate. We delivered more than \$700 million in run-rate savings as we exited 2014. In November 2014, we announced our goal to deliver an additional \$600 million in run-rate savings as we exit 2017. Achieving this goal would bring the total savings from the Invigorate program to \$1.3 billion in run-rate savings, compared to 2011.

Invigorate has consisted of several flagship programs, with structured plans in each, to drive savings and improve performance across the customer value chain. These flagship programs include: organization excellence; information technology excellence; procurement excellence; service excellence; lab excellence; and billing excellence. In addition to these programs, we have identified new key opportunities to change how we operate in order to meet our goal of delivering the additional \$600 million in run-rate savings as we exit 2017. These new key opportunities include: standardizing our processes, information technology systems, equipment and data; enhancing electronic enabling services; and enhancing reimbursement for

Table of Contents

work we perform. We believe that our efforts to standardize our information technology systems, equipment and data also will foster our efforts to restore growth, supporting the value creation initiatives of our clinical franchises by enhancing our operational flexibility, empowering and enhancing the customer experience, facilitating the delivery of actionable insights and bolstering our large data platform.

In January 2015, we adopted a course of action related to this multi-year program. We developed a high-level estimate of the pre-tax charges expected to be incurred in connection with the course of action for the program: \$300 million. We also developed high-level estimates of the pre-tax charges expected to be incurred in connection with the course of action for 2015 totaling \$95 million to \$115 million consisting of: \$25 million to \$30 million of employee separation costs; \$10 million to \$15 million of facility-related costs and asset impairment charges; and \$60 million to \$70 million of systems conversion and integration costs. As detailed plans to implement the course of action are approved and executed, it will result in charges to earnings. Principally all of the total estimated pre-tax charges expected to be incurred in 2015 are anticipated to result in cash expenditures. The actual charges incurred in connection with the course of action in 2015 could be materially different from these estimates.

From 2012 through 2014, the cumulative charges recorded in connection with the Invigorate program were approximately \$266 million, including approximately \$178 million of cumulative pre-tax employee separation costs and other restructuring related costs. Through June 30, 2015, the cumulative charges recorded in connection with the January 2015 course of action were approximately \$47 million, including approximately \$21 million of cumulative pre-tax employee separation costs and other restructuring related costs.

For additional information on the Invigorate program and associated costs, see Note 4 to the interim unaudited consolidated financial statements.

Assets Held for Sale

At June 30, 2015, certain assets of our clinical trials testing business are classified as held for sale in our interim unaudited consolidated balance sheet.

On March 30, 2015, we entered into a definitive agreement with Quintiles to form a global clinical trials central laboratory services joint venture, Q² Solutions. The transaction closed on July 1, 2015. In connection with the transaction, we contributed certain assets of our clinical trials testing business to the newly formed joint venture in exchange for a non-controlling, 40% ownership interest.

We expect to recognize a non-cash gain based on the difference between the fair value of our equity interest in the newly formed joint venture over the carrying value of the assets contributed. The non-cash gain, which is currently being determined, will be recorded in the third quarter of 2015 and is expected to be material to our results of operations.

Senior Notes Offering

In March 2015, we completed a \$1.2 billion senior notes offering (the "2015 Senior Notes") that was sold in three tranches: (a) \$300 million aggregate principal amount of 2.50% senior notes due March 2020, issued at a discount of \$1 million; (b) \$600 million aggregate principal amount of 3.50% senior notes due March 2025; and (c) \$300 million aggregate principal amount of 4.70% senior notes due March 2045. A portion of the proceeds from the 2015 Senior Notes were used to fund the cash tender offer (the "Tender Offer") in March 2015 in which we purchased \$176 million of our 6.95% Senior Notes due July 2037 and \$74 million of our 5.75% Senior Notes due January 2040. In connection with the Tender Offer, we recorded a \$79 million pre-tax loss on early retirement of debt in the first quarter of 2015.

The remaining proceeds from the 2015 Senior Notes, together with borrowing under our existing credit facilities, were used in April 2015 to redeem all of our \$500 million 5.45% Senior Notes due November 2015, \$150 million, or 50%, of our 3.2% Senior Notes due April 2016 and all of our \$375 million 6.4% Senior Notes due July 2017 (the "Redemption"). In connection with the Redemption, we recorded a \$65 million pre-tax loss on early retirement of debt in the second quarter of 2015.

The 2015 Senior Notes, Tender Offer and Redemption are further described in Note 9 to the interim unaudited consolidated financial statements.

Table of Contents

Critical Accounting Policies

Other than the "Accounting for stock-based compensation expense - valuation of stock option awards" discussed below, there have been no significant changes to our critical accounting policies from those disclosed in our 2014 Annual Report on Form 10-K.

Accounting for stock-based compensation expense - valuation of stock option awards

Beginning in 2015, we changed the method for estimating the fair value of our stock option awards from a lattice-based option-valuation method to a Black-Scholes option-valuation model which has been applied prospectively to stock option awards. The change did not have a significant effect on our stock-based compensation expense reported in our interim unaudited consolidated statements of operations because we grant stock option awards based on a prescribed dollar value.

We estimate the fair value of stock option awards on the date of grant using the Black-Scholes option-valuation model which requires management to make certain assumptions regarding: (i) the expected volatility in the market price of our common stock; (ii) dividend yield; (iii) risk-free interest rates; and (iv) the period of time employees are expected to hold the award prior to exercise (referred to as the expected holding period). The expected volatility under the Black-Scholes option-valuation model is based on historical volatilities of our common stock. The dividend yield is based on the approved annual dividend rate in effect and current market price of the underlying common stock at the time of grant. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for bonds with maturities consistent with the expected holding period of the related award. The expected holding period of the awards granted is estimated using the historical exercise behavior of employees.

Table of Contents

Results of Operations

The following tables sets forth certain results of operations data for the periods presented:

	Three Months Ended June 30,				Six Months Ended June 30,					
	2015	2014	Increase (Decrease)	% Increase (Decrease)	2015	2014	Increase (Decrease)	% Increase (Decrease)		
	(dollars in millions, except per share amounts)									
Net revenues:										
DIS business	\$1,771	\$1,763	\$8	0.4	%	\$3,463	\$3,377	\$86	2.6	%
DS businesses	154	139	15	11.1		301	271	30	11.1	
Total net revenues	\$1,925	\$1,902	\$23	1.2	%	\$3,764	\$3,648	\$116	3.2	%
Operating costs and expenses:										
Cost of services	\$1,182	\$1,174	\$8	0.7	%	\$2,345	\$2,275	\$70	3.1	%
Selling, general and administrative	429	440	(11)	(2.7)		848	855	(7)	(0.9)	
Amortization of intangible assets	20	25	(5)	(20.5)		41	47	(6)	(12.1)	
Other operating (income) expense, net	(7)	1	(8)	NM		1	1	—	NM	
Total operating costs and expenses	\$1,624	\$1,640	\$(16)	(1.0)	%	\$3,235	\$3,178	\$57	1.8	%
Operating income	\$301	\$262	\$39	14.9	%	\$529	\$470	\$59	12.6	%
Other income (expense):										
Interest expense, net	\$(37)	\$(42)	\$(5)	(9.8)	%	\$(82)	\$(81)	\$1	2.1	%
Equity in earnings of equity method investees	7	6	1	1.9		14	12	2	10.2	
Other (expense) income, net	(64)	3	67	NM		(142)	4	146	NM	
Total non-operating expenses, net	\$(94)	\$(33)	\$61	NM		\$(210)	\$(65)	\$145	NM	
Income tax expense	\$78	\$87	\$(9)	(10.8)	%	\$120	\$152	\$(32)	(21.3)	%
Effective income tax rate	37.6	% 37.9	% (0.3)	% NM		37.5	% 37.5	% —	% NM	
Net income attributable to Quest Diagnostics	\$118	\$133	\$(15)	(11.5)	%	\$179	\$237	\$(58)	(24.5)	%
Diluted earnings per common share	\$0.81	\$0.92	\$(0.11)	(12.0)	%	\$1.23	\$1.63	\$(0.40)	(24.5)	%

attributable to Quest
Diagnostics'
common
stockholders

NM - Not Meaningful

Table of Contents

The following table sets forth certain results of operations data as a percentage of net revenues for the periods presented:

	Three Months Ended June 30, 2015		2014		Six Months Ended June 30, 2015		2014	
Net revenues:								
DIS business	92.0	%	92.7	%	92.0	%	92.6	%
DS businesses	8.0		7.3		8.0		7.4	
Total net revenues	100.0	%	100.0	%	100.0	%	100.0	%
Operating costs and expenses:								
Cost of services	61.4	%	61.7	%	62.3	%	62.4	%
Selling, general and administrative	22.3		23.1		22.5		23.4	
Amortization of intangible assets	1.0		1.3		1.1		1.3	
Other operating (income) expense, net	(0.3	)	0.1		—		—	
Total operating costs and expenses	84.4	%	86.2	%	85.9	%	87.1	%
Operating income	15.6	%	13.8	%	14.1	%	12.9	%
Bad debt expense	4.1	%	3.9	%	4.2	%	4.1	%

Operating Results

Results for the three months ended June 30, 2015 were affected by certain items that impacted diluted earnings per share by \$0.36. During the three months ended June 30, 2015, we recorded pre-tax charges of \$66 million, or \$0.28 per diluted share, related to the loss on early retirement of debt and related refinancing charges in connection with the Redemption. In addition, we recorded pre-tax charges of \$23 million, or \$0.10 per diluted share, related to restructuring costs primarily associated with workforce reductions, integration costs associated with acquisitions and professional fees associated with the further restructuring of our business (\$11 million in cost of services and \$12 million in selling, general and administrative expenses). We also recorded other items comprising a net pre-tax gain of \$3 million, or \$0.02 per diluted share. The other items include a gain of \$13 million associated with a decrease in the fair value of the contingent consideration accrual associated with our Summit Health acquisition, which was partially offset by costs incurred related to legal matters and non-cash asset impairment charges.

Results for the six months ended June 30, 2015 were affected by certain items that impacted diluted earnings per share by \$0.90. During the six months ended June 30, 2015, we recorded pre-tax charges of \$150 million, or \$0.64 per diluted share, related to the loss on early retirement of debt and related refinancing charges in connection with the Tender Offer and Redemption. In addition, we recorded pre-tax charges of \$54 million, or \$0.22 per diluted share, related to restructuring costs primarily associated with workforce reductions, integration costs associated with acquisitions and professional fees associated with the further restructuring of our business (\$31 million in cost of services and \$23 million in selling, general and administrative expenses). We also incurred net pre-tax charges of \$7 million, or \$0.04 per diluted share, primarily associated with non-cash asset impairment charges primarily associated with our Celera Products business and costs incurred related to legal matters, partially offset by a gain of \$13 million associated with a decrease in the fair value of the contingent consideration accrual associated with our Summit Health acquisition.

Results for the three months ended June 30, 2014 were affected by certain items that impacted diluted earnings per share by \$0.16. During the three months ended June 30, 2014, we recorded pre-tax charges of \$27 million, or \$0.13

per diluted share, related to restructuring costs primarily associated with workforce reductions, integration costs and professional fees associated with the further restructuring of our business (\$11 million in cost of services and \$16 million in selling, general and administrative expenses), including \$5 million of pre-tax integration and transaction costs associated with acquisitions. In addition, we recorded a pre-tax charge of \$7 million, or \$0.03 per diluted share, principally associated with the settlement of legal matters.

Results for the six months ended June 30, 2014 were affected by certain items that impacted diluted earnings per share by \$0.29. During the six months ended June 30, 2014, we recorded pre-tax charges of \$51 million, or \$0.24 per diluted share, related to restructuring costs primarily associated with workforce reductions, integration costs and professional fees associated

Table of Contents

with the further restructuring of our business (\$23 million in cost of services and \$28 million in selling, general and administrative expenses), including \$11 million of pre-tax integration and transaction costs associated with acquisitions. In addition, we recorded pre-tax charges of \$11 million, or \$0.05 per diluted share, principally associated with the settlement of legal matters.

Net Revenues

Net revenues for the three months ended June 30, 2015 were 1.2% above the prior year level. Acquisitions contributed nearly 0.4% to net revenue growth.

DIS revenue, which accounted for over 90% of our consolidated net revenues, increased by 0.4% for the three months ended June 30, 2015 compared to the prior year period.

DIS volume, measured by the number of requisitions, decreased 0.4% for the three months ended June 30, 2015 compared to the prior year period.

Revenue per requisition for the three months ended June 30, 2015 increased 0.9% compared to the prior year period, reflecting growth in gene-based and esoteric testing and business mix shifts.

For the three months ended June 30, 2015, combined revenues in our DS businesses increased by 11.1% compared to the prior year period. The increase was primarily driven by an increase in revenues in our clinical trials testing, diagnostic products and risk assessment services businesses.

Net revenues for the six months ended June 30, 2015 were 3.2% above the prior year level. Acquisitions contributed nearly 2.4% to consolidated revenue growth.

DIS revenue, which accounted for over 90% of our consolidated net revenues, increased by 2.6% for the six months ended June 30, 2015 compared to the prior year period. Acquisitions contributed nearly 2.6% to DIS revenue growth.

DIS volume, measured by the number of requisitions, increased 2.4% for the six months ended June 30, 2015 compared to the prior year period. Acquisitions contributed approximately 2.9% to DIS volume in the period.

Revenue per requisition for the six months ended June 30, 2015 increased 0.1% compared to the prior year period, reflecting growth in gene-based and esoteric testing and business mix shifts. Acquisitions negatively impacted revenue per requisition by 0.3% in the period.

For the six months ended June 30, 2015, combined revenues in our DS businesses increased by 11.1% compared to the prior year period. The increase was primarily driven by an increase in revenues in our clinical trials testing, diagnostic products and risk assessment services businesses.

Cost of Services

Cost of services consists principally of costs for obtaining, transporting and testing specimens as well as facility costs used for the delivery of our services.

Cost of services increased \$8 million for the three months ended June 30, 2015 as compared to the prior year period. This increase was primarily driven by higher costs associated with increased revenues, which was partially offset by cost reductions under the Invigorate program and acquisition related synergies.

Cost of services increased \$70 million for the six months ended June 30, 2015 as compared to the prior year period. This increase was primarily driven by additional operating costs associated with our 2014 acquisitions and, to a lesser extent, higher restructuring and integration charges and higher compensation and benefits, which were partially offset by cost reductions under the Invigorate program and acquisition related synergies.

Selling, General and Administrative Expenses ("SG&A")

SG&A consist principally of the costs associated with our sales and marketing efforts, billing operations, bad debt expense and general management and administrative support as well as administrative facility costs.

Table of Contents

SG&A decreased \$11 million and \$7 million for the three and six months ended June 30, 2015 as compared to the prior year periods. The decrease in SG&A is primarily driven by lower compensation and benefits, primarily as a result of cost reductions under the Invigorate program and acquisition related synergies, and lower restructuring and integration charges. These decreases were partially offset by higher bad debt expense. For the six months ended June 30, 2015, the decreases were also partially offset by additional operating costs associated with our acquisitions.

Other Operating (Income) Expense, net

Other operating (income) expense, net includes miscellaneous income and expense items related to operating activities. Other operating (income) expense, net for the three months ended June 30, 2015, includes a gain of \$13 million associated with a decrease in the fair value of the contingent consideration accrual associated with our Summit Health acquisition, partially offset by a non-cash asset impairment charge. For the six months ended June 30, 2015, other operating (income) expense, net includes non-cash asset impairment charges primarily associated with our Celera Products business, substantially offset by a gain of \$13 million associated with a decrease in the fair value of the contingent consideration accrual associated with our Summit Health acquisition.

Interest Expense, net

Interest expense, net, for the three months ended June 30, 2015, decreased \$5 million as compared to the prior year period. The decrease in interest expense, net was primarily a result of lower outstanding debt balances compared to the prior year period and lower interest rates associated with our 2015 Senior Notes.

Interest expense, net, for the six months ended June 30, 2015, was essentially flat compared to the prior year period.

Other (Expense) Income, net

Other (expense) income, net represents miscellaneous income and expense items related to non-operating activities, such as gains and losses associated with investments and other non-operating assets. For the three and six months ended June 30, 2015, other (expense) income, net includes losses on early retirement of debt of \$65 million and \$144 million, respectively.

Income Tax Expense

The decrease in income tax expense for the three and six months ended June 30, 2015, compared to the prior year period, is primarily due to income tax benefits associated with the loss on early retirement of debt associated with the Tender Offer and Redemption.

Quantitative and Qualitative Disclosures About Market Risk

We address our exposure to market risks, principally the market risk of changes in interest rates, through a controlled program of risk management that includes the use of derivative financial instruments. We do not hold or issue derivative financial instruments for speculative purposes. We seek to mitigate the variability in cash outflows that result from changes in interest rates by maintaining a balanced mix of fixed-rate and variable-rate debt obligations. In order to achieve this objective, we have entered into interest rate swaps. Interest rate swaps involve the periodic exchange of payments without the exchange of underlying principal or notional amounts. Net settlements are recognized as an adjustment to interest expense. We believe that our exposures to foreign exchange impacts and changes in commodity prices are not material to our consolidated financial condition or results of operations.

At June 30, 2015 and December 31, 2014, the fair value of our debt was estimated at approximately \$3.8 billion and \$4.2 billion, respectively, using quoted prices in active markets and yields for the same or similar types of borrowings,

taking into account the underlying terms of the debt instruments. At June 30, 2015 and December 31, 2014, the estimated fair value exceeded the carrying value of the debt by \$84 million and \$416 million, respectively. A hypothetical 10% increase in interest rates (representing 38 basis points at June 30, 2015 and 45 basis points at December 31, 2014) would potentially reduce the estimated fair value of our debt by approximately \$116 million and \$108 million at June 30, 2015 and December 31, 2014, respectively.

Borrowings under our senior unsecured revolving credit facility and our secured receivables credit facility are subject to variable interest rates. Interest on our secured receivables credit facility is based on rates that are intended to approximate commercial paper rates for highly rated issuers. Interest on our senior unsecured revolving credit facility is subject to a pricing schedule that can fluctuate based on changes in our credit ratings. As such, our borrowing cost under this credit arrangement

Table of Contents

will be subject to both fluctuations in interest rates and changes in our credit ratings. At June 30, 2015, the borrowing rates under these debt instruments were: for our senior unsecured revolving credit facility, LIBOR plus 1.125%; and for our secured receivables credit facility, 0.88%. At of June 30, 2015, the weighted average LIBOR was 0.2%. As of June 30, 2015, there were \$85 million of borrowings outstanding under our \$525 million secured receivables credit facility and no borrowings outstanding under our \$750 million senior unsecured revolving credit facility.

The notional amount of fixed-to-variable interest rate swaps outstanding at both June 30, 2015 and December 31, 2014 was \$1.2 billion. The aggregate fair value of the fixed-to-variable interest rate swaps that are in a liability position was \$12 million at June 30, 2015. The aggregate fair value of the fixed-to-variable interest rate swaps that are in an asset position was \$15 million at June 30, 2015. There were no forward starting interest rate swaps outstanding at June 30, 2015. The notional amount of forward starting interest rate swaps outstanding at December 31, 2014 was \$150 million.

Based on our net exposure to interest rate changes, a hypothetical 10% change in interest rates on our variable rate indebtedness (representing 2 basis points) would not impact annual interest expense materially, assuming no changes to the debt outstanding at June 30, 2015. A hypothetical 10% change in interest rates (representing 20 basis points) would potentially change the fair value of our derivative liabilities by \$8 million. A hypothetical 10% change in interest rates (representing 24 basis points) would potentially change the fair value of our derivative assets by \$6 million.

For further details regarding our outstanding debt, see Note 9 to the interim unaudited consolidated financial statements and Note 13 to the consolidated financial statements included in our 2014 Annual Report on Form 10-K for the year ended December 31, 2014. For details regarding our financial instruments and hedging activities, see Note 10 to the interim unaudited consolidated financial statements and Note 14 to the consolidated financial statements included in our 2014 Annual Report 10-K for the year ended December 31, 2014.

Risk Associated with Investment Portfolio

Our investment portfolio includes equity investments comprised primarily of strategic equity holdings in privately and publicly held companies. These securities are exposed to price fluctuations and are generally concentrated in the life sciences industry. The carrying value of our equity investments was \$18 million at June 30, 2015.

We regularly evaluate the fair value measurements of our equity investments to determine if losses in value are other than temporary and if an impairment loss has been incurred. The evaluation considers whether the security has the ability to recover and, if so, the estimated recovery period. Other factors that are considered in this evaluation include the amount of the other-than-temporary decline and its duration, the issuer's financial condition and short-term prospects, and whether the market decline was caused by overall economic conditions or conditions specific to the individual security.

We do not hedge our equity price risk. The impact of an adverse movement in equity prices on our holdings in privately held companies cannot be easily quantified, as our ability to realize returns on investments depends on, among other things, the enterprises' ability to raise additional capital or derive cash inflows from continuing operations or through liquidity events such as initial public offerings, mergers or private sales.

Liquidity and Capital Resources

Six Months Ended June
30,
2015 2014
(dollars in millions)

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Net cash provided by operating activities	\$327	\$364
Net cash used in investing activities	(123)	) (841)
Net cash (used in) provided by financing activities	(246)	) 434
Net change in cash and cash equivalents	\$(42)	) \$(43)

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid short-term investments. Cash and cash equivalents at June 30, 2015 totaled \$150 million, compared to \$192 million at December 31, 2014.

Table of Contents

Cash Flows from Operating Activities

Net cash provided by operating activities for the six months ended June 30, 2015 was \$327 million compared to \$364 million for the six months ended June 30, 2014. This \$37 million decrease was primarily a result of \$146 million of pre-tax cash charges associated with the early retirement of debt and higher performance based compensation payments, which were partially offset by improved operating performance and improved working capital through management of days sales outstanding. Days sales outstanding, a measure of billing and collection efficiency, was 44 days at June 30, 2015, 48 days at December 31, 2014 and 47 days at June 30, 2014.

Cash Flows from Investing Activities

Net cash used in investing activities for the six months ended June 30, 2015 was \$123 million, compared to \$841 million for the six months ended June 30, 2014. This \$718 million decrease was a result of a \$717 million decrease in business acquisitions, primarily a result of fewer acquisitions in 2015 as compared to 2014.

Cash Flows from Financing Activities

Net cash (used in) provided by financing activities for the six months ended June 30, 2015 was \$(246) million, compared to \$434 million for the six month ended June 30, 2014. This \$680 million decrease was primarily a result of a \$571 million decrease in net borrowings (proceeds from borrowings less repayments of debt), primarily associated with the funding of the Solstas acquisition in 2014, and a \$92 million increase in repurchases of our common stock as discussed in "Share Repurchases" below.

Dividends

During the first and second quarters of 2015, our Board of Directors declared a quarterly cash dividend of \$0.38 per common share. During each of the quarters of 2014, our Board of Directors declared a quarterly cash dividend of \$0.33 per common share. We expect to fund future dividend payments with cash flows from operations and do not expect the dividend to have a material impact on our ability to finance future growth.

Share Repurchases

At June 30, 2015, \$547 million remained available under our share repurchase authorizations. The share repurchase authorization has no set expiration or termination date.

For the three months ended June 30, 2015, we repurchased 0.6 million shares of our common stock at an average price of \$72.03 per share for \$39 million. For the six months ended June 30, 2015, we repurchased 2.1 million shares of our common stock at an average price of \$71.62 per share for \$149 million.

For the three months ended June 30, 2014, we repurchased 0.4 million shares of our common stock at an average price of \$57.74 per share for \$25 million. For the six months ended June 30, 2014, we repurchased 1.0 million shares of our common stock at an average price of \$54.84 per share for \$57 million.

Table of Contents

Contractual Obligations and Commitments

The following table summarizes certain of our contractual obligations as of June 30, 2015:

Contractual Obligations	Payments due by period (in millions)				
	Total	Remainder of 2015	1-3 years	3-5 years	After 5 years
Outstanding debt	\$3,716	\$6	\$235	\$300	\$3,175
Capital lease obligations	28	6	15	6	1
Interest payments on outstanding debt	1,879	71	267	260	1,281
Operating leases	712	103	288	136	185
Purchase obligations	238	58	136	21	23
Merger consideration obligations	80	51	28	1	—
Total contractual obligations	\$6,653	\$295	\$969	\$724	\$4,665

Interest payments on our long-term debt have been calculated after giving effect to our interest rate swap agreements, using the interest rates as of June 30, 2015 applied to the June 30, 2015 balances, which are assumed to remain outstanding through their maturity dates.

A full description of the terms of our indebtedness and related debt service requirements and our future payments under certain of our contractual obligations is contained in Note 13 to the consolidated financial statements in our 2014 Annual Report on Form 10-K and Note 9 to the interim unaudited consolidated financial statements. A full discussion and analysis regarding our minimum rental commitments under noncancelable operating leases and noncancelable commitments to purchase product or services at December 31, 2014 is contained in Note 17 to the consolidated financial statements in our 2014 Annual Report on Form 10-K. Merger consideration obligation includes consideration owed, including any contingent consideration at maximum payout, on the UMass, Summit Health (see Note 7), and Steward acquisitions. A full discussion and analysis regarding our acquisitions of Summit Health, Steward and UMass and the related merger consideration obligations at December 31, 2014 is contained in Note 5 to the consolidated financial statements in our 2014 Annual Report on Form 10-K.

As of June 30, 2015, our total liabilities associated with unrecognized tax benefits were approximately \$104 million, which were excluded from the table above. We expect that these liabilities may decrease by up to approximately \$32 million within the next twelve months, primarily as a result of payments, settlements and/or the conclusion of tax examinations on certain tax positions. For the remainder, we cannot make reasonably reliable estimates of the timing of the future payments of these liabilities. Additionally, it is reasonably possible that within the next 12 months, as result of ongoing negotiations with tax authorities and the expiration of statutes of limitations, our total liabilities associated with unrecognized tax benefits will further decrease and beneficially impact the effective tax rate for continuing operations. However, due to the inherent uncertainty of the negotiations and the resulting outcomes, we are not able to estimate the effective tax rate impact at this time. See Note 8 to the consolidated financial statements in our 2014 Annual Report on Form 10-K for information regarding our contingent tax liability reserves.

Our credit agreements contain various covenants and conditions, including the maintenance of certain financial ratios, that could impact our ability to, among other things, incur additional indebtedness. As of June 30, 2015, we were in compliance with the various financial covenants included in our credit agreements and we do not expect these covenants to adversely impact our ability to execute our growth strategy or conduct normal business operations.

Equity Method Investees

Our equity method investees primarily consist of unconsolidated joint ventures in Phoenix, Arizona; Indianapolis, Indiana; Dayton, Ohio; and an investment in an Australian company, which are accounted for under the equity method of accounting. We believe that our transactions with our equity method investees are conducted at arm's length, reflecting current market conditions and pricing. Total net revenues of our equity method investees equal approximately 6% of our consolidated net revenues. Total assets associated with our equity method investees are less than 2% of our consolidated total assets. We have no material unconditional obligations or guarantees to, or in support of, our equity method investees and their operations.

Table of Contents

On July 1, 2015, Q² Solutions, our joint venture with Quintiles, will become an equity method investee. See "Assets Held for Sale" above for further details.

Requirements and Capital Resources

We estimate that we will invest approximately \$300 million during 2015 for capital expenditures, to support and grow our existing operations, principally related to investments in information technology, laboratory equipment and facilities, including specific initiatives associated with our Invigorate and other programs.

We expect to fund the repayment of the current portion of our long-term debt using a combination of cash on hand and existing credit facilities.

As of June 30, 2015, \$1.2 billion of borrowing capacity was available under our existing credit facilities consisting of \$440 million available under our secured receivables credit facility and \$750 million available under our senior unsecured revolving credit facility.

We believe the borrowing capacity under the credit facilities described above continues to be available to us. Should one or several banks no longer participate in either of our credit facilities, we would not expect it to impact our ability to fund operations. We expect that we will be able to replace our existing credit facilities with alternative arrangements prior to their expiration.

At June 30, 2015, approximately 50% of our \$150 million of consolidated cash and cash equivalents were held outside of the United States. These funds are considered indefinitely reinvested to be used to expand operations either organically or through acquisitions outside the United States. Further, our current plans do not demonstrate a need to repatriate foreign funds in order to fund U.S. operations. If the foreign cash and cash items are needed for operations in the United States, or we otherwise elect to repatriate the funds, we may be required to accrue and pay United States taxes on a significant portion of these amounts.

We believe that our cash and cash equivalents and cash from operations, together with our borrowing capacity under our credit facilities, will provide sufficient financial flexibility to fund seasonal and other working capital requirements, capital expenditures, debt service requirements and other obligations, cash dividends on common shares, share repurchases and additional growth opportunities for the foreseeable future. We believe that our credit profile should provide us with access to additional financing to refinance upcoming debt maturities and, if necessary, to fund growth opportunities that cannot be funded from existing sources.

Recent Accounting Pronouncements Not Yet Effective

The impacts of recent accounting pronouncements not yet effective on our consolidated financial statements are discussed in Note 2 to the interim unaudited consolidated financial statements.

Forward-Looking Statements

Some statements and disclosures in this document are forward-looking statements. Forward-looking statements include all statements that do not relate solely to historical or current facts and can be identified by the use of words such as "may," "believe," "will," "expect," "project," "estimate," "anticipate," "plan" or "continue." These forward-looking statements are based on our current plans and expectations and are subject to a number of risks and uncertainties that could cause our plans and expectations, including actual results, to differ materially from the forward-looking statements. Risks and uncertainties that may affect our future results include, but are not limited to, adverse results from pending or future government investigations, lawsuits or private actions, the competitive environment, changes in government

regulations, changing relationships with customers, payers, suppliers and strategic partners and other factors discussed in “Business,” “Risk Factors,” “Cautionary Factors That May Affect Future Results,” “Legal Proceedings,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Quantitative and Qualitative Disclosures About Market Risk” in our 2014 Annual Report on Form 10-K and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Quantitative and Qualitative Disclosures About Market Risk” in our 2015 Quarterly Reports on Form 10-Q and other items throughout the 2014 Form 10-K and our 2015 Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended). Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

During the second quarter of 2015, there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended) that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

See Note 13 to the interim unaudited consolidated financial statements for information regarding the status of legal proceedings involving the Company.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The table below sets forth the information with respect to purchases made by or on behalf of the Company of its common stock during the second quarter of 2015.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)
April 1, 2015 – April 30, 2015				
Share Repurchase Program (A)	26,319	\$75.23	26,319	\$583,627
Employee Transactions (B)	401	\$76.18	N/A	N/A
May 1, 2015 – May 31, 2015				
Share Repurchase Program (A)	508,073	\$71.86	508,073	\$547,115
Employee Transactions (B)	10,756	\$72.83	N/A	N/A
June 1, 2015 – June 30, 2015				
Share Repurchase Program (A)	—	\$—	—	\$547,115
Employee Transactions (B)	28	\$73.79	N/A	N/A
Total				
Share Repurchase Program (A)	534,392	\$72.03	534,392	\$547,115
Employee Transactions (B)	11,185	\$72.96	N/A	N/A

Since the share repurchase program's inception in May 2003, our Board of Directors has authorized \$6.5 billion of (A) share repurchases of our common stock through June 30, 2015. The share repurchase authorization has no set expiration or termination date.

Includes: (1) shares delivered or attested to in satisfaction of the exercise price and/or tax withholding obligations by holders of stock options (granted under the Company's Amended and Restated Employee Long-Term Incentive Plan and its Amended and Restated Non-Employee Director Long-Term Incentive Plan, collectively the "Stock Compensation Plans") who exercised options; and (2) shares withheld (under the terms of grants under the Stock Compensation Plans) to offset tax withholding obligations that occur upon the delivery of common shares underlying restricted stock units and performance share units.

Table of Contents

Item 6. Exhibits

Exhibits:

10.1	Amended and Restated Quest Diagnostics Incorporated Employee Long-Term Incentive Plan (As amended May 15, 2015)
10.2	Amended and Restated Employee Stock Purchase Plan (Effective as of June 29, 2015)
31.1	Rule 13a-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a) Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer
32.2	Section 1350 Certification of Chief Financial Officer
101.INS	dgx-20150630.xml
101.SCH	dgx-20150630.xsd
101.CAL	dgx-20150630_cal.xml
101.DEF	dgx-20150630_def.xml
101.LAB	dgx-20150630_lab.xml
101.PRE	dgx-20150630_pre.xml

Table of Contents

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

July 30, 2015

Quest Diagnostics Incorporated

By /s/ Stephen H. Rusckowski
Stephen H. Rusckowski
President and Chief Executive
Officer

By /s/ Mark J. Guinan
Mark J. Guinan
Senior Vice President and Chief
Financial Officer