

QUEST DIAGNOSTICS INC
Form 10-Q
November 03, 2011

**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 September 30, 2011
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 ☒

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

Accelerated filer ☐

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 October 27, 2011, there were outstanding 157,759,227 shares of the registrant's common stock, \$.01 par value.

PART I - FINANCIAL INFORMATION

	Page
Item 1. Financial Statements	
Index to consolidated financial statements filed as part of this report:	
<u>Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2011 and 2010</u>	2
<u>Consolidated Balance Sheets as of September 30, 2011 and December 31, 2010</u>	3
<u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2011 and 2010</u>	4
<u>Consolidated Statements of Stockholders' Equity for the Nine Months Ended September 30, 2011 and 2010</u>	5
<u>Notes to Consolidated Financial Statements</u>	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	
Management's Discussion and Analysis of Financial Condition and Results of Operations	32
Item 3. Quantitative and Qualitative Disclosures About Market Risk	
See Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	44
Item 4. Controls and Procedures	
Controls and Procedures	44

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(unaudited)
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net revenues	<u>\$ 1,906,405</u>	<u>\$ 1,864,655</u>	<u>\$ 5,631,183</u>	<u>\$ 5,544,885</u>
Operating costs and expenses:				
Cost of services	1,116,574	1,091,465	3,317,966	3,236,809
Selling, general and administrative	446,595	426,562	1,357,242	1,276,707
Amortization of intangible assets	19,402	9,915	47,843	28,544
Other operating expense (income), net	1,781	(154)	238,265	1,502
	<u>1,584,352</u>	<u>1,527,788</u>	<u>4,961,316</u>	<u>4,543,562</u>
Operating income	322,053	336,867	669,867	1,001,323
Other income (expense):				
Interest expense, net	(43,408)	(36,200)	(127,918)	(108,522)
Equity earnings in unconsolidated joint ventures	7,301	7,201	22,869	22,550
Other (expense) income, net	(2,677)	3,150	(815)	2,043
	<u>(38,784)</u>	<u>(25,849)</u>	<u>(105,864)</u>	<u>(83,929)</u>
Income from continuing operations before taxes	283,269	311,018	564,003	917,394
Income tax expense	101,126	102,902	256,114	333,931
	<u>182,143</u>	<u>208,116</u>	<u>307,889</u>	<u>583,463</u>
Income from continuing operations				
Loss from discontinued operations, net of taxes	(250)	(360)	(1,131)	(678)
	<u>181,893</u>	<u>207,756</u>	<u>306,758</u>	<u>582,785</u>
Net income				
Less: Net income attributable to noncontrolling interests	10,045	9,681	25,628	27,647
	<u>171,848</u>	<u>198,075</u>	<u>281,130</u>	<u>555,138</u>
Net income attributable to Quest Diagnostics				
	<u>\$ 171,848</u>	<u>\$ 198,075</u>	<u>\$ 281,130</u>	<u>\$ 555,138</u>
Amounts attributable to Quest Diagnostics stockholders:				
Income from continuing operations	\$ 172,098	\$ 198,435	\$ 282,261	\$ 555,816
Loss from discontinued operations, net of taxes	(250)	(360)	(1,131)	(678)
	<u>171,848</u>	<u>198,075</u>	<u>281,130</u>	<u>555,138</u>
Net income				
	<u>\$ 171,848</u>	<u>\$ 198,075</u>	<u>\$ 281,130</u>	<u>\$ 555,138</u>
Earnings per share attributable to Quest Diagnostics common stockholders - basic:				
Income from continuing operations	\$ 1.08	\$ 1.14	\$ 1.76	\$ 3.12
Loss from discontinued operations			(0.01)	
	<u>1.08</u>	<u>1.14</u>	<u>1.75</u>	<u>3.12</u>

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Net income	\$	1.08	\$	1.14	\$	1.75	\$	3.12
		<u> </u>		<u> </u>		<u> </u>		<u> </u>

Earnings per share attributable to Quest Diagnostics common stockholders - diluted:

Income from continuing operations	\$	1.08	\$	1.13	\$	1.75	\$	3.09
Loss from discontinued operations		(0.01)				(0.01)		

		<u> </u>		<u> </u>		<u> </u>		<u> </u>
Net income	\$	1.07	\$	1.13	\$	1.74	\$	3.09
		<u> </u>		<u> </u>		<u> </u>		<u> </u>

Weighted average common shares outstanding:

Basic	157,816	173,229	158,971	177,456
Diluted	159,002	174,315	160,519	179,153

Dividends per common share	\$	0.10	\$	0.10	\$	0.30	\$	0.30
-----------------------------------	----	------	----	------	----	------	----	------

The accompanying notes are an integral part of these statements.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2011 AND DECEMBER 31, 2010
(in thousands, except per share data)

	September 30, 2011	December 31, 2010
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 110,825	\$ 449,301
Accounts receivable, net of allowance for doubtful accounts of \$242,444 and \$228,917 at September 30, 2011 and December 31, 2010, respectively	936,259	845,299
Inventories	84,954	76,572
Deferred income taxes	166,907	142,470
Prepaid expenses and other current assets	97,332	91,775
	<hr/>	<hr/>
Total current assets	1,396,277	1,605,417
Property, plant and equipment, net	806,043	834,376
Goodwill	5,796,193	5,101,938
Intangible assets, net	1,054,606	796,405
Other assets	273,352	189,494
	<hr/>	<hr/>
Total assets	\$ 9,326,471	\$ 8,527,630
	<hr/>	<hr/>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 928,162	\$ 865,272
Short-term borrowings and current portion of long-term debt	835,910	348,996
	<hr/>	<hr/>
Total current liabilities	1,764,072	1,214,268
Long-term debt	3,367,847	2,641,160
Other liabilities	649,588	618,077
Stockholders' equity:		
Quest Diagnostics stockholders' equity:		
Common stock, par value \$0.01 per share; 600,000 shares authorized at both September 30, 2011 and December 31, 2010; 214,604 shares and 214,173 shares issued at September 30, 2011 and December 31, 2010, respectively	2,146	2,142
Additional paid-in capital	2,331,164	2,311,421
Retained earnings	4,101,066	3,867,420
Accumulated other comprehensive (loss) income	(5,444)	10,626
Treasury stock, at cost; 57,183 shares and 43,456 shares at September 30, 2011 and December 31, 2010, respectively	(2,906,546)	(2,158,129)
	<hr/>	<hr/>
Total Quest Diagnostics stockholders' equity	3,522,386	4,033,480
Noncontrolling interests	22,578	20,645
	<hr/>	<hr/>
Total stockholders' equity	3,544,964	4,054,125
	<hr/>	<hr/>
Total liabilities and stockholders' equity	\$ 9,326,471	\$ 8,527,630
	<hr/>	<hr/>

The accompanying notes are an integral part of these statements.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2011	2010
Cash flows from operating activities:		
Net income	\$ 306,758	\$ 582,785
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	209,431	190,444
Provision for doubtful accounts	214,373	222,882
Deferred income tax provision (benefit)	3,255	(4,673)
Stock-based compensation expense	50,789	45,042
Excess tax benefits from stock-based compensation arrangements	(4,575)	(24)
Provision for special charge	236,000	
Other, net	5,732	14,322
Changes in operating assets and liabilities:		
Accounts receivable	(271,113)	(279,879)
Accounts payable and accrued expenses	(84,408)	(26,646)
Settlement of special charge	(241,000)	
Income taxes payable	122,061	19,095
Other assets and liabilities, net	10,425	15,110
Net cash provided by operating activities	557,728	778,458
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(1,298,518)	
Sale of securities acquired in business acquisition	213,541	
Capital expenditures	(117,879)	(136,291)
Decrease (increase) in investments and other assets	798	(3,543)
Net cash used in investing activities	(1,202,058)	(139,834)
Cash flows from financing activities:		
Proceeds from borrowings	2,658,329	
Repayments of debt	(1,495,062)	(2,578)
Purchases of treasury stock	(884,995)	(750,000)
Exercise of stock options	104,004	40,787
Excess tax benefits from stock-based compensation arrangements	4,575	24
Dividends paid	(48,830)	(54,217)
Distributions to noncontrolling interests	(25,765)	(25,568)
Other financing activities	(6,402)	(12,067)
Net cash provided by (used in) financing activities	305,854	(803,619)
Net change in cash and cash equivalents	(338,476)	(164,995)
Cash and cash equivalents, beginning of period	449,301	534,256

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Cash and cash equivalents, end of period	\$	110,825	\$	369,261
		<u> </u>		<u> </u>

The accompanying notes are an integral part of these statements.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(unaudited)
(in thousands)

Quest Diagnostics Stockholders' Equity

	Shares of Common Stock Outstand- ing	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Compre- hensive Income (Loss)	Treasury Stock, at Cost	Compre- hensive Income	Non- controlling Interests	Total Stock- holders Equity
Balance, December 31, 2010	170,717	\$ 2,142	\$ 2,311,421	\$ 3,867,420	\$ 10,626	\$ (2,158,129)		\$ 20,645	\$ 4,054,125
Net income				281,130			\$ 281,130	25,628	306,758
Currency translation					(12,645)		(12,645)		(12,645)
Market valuation, net of tax benefit of \$1,389					(2,173)		(2,173)		(2,173)
Net deferred loss on cash flow hedges					(1,252)		(1,252)		(1,252)
Comprehensive income							\$ 265,060		
Dividends declared				(47,484)					(47,484)
Distributions to noncontrolling interests								(25,765)	(25,765)
Issuance of common stock under benefit plans	1,084	7	1,605			13,039			14,651
Stock-based compensation expense			48,203			2,586			50,789
Exercise of stock options	2,388		(16,949)			120,953			104,004
Shares to cover employee payroll tax withholdings on stock issued under benefit plans	(344)	(3)	(19,535)						(19,538)
Tax benefits associated with stock-based compensation plans			6,419						6,419
Purchases of treasury stock	(16,424)					(884,995)			(884,995)
Other								2,070	2,070
Balance, September 30, 2011	157,421	\$ 2,146	\$ 2,331,164	\$ 4,101,066	\$ (5,444)	\$ (2,906,546)		\$ 22,578	\$ 3,544,964

Quest Diagnostics Stockholders' Equity

	Shares of Common Stock Outstand- ing	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Compre- hensive Income (Loss)	Treasury Stock, at Cost	Compre- hensive Income	Non- controlling Interests	Total Stock- holders Equity
Balance, December 31, 2009	183,293	\$ 2,141	\$ 2,302,368	\$ 3,216,639	\$ (20,961)	\$ (1,510,548)		\$ 21,825	\$ 4,011,464
Net income				555,138			\$ 555,138	27,647	582,785
Currency translation					24,321		24,321		24,321
					2,373		2,373		2,373

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Market valuation, net of
tax expense of \$1,517
Net deferred loss on cash
flow hedges

543

543

543

Comprehensive income

\$ 582,375

Dividends declared			(52,948)					(52,948)
Distributions to noncontrolling interests							(25,568)	(25,568)
Issuance of common stock under benefit plans	993	2	(24,782)		39,790			15,010
Stock-based compensation expense			42,389		2,653			45,042
Exercise of stock options	1,048		(11,530)		52,317			40,787
Shares to cover employee payroll tax withholdings on stock issued under benefit plans	(274)	(1)	(5,600)		(9,614)			(15,215)
Tax benefits associated with stock-based compensation plans			2,675					2,675
Purchases of treasury stock	(14,693)				(750,000)			(750,000)
Other							(564)	(564)

Balance, September 30, 2010

170,367

\$ 2,142

\$ 2,305,520

\$ 3,718,829

\$ 6,276

\$ (2,175,402)

\$ 23,340

\$ 3,880,705

The accompanying notes are an integral part of these statements.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands unless otherwise indicated)

1. DESCRIPTION OF BUSINESS

Background

Quest Diagnostics Incorporated and its subsidiaries (Quest Diagnostics or the Company) is the world's leading provider of diagnostic testing, information and services, providing insights that enable patients, physicians and others to make better healthcare decisions. Quest Diagnostics offers patients and physicians the broadest access to diagnostic laboratory services through the Company's nationwide network of laboratories and patient service centers. The Company provides interpretive consultation through the largest medical and scientific staff in the industry, with approximately 900 M.D.s and Ph.D.s, primarily located in the United States. Quest Diagnostics is the leading provider of clinical testing, including gene-based and esoteric testing, anatomic pathology services and testing for drugs-of-abuse in the United States, and the leading provider of risk assessment services for the life insurance industry in North America. The Company is also a leading provider of testing for clinical trials. The Company's diagnostics products business manufactures and markets diagnostic test kits and specialized point-of-care testing. Quest Diagnostics empowers healthcare organizations and clinicians with robust information technology solutions that can improve patient care and medical practice.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The interim consolidated financial statements reflect all adjustments which in the opinion of management are necessary for a fair statement of financial condition, results of operations, and cash flows for the periods presented. Except as otherwise disclosed, all such adjustments are of a normal recurring nature. The interim consolidated financial statements have been compiled without audit. Operating results for the interim periods are not necessarily indicative of the results that may be expected for the full year. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's 2010 Annual Report on Form 10-K.

The year-end balance sheet data was derived from the audited financial statements as of December 31, 2010, but does not include all the disclosures required by accounting principles generally accepted in the United States (GAAP).

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 common stock and 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 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.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

Adoption of New Accounting Standards

On January 1, 2011, the Company adopted revised guidance issued by the Financial Accounting Standards Board (FASB) related to the accounting for revenue in certain revenue arrangements that include software elements and in arrangements with multiple deliverables. The adoption of these standards did not have a material impact on the Company's consolidated financial statements.

On January 1, 2011, the Company adopted a new accounting standard related to the disclosures about the Company's use of fair value measurements relating to the tabular reconciliation of beginning and ending balances of the Level 3 (fair value determined based on significant unobservable inputs) classification and that provides greater disaggregation for each class of assets and liabilities that use fair value measurements. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

On January 1, 2011, the Company adopted a new accounting standard related to the accounting for insurance claims and related insurance recoveries. This standard clarifies that a healthcare entity may not net insurance recoveries against related professional claim liabilities in its balance sheet and also requires that claim liabilities shall be determined without consideration of insurance recoveries. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

On January 1, 2011, the Company adopted a new accounting standard pertaining to disclosures of charity care provided by healthcare entities. Under this new standard, the measurement basis for charity care disclosures is the cost of performing the services. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

On January 1, 2011, the Company adopted a new accounting standard related to goodwill which (1) modifies step one of the goodwill impairment test by requiring entities with reporting units that have a zero or negative carrying value to assess whether it is more likely than not that a goodwill impairment exists and (2) does not prescribe a specific method of calculating the carrying value of a reporting unit in the performance of step one of the goodwill impairment test. Under the requirements of this standard, if the entity concludes that it is more likely than not that an impairment of goodwill exists, the entity must perform step two of the goodwill impairment test. In determining whether it is more likely than not that an impairment of goodwill exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment exists. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

New Accounting Standards

In May 2011, the FASB issued an amendment to the accounting standards related to fair value measurements and disclosure requirements that result in a consistent definition of fair value and common requirements for the measurement and disclosure of fair value between GAAP and International Financial Reporting Standards. This standard provides certain amendments to the existing guidance on the use and application of fair value measurements and maintains a definition of fair value that is based on the notion of exit price. This standard will become effective for the Company on January 1, 2012 and is not expected to have a material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued an amendment to the accounting standards related to the presentation of comprehensive income. This standard revises the manner in which entities present comprehensive income in their financial statements and removes the option to present items of other comprehensive income in the statement of changes in stockholders' equity. This standard requires an entity to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements of net income and other comprehensive income. This standard will become effective retrospectively for the Company on January 1, 2012.

In September 2011, the FASB issued an amendment to the accounting standards related to the testing of goodwill for impairment. Under the revised guidance, an entity has the option to perform a qualitative assessment of whether it is more-likely-than-not that a reporting unit's fair value is less than its carrying value prior to performing the

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

two-step quantitative goodwill impairment test. If, based on the qualitative factors, an entity determines that the fair value of the reporting unit is greater than its carrying amount, then the entity would not be required to perform the two-step quantitative impairment test for that reporting unit. However, if the qualitative assessment indicates that it is not more-likely-than-not that the reporting unit's fair value exceeds its carrying value, then the quantitative assessment must be performed. An entity is permitted to perform the qualitative assessment on none, some or all of its reporting units and may also elect to bypass the qualitative assessment and begin with the quantitative assessment of goodwill impairment. This amendment is effective for the Company for annual and interim goodwill impairment tests performed on or after January 1, 2012 and is not expected to have a material impact on the Company's consolidated financial statements.

3. EARNINGS PER SHARE

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Amounts attributable to Quest Diagnostics stockholders:				
Income from continuing operations	\$ 172,098	\$ 198,435	\$ 282,261	\$ 555,816
Loss from discontinued operations, net of taxes	(250)	(360)	(1,131)	(678)
Net income attributable to Quest Diagnostics common stockholders	\$ 171,848	\$ 198,075	\$ 281,130	\$ 555,138
Income from continuing operations	\$ 172,098	\$ 198,435	\$ 282,261	\$ 555,816
Less: Earnings allocated to participating securities	967	957	1,934	2,545
Earnings available to Quest Diagnostics common stockholders basic and diluted	\$ 171,131	\$ 197,478	\$ 280,327	\$ 553,271
Weighted average common shares outstanding basic	157,816	173,229	158,971	177,456
Effect of dilutive securities:				
Stock options and performance share units	1,186	1,086	1,548	1,697
Weighted average common shares outstanding diluted	159,002	174,315	160,519	179,153
Earnings per share attributable to Quest Diagnostics common stockholders basic:				
Income from continuing operations	\$ 1.08	\$ 1.14	\$ 1.76	\$ 3.12
Loss from discontinued operations			(0.01)	
Net income	\$ 1.08	\$ 1.14	\$ 1.75	\$ 3.12
Earnings per share attributable to Quest Diagnostics common stockholders diluted:				

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Income from continuing operations	\$	1.08	\$	1.13	\$	1.75	\$	3.09
Loss from discontinued operations		(0.01)				(0.01)		
		<u> </u>		<u> </u>		<u> </u>		<u> </u>
Net income	\$	1.07	\$	1.13	\$	1.74	\$	3.09
		<u> </u>		<u> </u>		<u> </u>		<u> </u>

Stock options and performance share units of 2.3 million shares and 2.2 million shares for the three and nine months ended September 30, 2011, respectively, were not included due to their antidilutive effect.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

Stock options and performance share units of 3.3 million shares and 3.0 million shares for the three and nine months ended September 30, 2010, respectively, were not included due to their antidilutive effect.

4. BUSINESS ACQUISITIONS

Acquisition of Athena Diagnostics

On April 4, 2011, the Company completed its acquisition of Athena Diagnostics (Athena) from Thermo Fisher Scientific, Inc., in an all-cash transaction valued at \$740 million. Athena is the leading provider of advanced diagnostic tests related to neurological conditions, and generated revenues of approximately \$110 million in 2010.

Through the acquisition, the Company acquired all of Athena's operations. The Company financed the all-cash purchase price of \$740 million and related transaction costs with a portion of the net proceeds from the Company's 2011 Senior Notes Offering. For the nine months ended September 30, 2011, transaction costs of \$8.2 million were recorded in selling, general and administrative expenses. See Note 8 for further discussion of the 2011 Senior Notes Offering.

The acquisition of Athena was accounted for under the acquisition method of accounting. As such, the cost to acquire Athena was allocated to the respective assets acquired and liabilities assumed based on their estimated fair values as of the closing date. A preliminary allocation of the cost to acquire Athena has been made to certain assets and liabilities of Athena based on preliminary estimates. The Company is continuing to assess the estimated fair values of certain assets acquired and liabilities assumed. The consolidated financial statements include the results of operations of Athena subsequent to the closing of the acquisition which are not material to the Company's consolidated results of operations.

The following table summarizes the Company's preliminary purchase price allocation of the cost to acquire Athena:

	Preliminary Fair Values as of April 4, 2011
Cash and cash equivalents	\$
Accounts receivable	17,853
Other current assets	13,427
Property, plant and equipment	3,038
Intangible assets	220,040
Goodwill	563,974
Other assets	135
Total assets acquired	818,467
Current liabilities	8,511
Non-current deferred income taxes	69,956
Total liabilities assumed	78,467
Net assets acquired	\$ 740,000

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

The acquired amortizable intangible assets are being amortized over their estimated useful lives as follows:

	Preliminary Fair Values	Weighted Average Useful Life
Technology	\$ 92,580	16 years
Non-compete agreement	37,000	4 years
Tradenname	34,520	10 years
Customer relationships	21,420	20 years
Informatics database	34,520	10 years
	\$ 220,040	

Of the amount allocated to goodwill and intangible assets, approximately \$42 million is expected to be deductible for tax purposes. All of the goodwill acquired in connection with the Athena acquisition has been allocated to the Company's clinical testing business. As of the acquisition date, the fair value of accounts receivable approximated its book value, all of which is expected to be collected.

Acquisition of Celera Corporation

On March 17, 2011, the Company entered into a definitive merger agreement with Celera Corporation (Celera) under which the Company agreed to acquire Celera in a transaction valued at approximately \$344 million, net of \$326 million in acquired cash and short-term marketable securities. Additionally, the Company expects to utilize Celera's available tax credits, net operating loss carryforwards and capitalized tax research and development expenditures to reduce its future tax payments by approximately \$110 million. Celera is a healthcare business delivering personalized cardiovascular disease management through a combination of products and services incorporating proprietary discoveries. Celera generated revenues of \$128 million in 2010.

Under the terms of the definitive merger agreement, the Company, through a wholly-owned subsidiary, commenced a cash tender offer to purchase all of the outstanding shares of common stock of Celera for \$8 per share in cash. On May 4, 2011, the Company announced that as a result of the tender offer, the Company had a controlling ownership interest in Celera. On May 17, 2011, the Company completed the acquisition by means of a short-form merger, in which the remaining shares of Celera common stock that had not been tendered into the tender offer were converted into the right to receive \$8 per share in cash. The Company has accounted for the acquisition of Celera as a single transaction, effective May 4, 2011.

Through the acquisition, the Company acquired all of Celera's operations. The Company financed the all-cash purchase price of \$670 million and related transaction costs with borrowings under its existing credit facilities and cash on hand. Of the total cash purchase price of \$670 million, \$669 million was paid through September 30, 2011. Accounts payable and accrued expenses at September 30, 2011 included a liability of \$1 million representing the remaining merger consideration related to shares of Celera which had not been surrendered as of September 30, 2011.

For the nine months ended September 30, 2011, transaction costs of \$8.4 million were recorded in selling, general and administrative expenses. Additionally, for the nine months ended September 30, 2011, financing related costs of \$3.1 million were recorded in interest expense, net.

The acquisition of Celera was accounted for under the acquisition method of accounting. As such, the cost to acquire Celera was allocated to the respective assets acquired and liabilities assumed based on their estimated fair values as of the date the Company acquired its controlling ownership interest in Celera. A preliminary allocation of the cost to acquire Celera has been made to certain assets and liabilities of Celera based on preliminary estimates. The Company is continuing to assess the estimated fair values of certain assets acquired and liabilities assumed. The consolidated financial statements include the results of operations of Celera subsequent to the Company acquiring its controlling ownership interest which are not material to the Company's consolidated results of operations.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

The following table summarizes the Company's preliminary purchase price allocation of the cost to acquire Celera:

	Preliminary Fair Values as of May 4, 2011
Cash and cash equivalents	\$ 112,312
Short-term marketable securities	213,418
Accounts receivable	16,810
Other current assets	26,796
Property, plant and equipment	11,091
Intangible assets	85,830
Goodwill	135,624
Non-current deferred income taxes	102,838
Other assets	34,586
	<hr/>
Total assets acquired	739,305
	<hr/>
Current liabilities	59,008
Long-term liabilities	10,717
	<hr/>
Total liabilities assumed	69,725
	<hr/>
Net assets acquired	\$ 669,580
	<hr/>

The acquired amortizable intangible assets are being amortized over their estimated useful lives as follows:

	Preliminary Fair Values	Weighted Average Useful Life
Outlicensed technology	\$ 46,450	6 years
Technology	21,730	8 years
Customer relationships	6,750	9 years
Tradename	5,400	5 years
	<hr/>	
	\$ 80,330	
	<hr/>	

In addition to the amortizable intangible assets noted above, \$5.5 million was allocated to in-process research and development, which is currently not subject to amortization.

Of the amount allocated to goodwill and intangible assets, approximately \$28 million is expected to be deductible for tax purposes. Of the total goodwill acquired in connection with the Celera acquisition, approximately \$104 million has been allocated to the Company's clinical testing business, with the remainder allocated to the Company's diagnostics products business. As of the acquisition date, the fair value of accounts receivable approximated its book value, all of which is expected to be collected.

Goodwill represents the excess of the fair value of the acquiree over the recognized bases of the net identifiable assets acquired and includes the future economic benefits from other assets that could not be individually identified and separately recognized. Specifically, the

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

goodwill recorded as part of the Athena and Celera acquisitions includes: the expected synergies resulting from combining the operations of the acquired businesses with those of the Company; and the value associated with an assembled workforce that has a historical track record of identifying opportunities, developing services and products, and commercializing them.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

Pro Forma Combined Financial Information

Supplemental pro forma combined financial information has not been presented as the combined impact of the Athena and Celera acquisitions is not material to the Company's consolidated financial statements.

5. FAIR VALUE MEASUREMENTS

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
		Level 1	Level 2	Level 3
September 30, 2011				
Assets:				
Trading securities	\$ 44,272	\$ 44,272	\$	\$
Interest rate swaps	54,331		54,331	
Cash surrender value of life insurance policies	19,173		19,173	
Available-for-sale equity securities	1,504			1,504
Foreign currency forward contracts	213		213	
Total	\$ 119,493	\$ 44,272	\$ 73,717	\$ 1,504
Liabilities:				
Deferred compensation liabilities	\$ 66,908	\$	\$ 66,908	\$
Foreign currency forward contracts	2,199		2,199	
Total	\$ 69,107	\$	\$ 69,107	\$

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands 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, 2010		Level 1	Level 2	Level 3
Assets:				
Trading securities	\$ 38,740	\$ 38,740	\$	\$
Cash surrender value of life insurance policies	20,314		20,314	
Interest rate swaps	10,483		10,483	
Available-for-sale equity securities	5,066			5,066
Foreign currency forward contracts	4,527		4,527	
Total	\$ 79,130	\$ 38,740	\$ 35,324	\$ 5,066
Liabilities:				
Deferred compensation liabilities	\$ 61,964	\$	\$ 61,964	\$
Foreign currency forward contracts	464		464	
Total	\$ 62,428	\$	\$ 62,428	\$

The Company offers certain employees the opportunity to participate in 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 foreign currency forward contracts are obtained from a third-party pricing service and are based on market prices in actual transactions and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The fair value measurements of the Company's interest rate 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. The Company does not believe that the changes in the fair values of its foreign currency forward contracts and interest rate swaps will materially differ from the amounts that could be realized upon settlement or maturity or that the changes in fair value will have a material effect on its results of operations, liquidity and capital resources.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Investments in available-for-sale equity securities consist of the revaluation of an existing investment in unregistered common shares of a publicly-held company. This investment is classified within Level 3 because the

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

unregistered securities contain restrictions on their sale, and therefore, the fair value measurement reflects a discount for the effect of the restriction.

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 September 30, 2011 and December 31, 2010, the fair value of the Company's debt was estimated at \$4.6 billion and \$3.1 billion, respectively, using quoted market prices and yields for the same or similar types of borrowings, taking into account the underlying terms of the debt instruments. At September 30, 2011 and December 31, 2010, the estimated fair value exceeded the carrying value of the debt by \$426 million and \$80 million, respectively.

6. TAXES ON INCOME

Income tax expense for the nine months ended September 30, 2011 and 2010 was \$256 million and \$334 million, respectively. The increase in the effective income tax rate for the nine months ended September 30, 2011 is primarily due to a charge recorded in the first quarter of 2011 associated with a settlement of certain legal claims (see Note 12), a portion for which a tax benefit has not been recorded.

7. GOODWILL AND INTANGIBLE ASSETS

The changes in goodwill for the nine months ended September 30, 2011 and for the year ended December 31, 2010 are as follows:

	September 30, 2011	December 31, 2010
	<u> </u>	<u> </u>
Balance at beginning of period	\$ 5,101,938	\$ 5,083,944
Goodwill acquired during the year	701,087	
Other purchase accounting adjustments		246
(Decrease) increase related to foreign currency translation	(6,832)	17,748
	<u> </u>	<u> </u>
Balance at end of period	<u>\$ 5,796,193</u>	<u>\$ 5,101,938</u>

Approximately 90% of the Company's goodwill as of September 30, 2011 and December 31, 2010 was associated with its clinical testing business.

For the nine months ended September 30, 2011, goodwill acquired was principally associated with the Athena and Celera acquisitions (see Note 4 for further details).

For the year ended December 31, 2010, other purchase accounting adjustments were primarily related to a milestone payment on an acquisition from 2008.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

Intangible assets at September 30, 2011 and December 31, 2010 consisted of the following:

	Weighted Average Amortization Period	September 30, 2011			December 31, 2010		
		Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Amortizing intangible assets:							
Customer-related intangibles	19 years	\$ 630,730	\$ (185,028)	\$ 445,702	\$ 603,203	\$ (161,345)	\$ 441,858
Non-compete agreements	4 years	91,981	(58,104)	33,877	54,886	(52,134)	2,752
Technology	14 years	165,188	(24,422)	140,766	51,830	(16,796)	35,034
Other	8 years	146,217	(18,973)	127,244	24,065	(9,380)	14,685
Total	16 years	1,034,116	(286,527)	747,589	733,984	(239,655)	494,329
Intangible assets not subject to amortization:							
In-process research and development		5,500		5,500			
Tradenames		300,753		300,753	302,076		302,076
Other		764		764			
Total intangible assets		\$ 1,341,133	\$ (286,527)	\$ 1,054,606	\$ 1,036,060	\$ (239,655)	\$ 796,405

The increase in intangible assets for the nine months ended September 30, 2011 was primarily due to intangible assets acquired as part of the Athena and Celera acquisitions (see Note 4 for further details).

Amortization expense related to intangible assets was \$19.4 million and \$9.9 million for the three months ended September 30, 2011 and 2010, respectively. For the nine months ended September 30, 2011 and 2010, amortization expense related to intangible assets was \$47.8 million and \$28.5 million, respectively.

The estimated amortization expense related to amortizable intangible assets for each of the five succeeding fiscal years and thereafter as of September 30, 2011 is as follows:

Fiscal Year Ending December 31,	
Remainder of 2011	\$ 18,941
2012	77,068
2013	75,174
2014	73,433
2015	62,972
2016	56,262
Thereafter	383,739

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Total \$ 747,589

8. DEBT

Short-term borrowings and current portion of long-term debt at September 30, 2011 and December 31, 2010 consisted of the following:

	<u>September 30, 2011</u>	<u>December 31, 2010</u>
Secured Receivables Credit Facility	\$ 85,000	\$
Current portion of long-term debt	750,910	348,996
	<u> </u>	<u> </u>
Total short-term borrowings and current portion of long-term debt	\$ 835,910	\$ 348,996
	<u> </u>	<u> </u>

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

Long-term debt at September 30, 2011 and December 31, 2010 consisted of the following:

	September 30, 2011	December 31, 2010
Senior Notes due July 2011	\$	\$ 159,234
Term Loan due May 2012	742,000	742,000
Floating Rate Senior Notes due March 2014	200,000	
Senior Notes due November 2015	499,347	499,227
Senior Notes due April 2016	311,773	
Senior Notes due July 2017	374,541	374,480
Senior Notes due January 2020	536,149	503,770
Senior Notes due April 2021	549,129	
Senior Notes due July 2037	420,958	420,840
Senior Notes due January 2040	438,218	243,422
Other	46,642	47,183
Total long-term debt	4,118,757	2,990,156
Less: current portion of long-term debt	750,910	348,996
Total long-term debt, net of current portion	\$ 3,367,847	\$ 2,641,160

2011 Senior Notes Offering

On March 24, 2011, the Company completed a \$1.25 billion senior notes offering (the 2011 Senior Notes). The 2011 Senior Notes were sold in four tranches: (a) \$200 million aggregate principal amount of three-month LIBOR plus 0.85% floating rate senior notes due March 24, 2014 (the Floating Rate Senior Notes due 2014), issued at par, (b) \$300 million aggregate principal amount of 3.20% senior notes due April 1, 2016 (the Senior Notes due 2016), issued at a discount of \$0.3 million, (c) \$550 million aggregate principal amount of 4.70% senior notes due April 1, 2021 (the Senior Notes due 2021), issued at a discount of \$0.9 million and (d) \$200 million aggregate principal amount of 5.75% senior notes due January 30, 2040 (the Senior Notes due 2040), issued at a discount of \$5.5 million. The Senior Notes due 2040 are a reopening of the \$250 million aggregate principal amount of 5.75% Senior Notes due 2040 issued on November 17, 2009. After considering the discounts, the effective interest rates on the Senior Notes due 2016, the Senior Notes due 2021 and the Senior Notes due 2040 are 3.22%, 4.72% and 5.95%, respectively. The Floating Rate Senior Notes due 2014 require quarterly interest payments, which commenced on June 24, 2011. The three-month LIBOR was 0.37% at September 30, 2011. The Senior Notes due 2016 and the Senior Notes due 2021 require semi-annual interest payments, which commenced on October 1, 2011. The Senior Notes due 2040 require semi-annual interest payments, which commenced on July 30, 2011. The 2011 Senior Notes are unsecured obligations of the Company and rank equally with the Company's other unsecured obligations. The 2011 Senior Notes do not have a sinking fund requirement and are guaranteed by certain of the Company's domestic, wholly-owned subsidiaries (the Subsidiary Guarantors).

The Company incurred \$10.4 million of costs associated with the 2011 Senior Notes, which is being amortized over the term of the related debt.

The Company used \$750 million of the net proceeds from the 2011 Senior Notes to fund the purchase price and related transaction costs associated with its acquisition of Athena, which closed on April 4, 2011 (see Note 4), and \$485 million of the net proceeds, together with \$90 million of cash on hand, to repay outstanding indebtedness under the Company's senior unsecured revolving credit facility and its secured receivables credit facility.

As further discussed in Note 9, the Company has hedged its interest rate exposure on a portion of the Senior Notes due 2016 and on a portion of the Senior Notes due 2020 which have been designated as fair value hedges. The carrying value of the Senior Notes due 2016 has been increased by the fair value of the related hedge of \$12.0 million in the consolidated balance sheet as of September 30, 2011. At September 30, 2011 and December 31, 2010, the carrying value of the Senior Notes due 2020 has been increased by the fair value of the related hedge of \$42.3 million and \$10.5 million, respectively.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED (dollars in thousands unless otherwise indicated)

Senior Unsecured Revolving Credit Facility

In September 2011, the Company entered into a \$750 million senior unsecured revolving credit facility (the "Credit Facility") which replaced the Company's then existing \$750 million senior unsecured revolving credit facility that was scheduled to mature in May 2012. Interest on the Credit Facility, which matures in September 2016, is based on certain published rates plus an applicable margin that will vary over a range from 75 basis points to 175 basis points based on changes in the Company's public debt ratings. At the option of the Company, it may elect to lock into LIBOR-based interest rates for periods up to six months. Interest on any outstanding amounts not covered under LIBOR-based interest rate contracts is based on an alternate base rate, which is calculated by reference to the prime rate, the federal funds rate or an adjusted LIBOR rate. At September 30, 2011, the Company's borrowing rate for LIBOR-based loans under the Credit Facility was LIBOR plus 1.125%. At December 31, 2010, the Company's borrowing rate for LIBOR-based loans under its then existing senior unsecured revolving credit facility was LIBOR plus 0.40%. The Credit Facility is currently guaranteed by the Subsidiary Guarantors. The Company expects that the guarantees provided by the Subsidiary Guarantors will no longer be required principally upon the full repayment of the amounts outstanding under the term loan due May 2012. The Credit Facility contains various covenants, including the maintenance of certain financial ratios, which could impact the Company's ability to, among other things, incur additional indebtedness. At both September 30, 2011 and December 31, 2010, there were no outstanding borrowings under the Company's senior unsecured revolving credit facility.

As of September 30, 2011, long-term debt matures as follows:

Fiscal Year Ending December 31,	
Remainder of 2011	\$ 184,201
2012	568,754
2013	8,357
2014	207,962
2015	505,411
2016	301,210
Thereafter	2,312,747
Total maturities of debt	4,088,642
Unamortized discount	(24,216)
Fair value basis adjustment attributable to hedged debt	54,331
Total debt	4,118,757
Less: current portion of long-term debt	750,910
Total long-term debt, net of current portion	\$ 3,367,847

A full description of the terms of the Company's indebtedness and related service requirements is contained in Note 10 to the Consolidated Financial Statements in the Company's 2010 Annual Report on Form 10-K.

9. FINANCIAL INSTRUMENTS

The Company uses derivative financial instruments to manage its exposure to market risks for changes in interest rates and 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 or trading purposes. The Company does not enter into derivative financial instruments that contain credit-risk-related contingent features or requirements to post collateral.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

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

		September 30, 2011		December 31, 2010	
		Balance Sheet Classification	Fair Value	Balance Sheet Classification	Fair Value
Derivatives Designated as Hedging Instruments					
Asset Derivatives:					
Interest rate swaps	Other assets	\$ 54,331		Other assets	\$ 10,483
Derivatives Not Designated as Hedging Instruments					
Asset Derivatives:					
Foreign currency forward contracts	Other current assets	\$ 213		Other current assets	\$ 4,527
Liability Derivatives:					
Foreign currency forward contracts	Other current liabilities	\$ 2,199		Other current liabilities	\$ 464
Total Net Derivatives Asset		\$ 52,345			\$ 14,546

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, which includes the use of interest rate swaps.

The Company formally documents its hedge relationships, including identifying the hedging instruments and the hedged items, as well as its risk management objectives and strategies for undertaking the hedge transaction. On the date the derivative is entered into, the Company designates the type of derivative as a fair value hedge or cash flow hedge, and accounts for the derivative in accordance with its designation as prescribed by the standards on accounting for derivative instruments and hedging activities. At inception and at least quarterly thereafter, the Company formally assesses whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in the fair value or cash flows of the hedged item. All components of each derivative financial instrument's gain or loss are included in the assessment of hedge effectiveness.

The Company accounts for its derivatives as either an asset or liability measured at its fair value. The fair value is based upon quoted market prices obtained from third-party financial institutions and includes an adjustment for the credit risk of the obligor's non-performance. For a derivative instrument that has been formally designated as a fair value hedge, fair value gains or losses on the derivative instrument are reported in earnings, together with offsetting fair value gains or losses on the hedged item that are attributable to the risk being hedged. For derivatives that have been formally designated as a cash flow hedge, the effective portion of changes in the fair value of the derivatives is recorded in accumulated other comprehensive income and the ineffective portion is recorded in earnings. Upon maturity or early termination of an effective interest rate swap designated as a cash flow hedge, unrealized gains or losses are deferred in stockholders' equity, as a component of accumulated other comprehensive income, and are amortized as an adjustment to interest expense over the period during which the hedged forecasted transaction affects earnings. If it is determined that a derivative ceases to be a highly effective hedge, the Company discontinues hedge accounting and any deferred gains or losses related to a discontinued cash flow hedge shall continue to be reported in accumulated other comprehensive income, unless it is probable that the forecasted transaction will not occur. If it is probable that the forecasted transaction

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

will not occur by the originally specified time period, the Company discontinues hedge accounting, and any deferred gains or losses reported in accumulated other comprehensive income are classified into earnings immediately.

Interest Rate Derivatives Cash Flow Hedges

In March 2011, the Company entered into interest rate lock agreements with several financial institutions for a total notional amount of \$400 million (the "Treasury Lock Agreements"). The Treasury Lock Agreements, which had an original maturity date of April 5, 2011, were entered into to hedge part of the Company's interest rate exposure associated with the variability in future cash flows attributable to changes in the 10-year and 30-year U.S. treasury rates related to the planned issuance of debt securities. In connection with the Company's senior notes offering in March 2011 (see Note 8), the Company paid \$3.1 million to settle the Treasury Lock Agreements which have been accounted for as cash flow hedges. These losses are deferred in stockholders' equity, as a component of accumulated other comprehensive income, and are amortized as an adjustment to interest expense over the term of the Senior Notes due 2021 and Senior Notes due 2040.

In previous years, the Company entered into various forward starting interest rate swap agreements and treasury-lock agreements that were accounted for as cash flow hedges (see Note 11 to the Consolidated Financial Statements in the Company's 2010 Annual Report on Form 10-K for further details). The effective portions of the changes in fair value of these derivatives represent deferred gains or losses that are recorded in accumulated other comprehensive income. These deferred gains or losses are reclassified from accumulated other comprehensive income to the statement of operations in the same period or periods during which the hedged transaction affects earnings, which is when the Company recognizes interest expense on the hedged cash flows. The total loss, net of tax benefit, recognized in accumulated other comprehensive income on the cash flow hedges as of September 30, 2011 and December 31, 2010 was \$7.9 million and \$6.6 million, respectively. The loss recognized on the Company's cash flow hedges for the three and nine months ended September 30, 2011 and 2010, 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 income into earnings within the next 12 months is \$1.3 million.

Interest Rate Derivatives Fair Value Hedges

In March 2011, the Company entered into various fixed-to-variable interest rate swap agreements (the "2011 Fixed-to-Variable Interest Rate Swap Agreements") which have an aggregate notional amount of \$200 million and a variable interest rate based on six-month LIBOR plus 0.54%.

In November 2009, the Company entered into various fixed-to-variable interest rate swap agreements (the "2009 Fixed-to-Variable Interest Rate Swap Agreements") which have an aggregate notional amount of \$350 million and a variable interest rate based on one-month LIBOR plus 1.33%.

These derivative financial instruments are accounted for as fair value hedges of a portion of the Senior Notes due 2016 and a portion of the Senior Notes due 2020 and effectively convert that portion of the debt into variable interest rate debt. The Company recognizes the changes in the fair value of both the fixed-to-variable interest rate swap agreements and the related underlying debt obligations in other (expense) income, net as equal and offsetting gains and losses. The fair value of the 2011 Fixed-to-Variable Interest Rate Swap Agreements was an asset of \$12.0 million at September 30, 2011. At September 30, 2011 and December 31, 2010, the fair value of the 2009 Fixed-to-Variable Interest Rate Swap Agreements was an asset of \$42.3 million and \$10.5 million, respectively. Since inception, the fair value hedges have been effective; therefore, there is no impact on earnings for the three and nine months ended September 30, 2011 and 2010 as a result of hedge ineffectiveness.

Foreign Currency Risk

The Company is exposed to market risk for changes in foreign exchange rates primarily under certain intercompany receivables and payables. Foreign exchange forward contracts are used to mitigate the exposure of the eventual net cash inflows or outflows resulting from these intercompany transactions. The objective is to hedge a portion of the forecasted foreign currency risk over a rolling 12-month time horizon to mitigate the eventual impacts of changes in foreign exchange rates on the cash flows of the intercompany transactions. As of September 30, 2011, the gross

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

notional amount of foreign currency forward contracts in U.S. dollars was \$35.4 million and principally consists of contracts in Swedish krona. The Company does not designate these derivative instruments as hedges under current accounting standards unless the benefits of doing so are material. The Company's foreign exchange exposure is not material to the Company's consolidated financial condition or results of operations. The Company does not hedge its net investment in non-U.S. subsidiaries because it views those investments as long-term in nature.

10. STOCKHOLDERS' EQUITY

Components of Comprehensive Income

The market valuation adjustment for the nine months ended September 30, 2011 and 2010 represents unrealized holding (losses) gains on available-for-sale securities, net of taxes. The net deferred loss on cash flow hedges for the nine months ended September 30, 2011 and 2010 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 9). Foreign currency translation adjustments are not adjusted for income taxes since they relate to indefinite investments in non-U.S. subsidiaries.

Comprehensive Income

For the three months ended September 30, 2011 and 2010, comprehensive income was \$132 million and \$253 million, respectively.

Dividend Program

During each of the quarters of 2011 and 2010, the Company's Board of Directors has declared a quarterly cash dividend of \$0.10 per common share. On October 25, 2011, the Company's Board of Directors announced an increase in the quarterly cash dividend from \$0.10 per common share to \$0.17 per common share, payable on January 24, 2012, to shareholders of record on January 9, 2012.

Share Repurchase Plan

In January 2011, the Company's Board of Directors authorized the Company to repurchase an additional \$750 million of the Company's common stock, increasing the total available authorization at that time to \$1 billion. The share repurchase authorization has no set expiration or termination date.

For the three months ended September 30, 2011, the Company repurchased 1.0 million shares of its common stock at an average price of \$47.79 per share for a total of \$50 million. For the nine months ended September 30, 2011, the Company repurchased 16.4 million shares of its common stock at an average price of \$53.89 per share for a total of \$885 million, including 15.4 million shares purchased in the first quarter from SB Holdings Capital Inc., a wholly-owned subsidiary of GlaxoSmithKline plc., at an average price of \$54.30 per share for a total of \$835 million. For the three and nine months ended September 30, 2011, the Company reissued 0.2 million shares and 2.7 million shares, respectively, for employee benefit plans. At September 30, 2011, \$115 million remained available under the Company's share repurchase authorizations.

For the three months ended September 30, 2010, the Company repurchased 7.0 million shares of its common stock at an average price of \$46.64 per share for a total of \$324 million. For the nine months ended September 30, 2010, the Company repurchased 14.7 million shares of its common stock at an average price of \$51.04 per share for \$750 million, including 4.5 million shares purchased in the first quarter at an average price per share of \$56.21 for \$251 million under an accelerated share repurchase transaction (ASR) with a bank.

Under the ASR, in January 2010, the Company repurchased 4.5 million shares of the Company's outstanding common stock for an initial purchase price of \$56.05 per share. The purchase price of these shares was subject to an adjustment based on the volume weighted average price of the Company's common stock during a period following execution of the agreement. The total cost of the initial purchase was \$250 million. The purchase price adjustment was

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

settled in the first quarter of 2010 and resulted in an additional cash payment of \$0.7 million, for a final purchase price of \$251 million, or \$56.21 per share.

For the three and nine months ended September 30, 2010, the Company reissued 0.1 million shares and 1.7 million shares, respectively, for employee benefit plans.

11. SUPPLEMENTAL CASH FLOW & OTHER DATA

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Depreciation expense	\$ 53,945	\$ 54,222	\$ 161,588	\$ 161,900
Interest expense	(44,059)	(36,472)	(129,570)	(109,642)
Interest income	651	272	1,652	1,120
Interest expense, net	(43,408)	(36,200)	(127,918)	(108,522)
Interest paid	55,718	62,131	128,301	118,546
Income taxes paid	24,934	127,298	132,655	324,416
Assets acquired under capital leases	2,927	12,018	5,624	16,230
<u>Businesses acquired:</u>				
Fair value of assets acquired	4,729		1,560,173	
Fair value of liabilities assumed			148,192	
Fair value of net assets acquired	4,729		1,411,981	
Merger consideration paid (payable)	157,409		(1,151)	
Cash paid for business acquisitions	162,138		1,410,830	
Less: Cash acquired			112,312	
Business acquisitions, net of cash acquired	\$ 162,138	\$	\$ 1,298,518	\$

12. 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 19, 2011 and is guaranteed by the Subsidiary Guarantors.

In support of its risk management program, to ensure the Company's performance or payment to third parties, \$63 million in letters of credit were outstanding at September 30, 2011. The letters of credit primarily represent collateral for current and future automobile liability and workers' compensation loss payments. In addition, \$5 million of bank guarantees were outstanding at September 30, 2011 in support of certain foreign operations.

Contingent Lease Obligations

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

The Company is subject to contingent obligations under certain leases and other instruments incurred in connection with real estate activities and other operations associated with LabOne, Inc., which the Company acquired in 2005, and certain of its predecessor companies. No liability has been recorded for any of these potential contingent obligations. See Note 15 to the Consolidated Financial Statements contained in the Company's 2010 Annual Report on Form 10-K for further details.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED (dollars in thousands unless otherwise indicated)

Legal Matters

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

California Lawsuit

In 2006 and 2008, the Company and several of its subsidiaries received subpoenas from the California Attorney General's Office (the Attorney General) seeking documents relating to the Company's billings to Medi-Cal, the California Medicaid program. The Company cooperated with the government's requests. Subsequently, the State of California intervened as plaintiff in a civil lawsuit, California ex rel. Hunter Laboratories, LLC v. Quest Diagnostics Incorporated., et al. (the California Lawsuit), filed in California Superior Court against a number of clinical laboratories, including the Company and several of its subsidiaries. The complaint was originally filed by a competitor laboratory in California under the whistleblower provisions of the California False Claims Act. The complaint was unsealed on March 20, 2009.

The plaintiffs alleged, among other things, that the Company overcharged Medi-Cal for testing services and violated the California False Claims Act. Specifically, the plaintiffs alleged, among other things, that the Company violated certain regulations that govern billing to Medi-Cal (Comparable Charge regulations). A liability finding could have led to an injunction, fines or penalties, and exclusion from Medi-Cal, as well as claims by third parties.

On May 9, 2011, the Company announced an agreement in principle to resolve these matters. On May 19, 2011, the Company finalized a settlement and release with the Attorney General, the Department and the *qui tam* relator. While denying liability, in order to avoid the uncertainty, expense and risks of litigation, the Company agreed to resolve these matters for \$241 million. The Company agreed to the settlement to resolve the Comparable Charge allegations; the Company received a full release of these and all other allegations in the complaint. The Company also agreed to certain reporting obligations regarding its pricing for a limited time period and, at the option of the Company in lieu of such obligations for a transitional period, to provide Medi-Cal with a discount (the Transitional Discount) until the end of July 2012. The Transitional Discount, to the extent provided, is not expected to have a material impact on the Company's consolidated revenues or results of operations.

As provided for in the settlement agreement, the Company resumed billing for unbilled services and expects to be reimbursed for all services provided prior to the effective date of the settlement agreement. Such reimbursement is expected to be consistent with the related amounts accrued.

As a result of the agreement in principle, the Company recorded a pre-tax charge to earnings in the first quarter of 2011 of \$236 million, which represented the cost to resolve the matters noted above and related claims, less amounts previously reserved for related matters. The Company funded the \$241 million payment in the second quarter of 2011 with cash on hand and borrowings under its existing credit facilities.

Other Legal Matters

In November 2009, the U.S. District Court for the Southern District of New York partially unsealed a civil complaint, U.S. ex rel. Fair Laboratory Practices Associates v. Quest Diagnostics Incorporated, filed against the Company under the whistleblower provisions of the federal False Claims Act. The complaint alleged, among other things, violations of the federal Anti-Kickback Statute and the federal False Claims Act in connection with the Company's pricing of laboratory services. The complaint seeks damages for alleged false claims associated with laboratory tests reimbursed by government payors, treble damages and civil penalties. In March 2011, the district court granted the Company's motion to dismiss the relators' complaint and disqualified the relators and their counsel from pursuing an action based on the facts alleged in the complaint; the relators filed a notice of appeal. The government was given additional time to decide whether to join the case. In July 2011, the government filed a notice declining to intervene in the action and the Court entered a final judgment in the Company's favor. The relators' appeal is pending.

In April 2010, a putative class action was filed against the Company and NID in the U.S. District Court for the Eastern District of New York on behalf of entities that allegedly purchased or paid for certain of NID's test kits. The

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED (dollars in thousands unless otherwise indicated)

complaint alleges that certain of NID's test kits were defective and that defendants, among other things, violated RICO and state consumer protection laws. The complaint alleges an unspecified amount of damages.

In August 2010, a shareholder derivative action was filed in the Superior Court of New Jersey, Morris County, on behalf of the Company against the directors and certain present officers of the Company. The complaint alleges that the defendants breached their fiduciary duties in connection with, among other things, alleged overcharges by the Company to Medi-Cal, the California Medicaid program, for testing services, and seeks unspecified compensatory damages and equitable relief. The action was dismissed without prejudice. On July 21, 2011, the action was re-filed.

In November 2010, a putative class action was filed against the Company and certain present and former officers of the Company in New Jersey state court, on behalf of the Company's sales people nationwide who were over forty years old and who either resigned or were terminated after being placed on a performance improvement plan. The complaint alleges that the defendants' conduct violates the New Jersey Law Against Discrimination, and seeks, among other things, unspecified damages. The defendants removed the complaint to the United States District Court for the District of New Jersey.

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. The complaint seeks unspecified damages on behalf of an alleged class of purchasers of Celera's stock during the period in which the alleged misrepresentations were made.

In June 2011, a shareholder derivative action was filed in the Superior Court of New Jersey, on behalf of the Company against the current directors and a former director of the Company. The complaint alleges that the defendants breached their fiduciary duties, wasted corporate assets and were unjustly enriched in connection with, among other things, alleged overcharges by the Company to Medi-Cal for testing services, and seeks unspecified compensatory damages and equitable relief.

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 addition, the Company and certain of its subsidiaries have received subpoenas from state agencies in five states and from the Office of the Inspector General of the U.S. Department of Health and Human Services which seek documents relating to the Company's billing practices. The Company is cooperating with the requests, and one state recently formally closed its investigation.

The federal or state governments may bring claims based on new theories as to the Company's practices which management believes to be in compliance with law. 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 certain pending individual or class action lawsuits, and has received several subpoenas, related to billing practices filed under the qui tam provisions of the Civil False Claims Act and/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.

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 September 30, 2011, the Company does not believe that any losses related to these matters are probable. While the Company believes that a reasonable possibility exists that losses may have been incurred, based on the nature and status of the matters, potential losses, if any, cannot be estimated.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED (dollars in thousands unless otherwise indicated)

Reserves for Legal Matters

Management has established reserves in accordance with generally accepted accounting principles for the matters discussed above. Such reserves totaled approximately \$2 million and \$10 million as of September 30, 2011 and December 31, 2010, respectively. 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 accruals for 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.

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 \$136 million and \$130 million as of September 30, 2011 and December 31, 2010, 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.

13. DISCONTINUED OPERATIONS

Summarized financial information for the discontinued operations of NID, a test kit manufacturing subsidiary which was closed in 2006, is set forth below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net revenues	\$	\$	\$	\$
Income (loss) from discontinued operations before income taxes	188	3	(93)	298
Income tax expense	(438)	(363)	(1,038)	(976)
Loss from discontinued operations, net of taxes	\$ (250)	\$ (360)	\$ (1,131)	\$ (678)

The remaining balance sheet information related to NID was not material at September 30, 2011 and December 31, 2010.

14. BUSINESS SEGMENT INFORMATION

Clinical testing is an essential element in the delivery of healthcare services. Physicians use clinical tests to assist in the detection, diagnosis, evaluation, monitoring and treatment of diseases and other medical conditions. Clinical testing is generally categorized as clinical laboratory testing and anatomic pathology services. Clinical laboratory testing is performed on whole blood, serum, plasma and other body fluids, such as urine, and specimens such as microbiology samples. Anatomic pathology services are principally for the detection of cancer and are performed on tissues, such as

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

biopsies, and other samples, such as human cells. Customers of the clinical testing business include patients, physicians, hospitals, employers, governmental institutions and other commercial clinical laboratories. The clinical testing business accounted for greater than 90% of net revenues from continuing operations in 2011 and 2010.

All other operating segments include the Company's non-clinical testing businesses and consist of its risk assessment services, clinical trials testing, healthcare information technology and diagnostics products businesses. The Company's risk assessment business provides underwriting support services to the life insurance industry including teleunderwriting, specimen collection and paramedical examinations, laboratory testing, medical record retrieval, case management, motor vehicle reports, telephone inspections, prescription histories and credit checks. The Company's clinical trials testing business provides clinical testing performed in connection with clinical research trials on new drugs, vaccines and certain medical devices. The Company's healthcare information technology business is a developer and integrator of clinical connectivity and data management solutions for healthcare organizations, physicians and clinicians that can help improve patient care and medical practice. The Company's diagnostics products business manufactures and markets products that enable healthcare professionals to make healthcare diagnoses, including products for point-of-care testing for the professional market. During the second quarter of 2011, the Company acquired Athena and Celera (see Note 4 for further details). Athena is included in the Company's clinical laboratory testing business. The majority of Celera's operations are included in the Company's clinical laboratory testing business, with the remainder in other operating segments.

On April 19, 2006, the Company decided to discontinue NID's operations and results of operations for NID have been classified as discontinued operations for all periods presented (see Note 13).

At September 30, 2011, 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 nine months ended September 30, 2011 and 2010. 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 management and administrative corporate expenses, including amortization of intangible assets and the charge to earnings in the first quarter of 2011 of \$236 million related to the settlement of the California Lawsuit (see Note 12), are included in general corporate expenses below. 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 2010 Annual Report on Form 10-K and Note 2 to the interim consolidated financial statements.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net revenues:				
Clinical laboratory testing business	\$ 1,723,102	\$ 1,708,051	\$ 5,112,215	\$ 5,080,230
All other operating segments	183,303	156,604	518,968	464,655
Total net revenues	\$ 1,906,405	\$ 1,864,655	\$ 5,631,183	\$ 5,544,885
Operating earnings (loss):				
Clinical laboratory testing business	\$ 352,757	\$ 369,168	\$ 1,036,789	\$ 1,101,733
All other operating segments	24,492	16,008	47,117	33,065
General corporate expenses	(55,196)	(48,309)	(414,039)	(133,475)
Total operating income	322,053	336,867	669,867	1,001,323
Non-operating expenses, net	(38,784)	(25,849)	(105,864)	(83,929)
Income from continuing operations before taxes	283,269	311,018	564,003	917,394
Income tax expense	101,126	102,902	256,114	333,931
Income from continuing operations	182,143	208,116	307,889	583,463
Loss from discontinued operations, net of taxes	(250)	(360)	(1,131)	(678)
Net income	181,893	207,756	306,758	582,785
Less: Net income attributable to noncontrolling interests	10,045	9,681	25,628	27,647
Net income attributable to Quest Diagnostics	\$ 171,848	\$ 198,075	\$ 281,130	\$ 555,138

15. SUMMARIZED FINANCIAL INFORMATION

The Company's Floating Rate Senior Notes due 2014, Senior Notes due 2015, Senior Notes due 2016, Senior Notes due 2017, Senior Notes due 2020, Senior Notes due 2021, Senior Notes due 2037 and Senior Notes due 2040 are fully and unconditionally guaranteed, jointly and severally, by the Subsidiary Guarantors. With the exception of Quest Diagnostics Receivables Incorporated (QDRI) (see paragraph below), the non-guarantor subsidiaries are primarily foreign subsidiaries and less than wholly-owned subsidiaries.

In conjunction with the Company's secured receivables credit facility, the Company maintains a wholly-owned non-guarantor subsidiary, QDRI. The Company and certain of its Subsidiary Guarantors transfer certain domestic receivables to QDRI. QDRI utilizes the transferred receivables to collateralize borrowings under the Company's secured receivables credit facility. The Company and the Subsidiary Guarantors provide collection services to QDRI. QDRI uses cash collections principally to purchase new receivables from the Company and the Subsidiary Guarantors.

The following condensed consolidating financial data illustrates the composition of the combined guarantors. Investments in subsidiaries are accounted for by the parent using the equity method for purposes of the supplemental consolidating presentation. Earnings (losses) of subsidiaries are therefore reflected in the parent's investment accounts and earnings. The principal elimination entries relate to investments in subsidiaries and intercompany balances and transactions.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

Condensed Consolidating Statement of Operations
Three Months Ended September 30, 2011

	Parent	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Net revenues	\$ 195,552	\$ 1,591,099	\$ 185,257	\$ (65,503)	\$ 1,906,405
Operating costs and expenses:					
Cost of services	130,350	920,778	65,446		1,116,574
Selling, general and administrative	29,507	332,204	92,314	(7,430)	446,595
Amortization of intangible assets	392	17,654	1,356		19,402
Royalty (income) expense	(104,113)	104,113			
Other operating (income) expense, net	(382)	455	1,708		1,781
Total operating costs and expenses	55,754	1,375,204	160,824	(7,430)	1,584,352
Operating income	139,798	215,895	24,433	(58,073)	322,053
Non-operating (expense) income, net	(43,595)	(53,859)	597	58,073	(38,784)
Income from continuing operations before taxes	96,203	162,036	25,030		283,269
Income tax expense	32,178	63,823	5,125		101,126
Income from continuing operations	64,025	98,213	19,905		182,143
Loss from discontinued operations, net of taxes		(250)			(250)
Equity earnings from subsidiaries	107,823			(107,823)	
Net income	171,848	97,963	19,905	(107,823)	181,893
Less: Net income attributable to noncontrolling interests			10,045		10,045
Net income attributable to Quest Diagnostics	\$ 171,848	\$ 97,963	\$ 9,860	\$ (107,823)	\$ 171,848

Condensed Consolidating Statement of Operations
Three Months Ended September 30, 2010

	Parent	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Net revenues	\$ 209,156	\$ 1,540,714	\$ 186,307	\$ (71,522)	\$ 1,864,655
Operating costs and expenses:					
Cost of services	133,527	894,001	63,937		1,091,465
Selling, general and administrative	32,043	307,533	94,515	(7,529)	426,562
Amortization of intangible assets	618	7,597	1,700		9,915
Royalty (income) expense	(105,055)	105,055			
Other operating expense (income), net	1,499	73	(1,726)		(154)
Total operating costs and expenses	62,632	1,314,259	158,426	(7,529)	1,527,788
Operating income	146,524	226,455	27,881	(63,993)	336,867
Non-operating (expense) income, net	(33,314)	(58,341)	1,813	63,993	(25,849)

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Income from continuing operations before taxes	113,210	168,114	29,694		311,018
Income tax expense	29,294	66,251	7,357		102,902
Income from continuing operations	83,916	101,863	22,337		208,116
Loss from discontinued operations, net of taxes		(360)			(360)
Equity earnings from subsidiaries	114,159			(114,159)	
Net income	198,075	101,503	22,337	(114,159)	207,756
Less: Net income attributable to noncontrolling interests			9,681		9,681
Net income attributable to Quest Diagnostics	\$ 198,075	\$ 101,503	\$ 12,656	\$ (114,159)	\$ 198,075

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

Condensed Consolidating Statement of Operations
Nine Months Ended September 30, 2011

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net revenues	\$ 597,362	\$ 4,671,748	\$ 566,136	\$ (204,063)	\$ 5,631,183
Operating costs and expenses:					
Cost of services	375,283	2,737,849	204,834		3,317,966
Selling, general and administrative	103,469	986,510	289,517	(22,254)	1,357,242
Amortization of intangible assets	1,098	41,851	4,894		47,843
Royalty (income) expense	(310,887)	310,887			
Other operating expense, net	235,924	826	1,515		238,265
Total operating costs and expenses	404,887	4,077,923	500,760	(22,254)	4,961,316
Operating income	192,475	593,825	65,376	(181,809)	669,867
Non-operating (expense) income, net	(127,721)	(164,314)	4,362	181,809	(105,864)
Income from continuing operations before taxes	64,754	429,511	69,738		564,003
Income tax expense	68,946	169,566	17,602		256,114
Income (loss) from continuing operations	(4,192)	259,945	52,136		307,889
Loss from discontinued operations, net of taxes		(1,131)			(1,131)
Equity earnings from subsidiaries	285,322			(285,322)	
Net income	281,130	258,814	52,136	(285,322)	306,758
Less: Net income attributable to noncontrolling interests			25,628		25,628
Net income attributable to Quest Diagnostics	\$ 281,130	\$ 258,814	\$ 26,508	\$ (285,322)	\$ 281,130

Condensed Consolidating Statement of Operations
Nine Months Ended September 30, 2010

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net revenues	\$ 638,796	\$ 4,564,026	\$ 560,016	\$ (217,953)	\$ 5,544,885
Operating costs and expenses:					
Cost of services	385,350	2,660,571	190,888		3,236,809
Selling, general and administrative	76,394	934,116	288,619	(22,422)	1,276,707
Amortization of intangible assets	653	22,829	5,062		28,544
Royalty (income) expense	(311,863)	311,863			
Other operating expense (income), net	1,178	539	(215)		1,502
Total operating costs and expenses	151,712	3,929,918	484,354	(22,422)	4,543,562
Operating income	487,084	634,108	75,662	(195,531)	1,001,323

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Non-operating (expense) income, net	(103,847)	(179,726)	4,113	195,531	(83,929)
Income from continuing operations before taxes	383,237	454,382	79,775		917,394
Income tax expense	133,356	179,329	21,246		333,931
Income from continuing operations	249,881	275,053	58,529		583,463
Loss from discontinued operations, net of taxes		(678)			(678)
Equity earnings from subsidiaries	305,257			(305,257)	
Net income	555,138	274,375	58,529	(305,257)	582,785
Less: Net income attributable to noncontrolling interests			27,647		27,647
Net income attributable to Quest Diagnostics	\$ 555,138	\$ 274,375	\$ 30,882	\$ (305,257)	\$ 555,138

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

Condensed Consolidating Balance Sheet
September 30, 2011

	Parent	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<u>Assets</u>					
Current assets:					
Cash and cash equivalents	\$ 53,183	\$ 10,914	\$ 46,728	\$	\$ 110,825
Accounts receivable, net	19,090	172,687	744,482		936,259
Other current assets	62,436	190,949	96,169	(361)	349,193
Total current assets	134,709	374,550	887,379	(361)	1,396,277
Property, plant and equipment, net	164,278	601,139	40,626		806,043
Goodwill and intangible assets, net	155,138	6,246,343	449,318		6,850,799
Intercompany (payable) receivable	(394,806)	680,511	(285,705)		
Investment in subsidiaries	7,854,227			(7,854,227)	
Other assets	310,661	43,311	50,011	(130,631)	273,352
Total assets	\$ 8,224,207	\$ 7,945,854	\$ 1,141,629	\$ (7,985,219)	\$ 9,326,471
<u>Liabilities and Stockholders' Equity</u>					
Current liabilities:					
Accounts payable and accrued expenses	\$ 740,094	\$ 140,012	\$ 48,417	\$ (361)	\$ 928,162
Short-term borrowings and current portion of long-term debt	743,346	6,944	85,620		835,910
Total current liabilities	1,483,440	146,956	134,037	(361)	1,764,072
Long-term debt	3,024,344	18,499	325,004		3,367,847
Other liabilities	194,037	537,677	48,505	(130,631)	649,588
Stockholders' equity:					
Quest Diagnostics stockholders' equity	3,522,386	7,242,722	611,505	(7,854,227)	3,522,386
Noncontrolling interests			22,578		22,578
Total stockholders' equity	3,522,386	7,242,722	634,083	(7,854,227)	3,544,964
Total liabilities and stockholders' equity	\$ 8,224,207	\$ 7,945,854	\$ 1,141,629	\$ (7,985,219)	\$ 9,326,471

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

Condensed Consolidating Balance Sheet
December 31, 2010

	Parent	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<u>Assets</u>					
Current assets:					
Cash and cash equivalents	\$ 392,525	\$ 928	\$ 55,848	\$	\$ 449,301
Accounts receivable, net	15,913	135,417	693,969		845,299
Other current assets	55,723	165,099	96,183	(6,188)	310,817
Total current assets	464,161	301,444	846,000	(6,188)	1,605,417
Property, plant and equipment, net	179,624	616,114	38,638		834,376
Goodwill and intangible assets, net	155,596	5,279,371	463,376		5,898,343
Intercompany receivable (payable)	84,107	231,268	(315,375)		
Investment in subsidiaries	6,195,557			(6,195,557)	
Other assets	227,822	10,090	48,319	(96,737)	189,494
Total assets	\$ 7,306,867	\$ 6,438,287	\$ 1,080,958	\$ (6,298,482)	\$ 8,527,630
<u>Liabilities and Stockholders' Equity</u>					
Current liabilities:					
Accounts payable and accrued expenses	\$ 623,610	\$ 190,334	\$ 57,516	\$ (6,188)	\$ 865,272
Current portion of long-term debt	203,659	144,004	1,333		348,996
Total current liabilities	827,269	334,338	58,849	(6,188)	1,214,268
Long-term debt	2,295,709	19,342	326,109		2,641,160
Other liabilities	150,409	512,681	51,724	(96,737)	618,077
Stockholders' equity:					
Quest Diagnostics stockholders' equity	4,033,480	5,571,926	623,631	(6,195,557)	4,033,480
Noncontrolling interests			20,645		20,645
Total stockholders' equity	4,033,480	5,571,926	644,276	(6,195,557)	4,054,125
Total liabilities and stockholders' equity	\$ 7,306,867	\$ 6,438,287	\$ 1,080,958	\$ (6,298,482)	\$ 8,527,630

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(dollars in thousands unless otherwise indicated)

Condensed Consolidating Statement of Cash Flows
Nine Months Ended September 30, 2011

	Parent	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities:					
Net income	\$ 281,130	\$ 258,814	\$ 52,136	\$ (285,322)	\$ 306,758
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	34,563	162,459	12,409		209,431
Provision for doubtful accounts	3,630	41,994	168,749		214,373
Provision for special charge	236,000				236,000
Other, net	(291,570)	69,318	(7,869)	285,322	55,201
Changes in operating assets and liabilities	(104,461)	(157,172)	(202,402)		(464,035)
Net cash provided by operating activities	159,292	375,413	23,023		557,728
Net cash used in investing activities	(1,212,729)	(197,558)	(9,269)	217,498	(1,202,058)
Net cash provided by (used in) financing activities	714,095	(167,869)	(22,874)	(217,498)	305,854
Net change in cash and cash equivalents	(339,342)	9,986	(9,120)		(338,476)
Cash and cash equivalents, beginning of period	392,525	928	55,848		449,301
Cash and cash equivalents, end of period	\$ 53,183	\$ 10,914	\$ 46,728	\$	\$ 110,825

Condensed Consolidating Statement of Cash Flows
Nine Months Ended September 30, 2010

	Parent	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities:					
Net income	\$ 555,138	\$ 274,375	\$ 58,529	\$ (305,257)	\$ 582,785
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	37,183	140,870	12,391		190,444
Provision for doubtful accounts	4,171	39,116	179,595		222,882
Other, net	(259,463)	15,487	(6,614)	305,257	54,667
Changes in operating assets and liabilities	274,106	(355,766)	(190,660)		(272,320)
Net cash provided by operating activities	611,135	114,082	53,241		778,458
Net cash provided by (used in) investing activities	20,930	(106,411)	(3,852)	(50,501)	(139,834)
Net cash used in financing activities	(775,597)	(24,937)	(53,586)	50,501	(803,619)

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Net change in cash and cash equivalents	(143,532)	(17,266)	(4,197)		(164,995)
Cash and cash equivalents, beginning of period	464,958	17,457	51,841		534,256
Cash and cash equivalents, end of period	\$ 321,426	\$ 191	\$ 47,644	\$	\$ 369,261

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

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions and select accounting policies that affect our reported financial results and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

While many operational aspects of our business are subject to complex federal, state and local regulations, the accounting for most of our business is generally straightforward with net revenues primarily recognized upon completion of the testing process. Our revenues are primarily comprised of a high volume of relatively low dollar transactions, and about one-half of our total costs and expenses consist of employee compensation and benefits. Due to the nature of our business, several of our accounting policies involve significant estimates and judgments. These accounting policies have been described in our Annual Report on Form 10-K for the year ended December 31, 2010.

Initiatives to Improve Operating Efficiency

The diagnostic testing industry is labor intensive. Employee compensation and benefits constitute approximately one-half of our total costs and expenses. Cost of services consists principally of costs for obtaining, transporting and testing specimens. Selling, general and administrative expenses consist principally of the costs associated with our sales and marketing efforts, billing operations, bad debt expense and general management and administrative support. In addition, performing diagnostic testing involves significant fixed costs for facilities and other infrastructure required to obtain, transport and test specimens. Therefore, relatively small changes in volume can have a significant impact on profitability in the short-term.

A large portion of our costs are fixed, making it more challenging to fully mitigate the profit impact of reduced volume in the short term. In response to reduced volume levels, as a result of a temporary slowdown in healthcare utilization, we have implemented a number of actions in the third quarter of 2011 to align our costs with reduced volume levels. These actions, which are broad in nature and affect most parts of our business, resulted in a charge to earnings in the third quarter of 2011 of \$26 million, comprised principally of employee separation costs.

In addition, in July 2011 we announced a multi-year program designed to reduce our cost structure by \$500 million by the end of 2014. This effort is intended to address continued reimbursement pressures and labor and benefit cost increases, free up additional resources to invest in science and innovation, and enable us to improve operating profitability. As detailed plans to implement these opportunities are approved and executed, it likely will result in charges to earnings associated with the implementation. These charges may be material to the results of operations and cash flows in the periods recorded or paid.

Acquisitions

Acquisition of Athena Diagnostics

On February 24, 2011, we signed a definitive agreement to acquire Athena Diagnostics (Athena) from Thermo Fisher Scientific, Inc., in an all-cash transaction valued at approximately \$740 million. Athena is the leading provider of advanced diagnostic tests related to neurological conditions, and generated revenues of approximately \$110 million in 2010. We completed the acquisition of Athena on April 4, 2011 (see Note 4 to the interim consolidated financial statements for further details).

Acquisition of Celera Corporation

On March 17, 2011, we entered into a definitive merger agreement with Celera Corporation ("Celera") under which we agreed to acquire Celera for \$8 per share, in a transaction valued at approximately \$344 million, net of \$326 million in acquired cash and short-term marketable securities. Additionally, we expect to utilize Celera's available tax credits, net operating loss carryforwards and capitalized tax research and development expenditures to reduce our future tax payments by approximately \$110 million. Celera is a healthcare business delivering personalized cardiovascular disease management through a combination of products and services incorporating proprietary discoveries. Celera generated revenues of \$128 million in 2010. We completed the acquisition of Celera on May 17, 2011. See Note 4 to the interim consolidated financial statements for further details.

Results of Operations

Our clinical testing business currently represents our one reportable business segment. In both 2011 and 2010, our clinical testing business accounted for greater than 90% of net revenues. Our other operating segments consist of our risk assessment services, clinical trials testing, healthcare information technology and diagnostic products businesses. Our business segment information is disclosed in Note 14 to the interim consolidated financial statements.

Settlement Related to the California Lawsuit

As a result of settlement discussions which resumed in the first quarter of 2011, on May 9, 2011, we announced an agreement in principle to resolve a previously disclosed civil lawsuit brought by a California competitor in which the State of California intervened (the "California Lawsuit"). In the lawsuit, the plaintiffs alleged, among other things, that we overcharged Medi-Cal for testing services and violated the California False Claims Act. Specifically, the plaintiffs alleged, among other things, that we violated certain regulations that govern billing to Medi-Cal ("Comparable Charge" regulations). While denying liability, in order to avoid the uncertainty, expense and risks of litigation, we agreed to resolve these matters for \$241 million. On May 19, 2011, we finalized a settlement agreement and release with the California Department of Health Care Services, the California Attorney General's Office and the *qui tam* relator. We agreed to the settlement to resolve claims pertaining to the Comparable Charge allegations; we received a full release of these and all other allegations in the complaint. We also agreed to certain reporting obligations regarding our pricing for a limited time period and, at our option in lieu of such obligations for a transitional period, to provide Medi-Cal with a discount (the "Transitional Discount") until the end of July 2012. The Transitional Discount, to the extent provided, is not expected to have a material impact on our consolidated revenues or results of operations.

As provided for in the settlement agreement, we have resumed billing for unbilled services and expect to be reimbursed for all services provided prior to the effective date of the final settlement agreement. Such reimbursement is expected to be consistent with the related amounts accrued.

As a result of the agreement in principle, we recorded a pre-tax charge to earnings in the first quarter of 2011 of \$236 million (the "Medi-Cal charge"), or \$1.21 per diluted share, which represented the cost to resolve the matters noted above and related claims, less amounts previously reserved for related matters.

We funded the \$241 million payment in the second quarter of 2011 with cash on hand and borrowings under our existing credit facilities. See Note 12 to the interim consolidated financial statements for further details.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Three and Nine Months Ended September 30, 2011 Compared with Three and Nine Months Ended September 30, 2010

Continuing Operations

	Three Months Ended September 30,		% Change: Increase (Decrease)	Nine Months Ended September 30,		% Change: Increase (Decrease)
	2011	2010		2011	2010	
(dollars in millions, except per share data)						
Net revenues	\$ 1,906.4	\$ 1,864.7	2.2%	\$ 5,631.2	\$ 5,544.9	1.6%
Income from continuing operations	172.1	198.4	(13.3)%	282.3	555.8	(49.2)%
Earnings per diluted share	\$ 1.08	\$ 1.13	(4.4)%	\$ 1.75	\$ 3.09	(43.4)%

Results for the three months ended September 30, 2011 were affected by a number of items which impacted earnings per diluted share by \$0.10. In connection with a number of cost actions that we implemented in the third quarter of 2011, we recorded pre-tax charges of \$26 million, or \$0.10 per diluted share, principally associated with workforce reductions. Of these costs, \$15.9 million and \$10.1 million were included in cost of services and selling, general and administrative expenses, respectively. In addition, results for the three months ended September 30, 2011 included pre-tax charges of \$1.3 million associated with the acquisitions of Athena and Celera, primarily related to integration charges, which were recorded in selling, general and administrative expenses.

Results for the nine months ended September 30, 2011 were affected by a number of items which impacted earnings per diluted share by \$1.55. During the first quarter of 2011, we recorded the Medi-Cal charge of \$236 million, or \$1.21 per diluted share, in other operating expense (income), net. In addition, results for the nine months ended September 30, 2011 included \$39.3 million of pre-tax charges, or \$0.15 per diluted share, principally associated with workforce reductions. Of these costs, \$24.9 million and \$14.4 million were included in cost of services and selling, general and administrative expenses, respectively. Results for the nine months ended September 30, 2011 also included pre-tax charges of \$27.1 million, or \$0.12 per diluted share, associated with the acquisitions of Athena and Celera. Of these costs, \$24.0 million, primarily related to professional fees and integration costs, were recorded in selling, general and administrative expenses and \$3.1 million of financing related costs were included in interest expense, net. In addition, we estimate that the impact of severe weather during the first quarter of 2011 adversely affected operating income for the nine months ended September 30, 2011 by \$18.5 million, or \$0.07 per diluted share.

In addition, results for the three and nine months ended September 30, 2011 included a benefit of \$0.05 per diluted share, primarily associated with the favorable resolution of certain tax contingencies.

Results for the nine months ended September 30, 2010 were affected by a number of items which impacted earnings per diluted share by \$0.11. During the first quarter of 2010, we recorded pre-tax charges of \$17.3 million, or \$0.06 per diluted share, principally associated with workforce reductions. Of these costs, \$4.5 million and \$12.8 million were included in cost of services and selling, general and administrative expenses, respectively. In addition, we estimate that the impact of severe weather during the first quarter of 2010 adversely affected operating income for the nine months ended September 30, 2010 by \$14.1 million, or \$0.05 per diluted share. Results for the three and nine months ended September 30, 2010 also included a benefit of \$0.08 per diluted share, primarily associated with the favorable resolution of certain tax contingencies.

Net Revenues

Net revenues for the three months ended September 30, 2011 were 2.2% above the prior year level with the Athena and Celera acquisitions contributing 3.0% revenue growth in the quarter.

Clinical testing revenue, which accounted for over 90% of our consolidated revenues, increased by 0.9% for the three months ended September 30, 2011 over the prior year period. The acquisitions of Athena and Celera contributed about 2.4% to clinical testing revenue growth in the quarter. Clinical testing volume, measured by the number of

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

requisitions, decreased by 1.2% for the third quarter of 2011 compared to the prior year period primarily due to continued market softness, as measured by physician office visits in the third quarter of 2011. The acquisitions of Athena and Celera contributed an insignificant positive impact to clinical testing volume in the quarter. Pre-employment drug testing volume, which has continued to rebound, grew about 5% in the quarter.

Revenue per requisition for the three months ended September 30, 2011 was 2.1% above the prior year period, with the improvement driven by an increase in esoteric testing mix from the acquired operations of Athena and Celera. While revenue per requisition is benefiting from an increased mix in gene-based and esoteric testing, it continues to be pressured by business and payer mix changes, the 1.75% Medicare fee schedule decrease, which went into effect January 1, 2011, and pricing changes in connection with several large contract extensions executed in the first half of last year. The business and payer mix changes, which continue to pressure revenue per requisition, include, among other things, a rebound in our lower-priced drugs-of-abuse testing, and continued weakness in our higher priced anatomic pathology testing services.

Net revenues for the nine months ended September 30, 2011 were 1.6% above the prior year level with the Athena and Celera acquisitions contributing 1.9% to consolidated revenue growth.

Clinical testing revenue, which accounted for over 90% of our consolidated revenues, grew 0.6%. The acquisitions of Athena and Celera contributed about 1.6% to clinical testing revenue growth for the nine months ended September 30, 2011. Clinical testing volume, measured by the number of requisitions, was essentially unchanged compared to the prior year period. The clinical testing volume contributed by the Athena and Celera acquisitions had an insignificant positive impact in the nine months ended September 30, 2011. Pre-employment drug testing volume grew about 7% during the nine months ended September 30, 2011.

Revenue per requisition for the nine months ended September 30, 2011 was 0.7% above the prior year level. Revenue per requisition continues to benefit from an increased mix in gene-based and esoteric testing, particularly from the impact of the acquired operations of Athena and Celera. Offsetting this benefit was business and payor mix changes including: an increase in lower priced drugs-of-abuse testing and a decrease in higher priced anatomic pathology testing; price changes in connection with several large contract extensions executed in the first half of last year; and the 1.75% Medicare fee schedule decrease, which went into effect January 1, 2011.

Our businesses other than clinical laboratory testing accounted for approximately 9% of our net revenues for the three and nine months ended September 30, 2011 and 2010. These businesses include our risk assessment services, clinical trials testing, healthcare information technology and diagnostic products businesses. For the three and nine months ended September 30, 2011, revenue in our non-clinical testing businesses, which contain most of our international operations, grew by approximately 17.0% and 11.7%, respectively, and primarily benefited from the diagnostics products operations acquired as part of the Celera acquisition and foreign currency exchange rates.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Operating Costs and Expenses

Three Months Ended September 30,

	2011		2010		Change: Increase (Decrease)	
	\$	% Net Revenue	\$	% Net Revenue	\$	% Net Revenue
(dollars in millions)						
Cost of services	\$ 1,116.6	58.6%	\$ 1,091.5	58.5%	\$ 25.1	0.1%
Selling, general and administrative expenses (SG&A)	446.6	23.4%	426.6	22.9%	20.0	0.5%
Amortization of intangible assets	19.4	1.0%	9.9	0.5%	9.5	0.5%
Other operating expense (income), net	1.8	0.1%	(0.2)	%	2.0	0.1%
Total operating costs and expenses	\$ 1,584.4	83.1%	\$ 1,527.8	81.9%	\$ 56.6	1.2%
Bad debt expense (included in SG&A)	\$ 68.4	3.6%	\$ 74.5	4.0%	\$ (6.1)	(0.4)%

Nine Months Ended September 30,

	2011		2010		Change: Increase (Decrease)	
	\$	% Net Revenue	\$	% Net Revenue	\$	% Net Revenue
(dollars in millions)						
Cost of services	\$ 3,318.0	58.9%	\$ 3,236.8	58.4%	\$ 81.2	0.5%
Selling, general and administrative expenses (SG&A)	1,357.2	24.1%	1,276.7	23.0%	80.5	1.1%
Amortization of intangible assets	47.8	0.9%	28.5	0.5%	19.3	0.4%
Other operating expense, net	238.3	4.2%	1.6	%	236.7	4.2%
Total operating costs and expenses	\$ 4,961.3	88.1%	\$ 4,543.6	81.9%	\$ 417.7	6.2%
Bad debt expense (included in SG&A)	\$ 214.4	3.8%	\$ 222.9	4.0%	\$ (8.5)	(0.2)%

Total Operating Costs and Expenses

For the third quarter of 2011, the impacts of the costs associated with actions we have taken to adjust our cost structure, higher costs associated with employee compensation and benefits, investments we have made in our sales force and service capabilities, and the impact of the Athena and Celera acquisitions served to increase total operating expenses as a percent of net revenues compared to the prior year period. Results for the third quarter of 2011 included pre-tax charges, principally associated with workforce reductions, of \$26.0 million (\$15.9 million in cost of services and \$10.1 million in selling, general and administrative expenses). Results for the third quarter of 2011 also included pre-tax charges of \$1.3 million, primarily related to integration charges associated with the acquisitions of Athena and Celera.

For the nine months ended September 30, 2011, the impacts of the Medi-Cal charge, severe weather, costs associated with actions we have taken to adjust our cost structure, higher costs associated with employee compensation and benefits, and investments we have made in our sales force and service capabilities, as well the impact of the Athena and Celera acquisitions, served to increase total operating expenses as a percent of net revenues compared to the prior year period. Results for the nine months ended September 30, 2011 included the Medi-Cal charge of \$236 million.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

recorded in connection with the California Lawsuit. In addition, results for the nine months ended September 30, 2011 and 2010 included pre-tax charges, principally associated with workforce reductions, of \$39.3 million (\$24.9 million in cost of services and \$14.4 million in selling, general and administrative expenses) and \$17.3 million (\$4.5 million in cost of services and \$12.8 million in selling, general and administrative expenses), respectively. Selling, general and administrative expenses for the nine months ended September 30, 2011 also included \$24.0 million of pre-tax charges, primarily related to professional fees and integration charges associated with the acquisitions of Athena and Celera.

Also, year-over-year comparisons for both the three and nine months ended September 30, 2011 were favorably impacted by approximately \$9.7 million and \$5.9 million, respectively, associated with losses on investments in our supplemental deferred compensation plans. Under our supplemental deferred compensation plans, employee compensation deferrals, together with Company matching contributions, are invested in a variety of investments held in trusts. Gains and losses associated with the investments are recorded in earnings within other (expense) income, net. A corresponding and offsetting adjustment is also recorded to the deferred compensation obligation to reflect investment gains and losses earned by the employee. Such adjustments to the deferred compensation obligation are recorded in earnings principally within selling, general and administrative expenses and offset the amount of investment gains and losses recorded in other (expense) income, net. Results for the three and nine months ended September 30, 2011 included a decrease in operating costs of \$5.9 million and \$3.5 million, respectively, representing decreases in the deferred compensation obligation to reflect investment losses incurred by employees participating in our deferred compensation plans. Results for the three and nine months ended September 30, 2010 included an increase in operating costs of \$3.8 million and \$2.4 million, respectively, representing an increase in the deferred compensation obligation to reflect investment gains earned by employees participating in our deferred compensation plans.

Cost of Services

The increase in cost of services as a percentage of net revenues for the three months ended September 30, 2011 compared to the prior year period primarily reflects pre-tax charges of \$15.9 million, primarily associated with workforce reductions, higher costs associated with employee compensation and benefits, and investments we have made in service capabilities, partially offset by actions we have taken to reduce our cost structure and an increase in revenue per requisition attributable to the acquired operations of Athena and Celera.

The increase in cost of services as a percentage of revenues for the nine months ended September 30, 2011 compared to the prior year period primarily reflects the impact of severe weather in the first quarter, a \$20.4 million increase in pre-tax charges, primarily associated with workforce reductions, and higher costs associated with employee compensation and benefits, and investments we have made in service capabilities. These increases have been partially offset by actions we have taken to reduce our cost structure and the acquired operations of Athena and Celera, which served to reduce the percentage.

Selling, General and Administrative Expenses

The increase in selling, general and administrative expenses as a percentage of net revenues for the three months ended September 30, 2011 compared to the prior year period reflects pre-tax charges of \$10.1 million, primarily related to workforce reductions, higher costs associated with employee compensation and benefits, investments we have made in our sales force and the impact of the Celera operations. These increases have been partially offset by actions we have taken to reduce our cost structure.

The increase in selling, general and administrative expenses as a percentage of net revenues for the nine months ended September 30, 2011 compared to the prior year period primarily reflects the impact of severe weather, a \$1.6 million increase in pre-tax charges, primarily associated with workforce reductions, higher costs associated with employee compensation and benefits and investments we have made in our sales force. In addition, selling, general and administrative expenses for the nine months ended September 30, 2011 included pre-tax charges of \$24.0 million, primarily related to professional fees and integration charges associated with the acquisitions of Athena and Celera. These increases have been partially offset by actions we have taken to reduce our cost structure.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

For the three and nine months ended September 30, 2011, bad debt expense as a percentage of net revenues improved compared to the prior year periods, primarily reflecting continued strong performance in our billing operations and collection metrics.

Amortization of Intangible Assets

The increase in amortization of intangible assets for the three and nine months ended September 30, 2011 compared to the prior year periods reflects the impact of amortization of intangible assets acquired as part of the Athena and Celera acquisitions.

Other Operating Expense (Income), net

Other operating expense (income), net includes special charges, and miscellaneous income and expense items related to operating activities. For the nine months ended September 30, 2011, other operating expense (income), net included the Medi-Cal charge of \$236 million recorded in connection with the California Lawsuit.

Operating Income

	Three Months Ended September 30,		Change: Increase (Decrease)	Nine Months Ended September 30,		Change: Increase (Decrease)
	2011	2010		2011	2010	
	(dollars in millions)					
Operating income	\$ 322.1	\$ 336.9	\$ (14.8)	\$ 669.9	\$ 1,001.3	\$ (331.4)
Operating income % of net revenues	16.9%	18.1%	(1.2)%	11.9%	18.1%	(6.2)%

For the third quarter of 2011, the impacts of the costs associated with actions we have taken to adjust our cost structure, higher costs associated with employee compensation and benefits, investments we have made in our sales force and service capabilities, and the increased amortization of intangibles associated with the acquisitions of Athena and Celera served to decrease operating income as a percent of net revenues compared to the prior year period.

For the nine months ended September 30, 2011, the impacts of the Medi-Cal charge, severe weather, costs associated with actions we have taken to adjust our cost structure, higher costs associated with employee compensation and benefits, and investments we have made in our sales force and service capabilities, as well as increased amortization of intangibles and transaction costs related to the Athena and Celera acquisitions, served to decrease operating income as a percent of net revenues compared to the prior year period.

Interest Expense, net

	Three Months Ended September 30,		Change: Increase (Decrease)	Nine Months Ended September 30,		Change: Increase (Decrease)
	2011	2010		2011	2010	
	(dollars in millions)					
Interest expense, net	\$ 43.4	\$ 36.2	\$ 7.2	\$ 127.9	\$ 108.5	\$ 19.4

Interest expense, net for the three and nine months ended September 30, 2011 increased from the prior year period primarily due to incremental debt of approximately \$1.2 billion, used to partially fund \$885 million of share repurchases and approximately \$1 billion paid for acquisitions. In addition, for the nine months ended September 30, 2011, interest expense, net included \$3.1 million of financing commitment fees related to the acquisition of Celera which were expensed. See Note 8 to the interim consolidated financial statements for further details regarding our senior notes offering.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

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 nine months ended September 30, 2011 and 2010, other (expense) income, net consisted of the following:

	Three Months Ended September 30,		Change: Increase (Decrease)	Nine Months Ended September 30,		Change: Increase (Decrease)
	2011	2010		2011	2010	
(dollars in millions)						
Investment (losses) gains associated with our supplemental deferred compensation plans	\$ (5.9)	\$ 3.8	\$ (9.7)	\$ (3.5)	\$ 2.4	\$ (5.9)
Gain on an investment	3.2		3.2	3.2		3.2
Other (expense) income items, net		(0.6)	0.6	(0.5)	(0.4)	(0.1)
Total other (expense) income, net	\$ (2.7)	\$ 3.2	\$ (5.9)	\$ (0.8)	\$ 2.0	\$ (2.8)

Income Tax Expense

	Three Months Ended September 30,		Change: Increase (Decrease)	Nine Months Ended September 30,		Change: Increase (Decrease)
	2011	2010		2011	2010	
Effective income tax rate	35.7%	33.1%	2.6%	45.4%	36.4%	9.0%

The increase in the effective income tax rate for the nine months ended September 30, 2011 is primarily due to the Medi-Cal charge recorded in the first quarter of 2011 associated with the California Lawsuit (see Note 12 to the interim consolidated financial statements), a portion for which a tax benefit has not been recorded.

Income tax expense for the three and nine months ended September 30, 2011 included a benefit of \$7.9 million, or \$0.05 per diluted share, primarily associated with the favorable resolution of certain tax contingencies. For the three and nine months ended September 30, 2010, income tax expense included a benefit of \$14.4 million, or \$0.08 per diluted share, primarily associated with the favorable resolution of certain tax contingencies.

Discontinued Operations

Loss from discontinued operations, net of taxes, for the three months ended September 30, 2011 was \$0.3 million, or \$0.01 per diluted share. For the three months ended September 30, 2010, loss from discontinued operations was \$0.4 million with no impact on diluted earnings per share. Loss from discontinued operations, net of taxes, for the nine months ended September 30, 2011 was \$1.1 million, or \$0.01 per diluted share. For the nine months ended September 30, 2010, loss from discontinued operations was \$0.7 million with no impact on diluted earnings per share. See Note 13 to the interim consolidated financial statements for further details.

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 trading purposes. 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. See Note 9 to the interim consolidated financial statements for additional discussion of our financial instruments and hedging activities.

At September 30, 2011 and December 31, 2010, the fair value of our debt was estimated at approximately \$4.6 billion and \$3.1 billion, respectively, using quoted market prices and yields for the same or similar types of borrowings.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

taking into account the underlying terms of the debt instruments. At September 30, 2011 and December 31, 2010, the estimated fair value exceeded the carrying value of the debt by \$426 million and \$80 million, respectively. A hypothetical 10% increase in interest rates (representing 41 basis points and 45 basis points at September 30, 2011 and December 31, 2010, respectively) would potentially reduce the estimated fair value of our debt by approximately \$113 million and \$89 million at September 30, 2011 and December 31, 2010, respectively.

Borrowings under our floating rate senior notes due 2014, our term loan due May 2012, 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 term loan due May 2012 and our senior unsecured revolving credit facility are subject to a pricing schedule that can fluctuate based on changes in our credit ratings. As such, our borrowing cost under these credit arrangements will be subject to both fluctuations in interest rates and changes in our credit ratings. At September 30, 2011, the borrowing rates under these debt instruments were: for our floating rate senior notes due 2014, LIBOR plus 0.85%; for our term loan due May 2012, LIBOR plus 0.40%; for our senior unsecured revolving credit facility, LIBOR plus 1.125%; and for our secured receivables credit facility, 1.2%. At September 30, 2011, the weighted average LIBOR was 0.3%. As of September 30, 2011, \$200 million, \$742 million, and \$85 million were outstanding under our floating rate senior notes due 2014, our term loan due May 2012, and our \$525 million secured receivables credit facility, respectively. There were no borrowings outstanding under our \$750 million senior unsecured revolving credit facility as of September 30, 2011.

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.

In March 2011, we entered into various fixed-to-variable interest rate swap agreements which have a notional amount totaling \$200 million and a variable interest rate based on six-month LIBOR plus 0.54%. These derivative financial instruments are accounted for as fair value hedges of a portion of our senior notes due 2016. In addition, in previous years we entered into various fixed-to-variable interest rate swap agreements with a notional amount of \$350 million and a variable interest rate based on one-month LIBOR plus 1.33% that were accounted for as fair value hedges of a portion of our senior notes due 2020. Based on our net exposure to interest rate changes, a hypothetical 10% change in interest rates on our variable rate indebtedness (representing 3 basis points) would impact annual interest expense by approximately \$0.5 million, assuming no changes to the debt outstanding at September 30, 2011.

The fair value of the fixed-to-variable interest rate swap agreements related to our senior notes due 2016 and our senior notes due 2020 was an asset of \$54.3 million at September 30, 2011. A hypothetical 10% change in interest rates (representing 15 basis points) would potentially change the fair value of the asset by approximately \$6 million.

For further details regarding our outstanding debt, see Note 10 to the consolidated financial statements included in our 2010 Annual Report on Form 10-K for the year ended December 31, 2010 and Note 8 to the interim consolidated financial statements. For details regarding our financial instruments, see Note 9 to the interim consolidated financial statements.

Risk Associated with Investment Portfolio

Our investment portfolio includes equity investments in publicly held companies that are classified as available-for-sale securities and other strategic equity holdings in privately held companies. These securities are exposed to price fluctuations and are generally concentrated in the life sciences industry. The carrying values of our available-for-sale equity securities and privately held securities were \$13.1 million at September 30, 2011.

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.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

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

Cash and Cash Equivalents

Cash and cash equivalents at September 30, 2011 totaled \$111 million, compared to \$449 million at December 31, 2010. Cash and cash equivalents consist of cash and highly liquid short-term investments. For the nine months ended September 30, 2011, cash flows from operating activities of \$558 million, together with cash on hand and cash flows from financing activities of \$306 million, were used to fund investing activities of \$1.2 billion. Cash and cash equivalents at September 30, 2010 totaled \$369 million, compared to \$534 million at December 31, 2009. For the nine months ended September 30, 2010, cash flows from operating activities of \$778 million, together with cash on hand, were used to fund investing and financing activities of \$140 million and \$804 million, respectively.

Cash Flows from Operating Activities

Net cash provided by operating activities for the nine months ended September 30, 2011 was \$558 million compared to \$778 million in the prior year period. For the nine months ended September 30, 2011, cash flows from operating activities included the second quarter payment to Medi-Cal, the California Medicaid program, of \$241 million in connection with the settlement of the California Lawsuit (see Note 12 to the interim consolidated financial statements), or \$194 million net of an associated reduction in estimated tax payments through the third quarter. In addition, 2011 cash flows from operating activities were reduced by \$37 million of payments related to transaction and integration costs associated with the acquisitions of Athena and Celera, or \$29 million net of an associated reduction in estimated tax payments. After giving consideration to the net settlement and transaction and integration payments, underlying cash flows from operating activities for the nine months ended September 30, 2011 increased by \$2.7 million in comparison to the prior year. This increase was a function of the timing of, as well as a reduction in, estimated tax payments, partially offset by the timing of payroll related payments, and an increase in payments associated with restructuring and integration activities and interest payments. Days sales outstanding, a measure of billing and collection efficiency, were 44 days at both September 30, 2011 and December 31, 2010, compared to 43 days at September 30, 2010.

Cash Flows from Investing Activities

Net cash used in investing activities for the nine months ended September 30, 2011 was \$1.2 billion, consisting principally of \$740 million related to the acquisition of Athena and \$556 million net of cash acquired related to the acquisition of Celera, or \$343 million net of cash and \$213 million of short-term marketable securities acquired. Proceeds from the sale of the short-term marketable securities, acquired as part of the Celera acquisition, were used to repay borrowings outstanding under our secured receivables credit facility and our senior unsecured revolving credit facility in the second quarter of 2011. In addition, cash flows from investing activities for the nine months ended September 30, 2011 included capital expenditures of \$118 million. Net cash used in investing activities for the nine months ended September 30, 2010 was \$140 million, and consisted principally of capital expenditures.

Cash Flows from Financing Activities

Net cash provided by financing activities for the nine months ended September 30, 2011 was \$306 million, consisting primarily of net increases in debt of \$1.2 billion, and proceeds from the exercise of stock options and related tax benefits totaling \$109 million, partially offset by purchases of treasury stock of \$885 million, dividend payments of \$49 million, distributions to noncontrolling interests of \$26 million and \$13 million of payments primarily related to debt issuance costs incurred in connection with our senior notes offering in the first quarter of 2011 and our senior unsecured revolving credit facility in the third quarter of 2011. The net increase in debt consists of \$2.7 billion of borrowings and \$1.5 billion of repayments.

In February 2011, borrowings of \$500 million under our secured receivables credit facility and \$75 million under our senior unsecured credit facility, together with \$260 million of cash on hand, were used to fund purchases of treasury stock totaling \$835 million. In addition, we completed a \$1.25 billion senior notes offering in March 2011 (the 2011

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Senior Notes). We used \$485 million of the \$1.24 billion in net proceeds from the 2011 Senior Notes offering, together with \$90 million of cash on hand, to fund the repayment of \$500 million outstanding under our secured receivables credit facility, and the repayment of \$75 million outstanding under our senior unsecured revolving credit facility. The remaining portion of the net proceeds from the 2011 Senior Notes offering were used to fund our acquisition of Athena in April 2011 (see Note 4 and Note 8 to the interim consolidated financial statements for further details).

During the second quarter of 2011, \$585 million and \$30 million of borrowings under our secured receivables credit facility and our senior unsecured revolving credit facility, respectively, together with cash on hand, were used to fund the acquisition of Celera in May 2011 (see Note 4 to the interim consolidated financial statements for further details). During the second quarter of 2011, proceeds from the sale of short-term marketable securities acquired as part of the Celera acquisition totaling \$214 million, together with cash on hand, were used to fund \$500 million and \$30 million of debt repayments under our secured receivables credit facility and our senior unsecured revolving credit facility, respectively.

During the third quarter of 2011, \$225 million of borrowings under our secured receivables credit facility were used primarily to fund \$159 million of debt repayments under our senior notes due July 2011 and purchases of treasury stock totaling \$50 million. Later in the quarter, we repaid \$225 million of borrowings outstanding under our secured receivables credit facility with cash on hand.

In September 2011, we entered into a \$750 million senior unsecured revolving credit facility which replaced our prior \$750 million senior unsecured revolving credit facility that was scheduled to mature in May 2012. See Note 8 to the interim consolidated financial statements for further details.

Net cash used in financing activities for the nine months ended September 30, 2010 was \$804 million, consisting primarily of purchases of treasury stock totaling \$750 million, dividend payments of \$54 million and distributions to noncontrolling interests of \$26 million, partially offset by \$41 million in proceeds from the exercise of stock options, including related tax benefits.

Dividends

During each of the quarters of 2011 and 2010, our Board of Directors declared a quarterly cash dividend of \$0.10 per common share. On October 25, 2011, our Board of Directors announced an increase in our quarterly cash dividend from \$0.10 per common share to \$0.17 per common share, payable on January 24, 2012, to shareholders of record on January 9, 2012. 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

In January 2011, our Board of Directors authorized \$750 million of additional share repurchases of our common stock, increasing our total available authorization at that time to \$1 billion. The share repurchase authorization has no set expiration or termination date.

For the three months ended September 30, 2011, we repurchased 1.0 million shares of our common stock at an average price of \$47.79 per share for a total of \$50 million. For the nine months ended September 30, 2011, we repurchased 16.4 million shares of our common stock at an average price of \$53.89 per share for a total of \$885 million, including 15.4 million shares purchased in the first quarter from SB Holdings Capital Inc., a wholly-owned subsidiary of GlaxoSmithKline plc., at an average price of \$54.30 per share for a total of \$835 million. At September 30, 2011, \$115 million remained available under the share repurchase authorizations.

For the three months ended September 30, 2010, we repurchased 7.0 million shares of our common stock at an average price of \$46.64 per share for \$324 million. For the nine months ended September 30, 2010, we repurchased 14.7 million shares of our common stock at an average price of \$51.04 per share for \$750 million, including 4.5 million shares purchased in the first quarter at an average price of \$56.21 per share for \$251 million under an accelerated share repurchase transaction with a bank.

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

Contractual Obligations and Commitments

The following table summarizes certain of our contractual obligations as of September 30, 2011:

Payments due by period

Contractual Obligations	Total	(in thousands)			
		Remainder of 2011	1-3 years	3-5 years	After 5 years
Outstanding debt	\$ 4,127,000	\$ 267,000	\$ 560,000	\$ 700,000	\$ 2,600,000
Capital lease obligations	46,642	2,201	17,111	13,373	13,957
Interest payments on outstanding debt	2,185,740	31,922	310,568	303,987	1,539,263
Operating leases	648,505	51,746	281,813	149,139	165,807
Purchase obligations	80,470	12,845	49,888	14,839	2,898
Merger consideration obligation	1,151	1,151			
Total contractual obligations	\$ 7,089,508	\$ 366,865	\$ 1,219,380	\$ 1,181,338	\$ 4,321,925

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 September 30, 2011 applied to the September 30, 2011 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 10 to the Consolidated Financial Statements in our 2010 Annual Report on Form 10-K, as updated in Note 8 to the interim 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, 2010 is contained in Note 15 to the Consolidated Financial Statements in our 2010 Annual Report on Form 10-K. See Note 4 to the interim consolidated financial statements for a discussion with respect to merger consideration related to shares of Celera which had not been surrendered as of September 30, 2011.

As of September 30, 2011, our total liabilities associated with unrecognized tax benefits were approximately \$200 million, which were excluded from the table above. We believe it is reasonably possible that these liabilities may decrease by up to \$6 million within the next twelve months, primarily as a result of the expiration of statutes of limitations, 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. See Note 5 to the Consolidated Financial Statements in our 2010 Annual Report on Form 10-K for information regarding our contingent tax liability reserves.

Our credit agreements and our term loan due May 2012 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 September 30, 2011, 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.

Unconsolidated Joint Ventures

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

Requirements and Capital Resources

We estimate that we will invest approximately \$190 million during 2011 for capital expenditures, including assets under capitalized leases, to support and expand our existing operations, principally related to investments in

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

information technology, equipment and facility upgrades. We expect to fund the repayment of the current portion of our long-term debt using cash on hand and existing credit facilities.

We expect to record charges of approximately \$14 million in connection with the succession of our CEO, of which we currently estimate approximately \$5 million will be recorded in the fourth quarter of 2011; with the remainder expected to be recorded principally in the first quarter of 2012. Separately, we expect to incur approximately \$10 million to \$15 million in the fourth quarter of 2011 in connection with the further restructuring and integration of our business.

As of September 30, 2011, \$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 banks participating in our various credit facilities are predominantly highly-rated banks, and that the borrowing capacity under the credit facilities described above is currently 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 secured receivables credit facility with alternative arrangements prior to its expiration.

We believe that cash and cash equivalents on hand and cash from operations, together with our borrowing capacity under our credit facilities, will provide sufficient financial flexibility to meet seasonal 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, if necessary, to fund growth opportunities that cannot be funded from existing sources.

Impact of New Accounting Standards

In May 2011, the Financial Accounting Standards Board (FASB) issued an amendment to the accounting standards related to fair value measurements. In June 2011, the FASB issued an amendment to the accounting standards related to the presentation of comprehensive income. In September 2011, the FASB issued an amendment to the accounting standards related to the testing of goodwill for impairment. The impact of these accounting standards is discussed in Note 2 to the interim 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 2010 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 2011 Quarterly Reports on Form 10-Q and other items throughout the 2010 Form 10-K and our 2011 Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.

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

Edgar Filing: QUEST DIAGNOSTICS INC - Form 10-Q

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 third quarter of 2011, 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.

PART II - OTHER INFORMATION**Item 1. Legal Proceedings**

See Note 12 to the interim 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 third quarter of 2011.

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)
July 1, 2011 – July 31, 2011				
Share Repurchase Program (A)		\$		\$ 165,049
Employee Transactions (B)	1,857	\$ 56.11	N/A	N/A
August 1, 2011 – August 31, 2011				
Share Repurchase Program (A)	1,022,719	\$ 47.74	1,022,719	\$ 116,222
Employee Transactions (B)	2,051	\$ 49.57	N/A	N/A
September 1, 2011 – September 30, 2011				
Share Repurchase Program (A)	23,300	\$ 50.09	23,300	\$ 115,055
Employee Transactions (B)	922	\$ 49.46	N/A	N/A
Total				
Share Repurchase Program (A)	1,046,019	\$ 47.79	1,046,019	\$ 115,055
Employee Transactions (B)	4,830	\$ 52.07	N/A	N/A

- (A) In January 2011, our Board of Directors authorized the Company to repurchase an additional \$750 million of the Company's common stock, increasing the total available authorization at that time to \$1 billion. Since the share repurchase program's inception in May 2003, our Board of Directors has authorized \$4.5 billion of share repurchases of our common stock through September 30, 2011. The share repurchase authorization has no set expiration or termination date.
- (B) 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; (2) restricted common shares withheld (under the terms of grants under the Stock Compensation Plans) to offset tax withholding obligations that occur upon vesting and release of the restricted common shares; and (3) 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.

Item 6. Exhibits

Exhibits:

3.1	Restated Certificate of Incorporation of Quest Diagnostics Incorporated
10.1	Amended and Restated Quest Diagnostics Incorporated Executive Officer Severance Plan
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-20110930.xml
101.SCH	dgx-20110930.xsd
101.CAL	dgx-20110930_cal.xml
101.DEF	dgx-20110930_def.xml
101.LAB	dgx-20110930_lab.xml
101.PRE	dgx-20110930_pre.xml

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.

November 3, 2011

Quest Diagnostics Incorporated

By /s/ Surya N. Mohapatra

Surya N. Mohapatra, Ph.D.
Chairman of the Board, President
and
Chief Executive Officer

By /s/ Robert A. Hagemann

Robert A. Hagemann
Senior Vice President and
Chief Financial Officer