QUEST DIAGNOSTICS INC
Form 10-Q
July 24, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2008
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 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 __X__ 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 definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer __X__ Accelerated filer _____
Non-accelerated filer _____ (Do not check if a smaller reporting company) Smaller reporting company _____

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

As of July 18, 2008, there were 195,131,806 outstanding shares of the registrant’s common stock, $.01 par value.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

	Page
Index to consolidated financial statements filed as part of this report:	
Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2008 and 2007	2
Consolidated Balance Sheets as of June 30, 2008 and December 31, 2007	3
Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2008 and 2007	4
Notes to Consolidated Financial Statements	5
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	26
Item 3. Quantitative and Qualitative Disclosures About Market Risk	
See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations"	33
Item 4. Controls and Procedures	
Controls and Procedures	33

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007
(unaudited)
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Net revenues	$ 1,837,901	$ 1,641,156	$ 3,622,538	$ 3,167,364
Operating costs and expenses:				
Cost of services	1,083,481	968,742	2,142,108	1,900,527
Selling, general and administrative	438,037	395,105	873,115	779,898
Amortization of intangible assets	9,916	5,350	19,180	9,810
Other operating (income) expense, net	(1,656)	(450)	(249)	3,850
Total operating costs and expenses	1,529,778	1,368,747	3,034,154	2,694,085
Operating income	308,123	272,409	588,384	473,279
Other income (expense):				
Interest expense, net	(45,432)	(39,158)	(93,049)	(65,685)
Minority share of income	(7,826)	(6,353)	(14,880)	(12,483)
Equity earnings in unconsolidated joint ventures	7,592	6,597	15,591	13,501
Other income (expense), net	548	337	(489)	2,345
Total non-operating expenses, net	(45,118)	(38,577)	(92,827)	(62,322)
Income from continuing operations before taxes	263,005	233,832	495,557	410,957
Income tax expense	100,787	91,853	192,645	161,463
Income from continuing operations	162,218	141,979	302,912	249,494
Loss from discontinued operations, net of taxes	(890)	(647)	(1,977)	(2,269)
Net income	$ 161,328	$ 141,332	$ 300,935	$ 247,225
Earnings per common share - basic:				
Income from continuing operations	$ 0.83	$ 0.74	$ 1.56	$ 1.29
Loss from discontinued operations	-	-	(0.01)	(0.01)
Net income	$ 0.83	$ 0.74	$ 1.55	$ 1.28
Earnings per common share - diluted:				
Income from continuing operations	$ 0.83	$ 0.73	$ 1.55	$ 1.28
Loss from discontinued operations	(0.01)	-	(0.01)	(0.01)
Net income	$ 0.82	$ 0.73	$ 1.54	$ 1.27
Weighted average common shares outstanding:				
Basic	194,527	192,651	194,335	193,015
Diluted	196,119	194,476	195,951	194,870

Dividends per common share	$ 0.10	$ 0.10	$ 0.20	$ 0.20

The accompanying notes are an integral part of these statements.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
JUNE 30, 2008 AND DECEMBER 31, 2007
(in thousands, except per share data)

	June 30, 2008 (unaudited)	December 31, 2007 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 143,398	$ 167,594
Accounts receivable, net of allowance for doubtful accounts of $286,752 and $250,067 at June 30, 2008 and December 31, 2007, respectively	922,513	881,967
Inventories	98,331	95,234
Deferred income taxes	161,182	149,841
Prepaid expenses and other current assets	91,664	79,721
Total current assets	1,417,088	1,374,357
Property, plant and equipment, net	893,073	911,998
Goodwill, net	5,219,770	5,220,104
Intangible assets, net	873,633	886,733
Other assets	163,469	172,501
Total assets	$ 8,567,033	$ 8,565,693
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 1,080,236	$ 1,124,716
Short-term borrowings and current portion of long-term debt	50,364	163,581
Total current liabilities	1,130,600	1,288,297
Long-term debt	3,209,298	3,377,212
Other liabilities	559,481	575,942
Stockholders' equity:		
Common stock, par value $0.01 per share; 600,000 shares authorized at both June 30, 2008 and December 31, 2007; 214,112 and 213,745 issued at June 30, 2008 and December 31, 2007, respectively	2,141	2,137
Additional paid-in capital	2,237,346	2,210,825
Retained earnings	2,319,730	2,057,744
Accumulated other comprehensive income	46,951	25,279
Treasury stock, at cost; 19,032 and 19,705 shares at June 30, 2008 and December 31, 2007, respectively	(938,514)	(971,743)
Total stockholders' equity	3,667,654	3,324,242
Total liabilities and stockholders' equity	$ 8,567,033	$ 8,565,693

The accompanying notes are an integral part of these statements.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2008 AND 2007
(unaudited)
(in thousands)

	Six Months Ended June 30,	
	2008	**2007**
Cash flows from operating activities:		
Net income	$ 300,935	$ 247,225
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	132,684	105,233
Provision for doubtful accounts	167,568	138,725
Stock-based compensation expense	36,841	31,608
Deferred income tax (benefit) provision	(6,061)	7,680
Minority share of income	14,880	12,483
Excess tax benefits from stock-based compensation arrangements	(1,223)	(5,576)
Other, net	(4,811)	539
Changes in operating assets and liabilities:		
Accounts receivable	(213,615)	(185,462)
Accounts payable and accrued expenses	(40,065)	(68,214)
Integration, settlement and other special charges	(4,196)	(5,163)
Income taxes payable	2,187	5,697
Other assets and liabilities, net	(13,914)	(4,429)
Net cash provided by operating activities	371,210	280,346
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	19,887	(1,479,439)
Capital expenditures	(94,821)	(89,332)
Decrease (increase) in investments and other assets	5,965	(6,488)
Net cash used in investing activities	(68,969)	(1,575,259)
Cash flows from financing activities:		
Repayments of debt	(304,082)	(2,247,838)
Proceeds from borrowings	20,039	3,670,995
Purchases of treasury stock	-	(105,000)
Dividends paid	(38,889)	(38,662)
Exercise of stock options	11,562	27,260
Excess tax benefits from stock-based compensation arrangements	1,223	5,576
Decrease in book overdrafts	(4,167)	(18,427)
Financing costs paid	(289)	(16,997)
Distributions to minority partners	(11,834)	(9,336)
Net cash (used in) provided by financing activities	(326,437)	1,267,571
Net change in cash and cash equivalents	(24,196)	(27,342)
Cash and cash equivalents, beginning of period	167,594	149,640
Cash and cash equivalents, end of period	$ 143,398	$ 122,298

The accompanying notes are an integral part of these statements.

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

1. BASIS OF PRESENTATION

Background

Quest Diagnostics Incorporated and its subsidiaries ("Quest Diagnostics" or the "Company") is the world's largest provider of diagnostic testing, information and services, providing insights that enable physicians and other healthcare professionals to make decisions to improve health. Quest Diagnostics offers patients and physicians the broadest access to diagnostic laboratory services through the Company's network of laboratories and owned 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 around the country. Quest Diagnostics is the leading provider of gene-based and other esoteric testing, the leading provider of anatomic pathology services and the leading provider of testing for drugs-of-abuse. The Company is also a leading provider of testing for clinical trials, and risk assessment services for the life insurance industry. 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 state-of-the-art information technology solutions that can improve patient care and medical practice.

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 and results of operations 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 2007 Annual Report on Form 10-K.

Earnings Per Share

Basic earnings per common share is calculated by dividing net income by the weighted average common shares outstanding. Diluted earnings per common share is calculated by dividing net income by the weighted average 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, performance share units, restricted common shares and restricted stock units granted under the Company's Amended and Restated Employee Long-Term Incentive Plan and its Amended and Restated Director Long-Term Incentive Plan.

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Income from continuing operations	$ 162,218	$ 141,979	$ 302,912	$ 249,494
Loss from discontinued operations	(890)	(647)	(1,977)	(2,269)
Net income available to common stockholders – basic and diluted	$ 161,328	$ 141,332	$ 300,935	$ 247,225
Weighted average common shares outstanding – basic	194,527	192,651	194,335	193,015
Effect of dilutive securities:				
Stock options, restricted common shares and performance share units	1,592	1,825	1,616	1,855
Weighted average common shares outstanding – diluted	196,119	194,476	195,951	194,870
Earnings per common share – basic:				
Income from continuing operations	$ 0.83	$ 0.74	$ 1.56	$ 1.29
Loss from discontinued operations	-	-	(0.01)	(0.01)
Net income	$ 0.83	$ 0.74	$ 1.55	$ 1.28
Earnings per common share – diluted:				
Income from continuing operations	$ 0.83	$ 0.73	$ 1.55	$ 1.28
Loss from discontinued operations	(0.01)	-	(0.01)	(0.01)
Net income	$ 0.82	$ 0.73	$ 1.54	$ 1.27

Stock options, restricted common shares, restricted stock units and performance share units of 5.2 million shares and 4.7 million shares for the three and six months ended June 30, 2008, respectively, were not included due to their antidilutive effect.

Stock options, restricted common shares and performance share units of 4.2 million shares and 4.4 million shares for the three and six months ended June 30, 2007, respectively, were not included due to their antidilutive effect.

Fair Value Measurements

On January 1, 2008, the Company adopted Statement of Financial Accounting Standards (“SFAS”) No. 157, “Fair Value Measurements” (“SFAS 157”). SFAS 157 provides a single definition of fair value and a common framework for measuring fair value as well as new disclosure requirements for fair value measurements used in financial statements. Under SFAS 157, fair value is determined based upon the exit price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants exclusive of any transaction costs. Fair value measurements are determined by either the principal market or the most

advantageous market. The principal market is the market with the greatest level of activity and volume for the asset or liability. Absent a principal market to measure fair value, the Company has used the most advantageous market which is the market that the Company would receive the highest selling price for the asset or pay the lowest price to settle the liability, after considering transaction costs. However, when using the most advantageous market, transactions costs are only considered to determine which market is the most advantageous and these costs are then excluded when applying a fair value measurement. Adoption of SFAS 157 did not have a material effect on the Company’s financial position, results of operations or cash flows.

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

In February 2008, the Financial Accounting Standards Board ("FASB") issued FSP FAS 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" ("FSP FAS 157-1"). FSP FAS 157-1 amended SFAS 157 to exclude from its scope SFAS No. 13, "Accounting for Leases", and its related interpretive accounting pronouncements that address leasing transactions. However, this exclusion does not apply to the Company's impairment of long-lived assets under a capital lease pursuant to SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets," the Company's cost to terminate an operating lease under SFAS No. 146, "Accounting for Costs Associated with Exit and Disposal Activities," and the measurement of acquired leases in a business combination pursuant to SFAS No. 141 or 141(R), "Business Combinations." Also in February 2008, the FASB issued FSP FAS 157-2, "Effective Date of FASB Statement No. 157" ("FSP FAS 157-2"). FSP FAS 157-2 amended SFAS 157 to defer the effective date of SFAS 157 for one year (January 1, 2009 for Quest Diagnostics) for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, at least annually. The Company is currently assessing the impact of SFAS 157 on its non-financial assets and non-financial liabilities measured at fair value on a nonrecurring basis.

SFAS 157 creates a three-level hierarchy to prioritize the inputs used in the valuation techniques to derive fair values. The basis for fair value measurements for each level within the hierarchy is described below with Level 1 having the highest priority and Level 3 having the lowest.

Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs are observable in active markets.

Level 3: Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

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		
	June 30, 2008	Quoted Prices in Active Markets for Identical Assets / Liabilities Level 1	Significant Other Observable Inputs Level 2	Signific Unobserv Input Level
Assets:				
Trading securities	$ 31,529	$ 31,529	$ -	$
Cash surrender value of life insurance policies	16,510	-	16,510	
Available-for-sale securities	2,045	2,045	-	
Total	$ 50,084	$ 33,574	$ 16,510	$
Liabilities:				

Interest rate swaps	$	7,301	$	-	$	7,301	$
Deferred compensation liabilities		50,571		-		50,571	
Total	$	57,872	$	-	$	57,872	$

The Company offers certain employees the opportunity to participate in a supplemental deferred compensation plan. A participant's deferrals, together with Company matching credits, are invested in a variety of

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

participant directed stock and bond mutual funds as well as Company stock and 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.

In connection with the acquisition of AmeriPath Group Holdings, Inc. (“AmeriPath”) in May 2007, the Company assumed a non-qualified deferred compensation program AmeriPath offers to certain employees. 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 Company’s investments in available-for-sale securities are exposed to equity price fluctuations. The fair value measurements for available-for-sale securities are based upon the quoted price in active markets multiplied by the number of shares owned exclusive of any transaction costs and without any adjustments to reflect discounts that may be applied to selling a large block of the securities at one time. The Company does not believe that the changes in fair value of these assets will materially differ from the amounts that could be realized upon settlement or that the changes in fair value will have a material effect on the Company’s results of operations, liquidity and capital resources. However, the ultimate amount that could be realized upon sale or settlement of certain equity investments is dependent on several factors including external market conditions, the terms and conditions of a sale agreement, the counterparty to a sale agreement, the investment’s liquidity in capital markets and the length of time to liquidate an equity investment.

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 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.

SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (“SFAS 159”) became effective for the Company on January 1, 2008. SFAS 159 provides companies with an option to irrevocably elect to measure certain financial assets and financial liabilities at fair value on an instrument-by-instrument basis with the resulting changes in fair value recorded in earnings. The objective of SFAS 159 is to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by using different measurement attributes for financial assets and financial liabilities. As of January 1, 2008 and for the period ended June 30, 2008, the Company has elected not to apply the fair value option to any of its financial assets or financial liabilities on-hand because the Company does not believe that application of SFAS 159’s fair value option is appropriate, given the nature of its business operations.

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable and accrued expenses approximate fair value based on the short maturity of these instruments. In accordance with the provisions of SFAS No. 107, “Disclosures About Fair Value of Financial Instruments” at June 30, 2008 and December 31, 2007, the fair value of the Company’s debt was estimated at $3.2 billion and $3.6 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 June 30, 2008, the carrying value exceeded the estimated fair value of the debt by approximately $13.6 million and at December 31, 2007, the estimated fair

value exceeded the carrying value of the debt by $59.1 million.

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

New Accounting Standards

In March 2008, the FASB issued SFAS No. 161 "Disclosures About Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133" ("SFAS 161"). SFAS 161 amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," by requiring expanded disclosures about an entity's derivative instruments and hedging activities. SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments. SFAS 161 is effective for the Company as of January 1, 2009. The adoption of SFAS 161 is not expected to have a material impact on the Company's consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162 "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS 162"). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy). SFAS 162 will become effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AICPA Professional Standards AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." The adoption of SFAS 162 is not expected to have a material impact on the Company's consolidated financial statements.

In June 2008, the FASB issued FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" ("FSP EITF 03-6-1"). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in computing earnings per share under the two-class method described in SFAS No. 128, "Earnings Per Share." FSP EITF 03-6-1 is effective for the Company as of January 1, 2009 and in accordance with its requirements it will be applied retrospectively. The Company does not expect the adoption of FSP EITF 03-6-1 to have a material impact on its consolidated financial statements.

2. BUSINESS ACQUISITIONS

2007 Acquisitions

Acquisition of HemoCue

On January 31, 2007, the Company completed its acquisition of POCT Holding AB ("HemoCue"), a Sweden-based company specializing in point-of-care testing, in an all-cash transaction valued at approximately $450 million, including $113 million of assumed debt. HemoCue is the leading international provider in point-of-care for hemoglobin, with a growing share in professional glucose and microalbumin testing.

HemoCue received Food and Drug Administration ("FDA") 510(k) clearance in October 2007 for its White Blood Cell Analyzer, a whole-blood test performed on finger-stick samples that assist physicians diagnosing infection, inflammation, bone marrow failure, autoimmune diseases and many other medical conditions now routinely tested by reference laboratories. Additionally, in June 2008, HemoCue was granted a Clinical Laboratories Improvement Amendments of 1988 ("CLIA") waiver for its Albumin 201 System, which will screen patients for microalbuminuria and allow physicians to begin treatment based on the test's results during a single office visit.

In conjunction with the acquisition of HemoCue, the Company repaid approximately $113 million of debt, representing substantially all of HemoCue's existing outstanding debt as of January 31, 2007.

The Company financed the aggregate purchase price of $344 million, which includes transaction costs of approximately $7 million, of which $2 million was paid in 2006, and the repayment of substantially all of

HemoCue's outstanding debt with the proceeds from a new $450 million term loan and cash on-hand. On May 31, 2007, the Company refinanced this term loan. In January 2008, the Company received a payment of approximately $23 million from an escrow fund established at the time of the acquisition which reduced the aggregate purchase price to $321 million.

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

The acquisition of HemoCue was accounted for under the purchase method of accounting. As such, the cost to acquire HemoCue was allocated to the respective assets and liabilities acquired based on their estimated fair values as of the closing date. During 2007, the Company finalized its fair value estimates of the assets and liabilities acquired. The consolidated financial statements include the results of operations of HemoCue subsequent to the closing of the acquisition.

Of the aggregate purchase price of $321 million, $298 million was allocated to goodwill, $38 million was allocated to customer relationships that are being amortized over 20 years and $39 million was allocated to technology that is being amortized over 14 years.

In addition to the amortizable intangibles noted above, $53.8 million was allocated to tradenames, which is not subject to amortization, and $4.0 million was allocated to in-process research and development (“IPR&D”). The IPR&D was expensed in the Company’s results of operations during the first quarter of 2007, in accordance with FASB Interpretation No. 4, “Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method,” and is included in “other operating (income) expense, net” within the consolidated statements of operations.

Supplemental pro forma combined financial information has not been presented as the acquisition is not material to the Company’s consolidated results of operations.

Acquisition of AmeriPath

On May 31, 2007, the Company completed its acquisition of AmeriPath, in an all-cash transaction valued at approximately $2.0 billion, including approximately $780 million of assumed debt and related accrued interest. AmeriPath is a leading provider of anatomic pathology, including dermatopathology, and esoteric testing which generates annual revenues of approximately $800 million.

Through the acquisition, the Company acquired all of AmeriPath’s operations. AmeriPath, with its team of approximately 400 board certified pathologists, operates 40 outpatient anatomic pathology laboratories and provides inpatient anatomic pathology and medical director services for approximately 200 hospitals throughout the United States. The Company financed the all-cash purchase price and related transaction costs, together with the repayment of approximately $780 million of principal and related accrued interest representing substantially all of AmeriPath’s debt as well as the refinancing of the term loan used to finance the acquisition of HemoCue with: $1.6 billion of borrowings under a new five-year term loan facility, $780 million of borrowings under a new one-year bridge loan, and cash on-hand. In June 2007, the Company completed an $800 million senior notes offering. The net proceeds of the senior notes offering were used to repay the $780 million borrowed under the bridge loan.

The acquisition of AmeriPath was accounted for under the purchase method of accounting. As such, the cost to acquire AmeriPath was allocated to the respective assets and liabilities acquired based on their estimated fair values as of the closing date. During the second quarter of 2008, the Company finalized its fair value estimates of the assets and liabilities acquired.

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

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

	Fair Values as of May 31, 2007
Current assets	$ 196,165
Property and equipment	125,817
Intangible assets	561,300
Goodwill	1,467,367
Other assets	67,685
Total assets acquired	2,418,334
Current liabilities	141,435
Long-term liabilities	260,453
Long-term debt	801,424
Total liabilities assumed	1,203,312
Net assets acquired	$ 1,215,022

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

	Fair Value	Weighted average useful life
Customer relationships	$ 327,500	20 years
Non-compete agreement	5,800	5 years
Tradename	2,500	2 years

In addition to the amortizable intangibles noted above, $226 million was allocated to tradenames, which is not subject to amortization.

Of the amount allocated to goodwill and intangible assets, approximately $100 million is expected to be deductible for tax purposes.

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

Pro Forma Combined Financial Information

The following unaudited pro forma combined financial information for the three and six months ended June 30, 2007 assumes that the AmeriPath acquisition and related financing, including the Company's June 2007 senior notes offering, were completed on January 1, 2007 (in thousands, except per share data):

	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007
Net revenues	$ 1,774,336	$ 3,501,238
Net income	117,458	212,695
Basic earnings per common share:		
Net income	$ 0.61	$ 1.10
Weighted average common shares outstanding - basic	192,651	193,015
Diluted earnings per share:		
Net income	$ 0.60	$ 1.09
Weighted average common shares outstanding – diluted	194,476	194,870

The unaudited pro forma combined financial information presented above reflects certain reclassifications to the historical financial statements of AmeriPath to conform the acquired company's accounting policies and classification of certain costs and expenses to that of Quest Diagnostics. These adjustments had no impact on pro forma net income. Pro forma results for the three and six months ended June 30, 2007 exclude transaction related costs of $44 million, which were incurred and expensed by AmeriPath in conjunction with its acquisition by Quest Diagnostics.

3. GOODWILL AND INTANGIBLE ASSETS

Goodwill at June 30, 2008 and December 31, 2007 consisted of the following:

	June 30, 2008	December 31, 2007
Goodwill	$ 5,400,808	$ 5,401,216
Less: accumulated amortization	(181,038)	(181,112)
Goodwill, net	$ 5,219,770	$ 5,220,104

The changes in the gross carrying amount of goodwill for the six month period ended June 30, 2008 and for the year ended December 31, 2007 are as follows:

	June 30,	December 31,

	2008	2007
Balance at beginning of period	$ 5,401,216	$ 3,572,238
Goodwill acquired during the period	(23,982)	1,789,732
Other	23,574	39,246
Balance at end of period	$ 5,400,808	$ 5,401,216

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

For the six months ended June 30, 2008, the decrease in goodwill acquired was primarily due to a payment received from an escrow fund established at the time of the HemoCue acquisition, (see Note 2 for further discussion), and the realization of certain pre-acquisition net operating loss carry forwards. The increase in other was primarily related to foreign currency translation. Approximately 90% of the Company's goodwill as of June 30, 2008 and December 31, 2007 was associated with its clinical testing business.

For the year ended December 31, 2007, the increase in goodwill was primarily related to the acquisitions of AmeriPath and HemoCue, and the impact on goodwill as a result of the adoption of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes". (See Notes 3 and 5 to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 for further discussions.)

Intangible assets at June 30, 2008 and December 31, 2007 consisted of the following:

	Weighted Average Amortization Period	June 30, 2008 Cost	June 30, 2008 Accumulated Amortization	June 30, 2008 Net	December 3 Cost	December 3 Accumu Amortiz
Amortizing intangible assets:						
Customer-related intangibles	19 years	$ 591,181	$ (85,388)	$ 505,793	$ 589,418	$ (7
Non-compete agreements	5 years	54,016	(47,412)	6,604	53,832	(4
Other	13 years	64,373	(11,700)	52,673	64,214	
Total	19 years	709,570	(144,500)	565,070	707,464	(12
Intangible assets not subject to amortization:						
Tradenames		308,563	-	308,563	304,175	
Total intangible assets		$ 1,018,133	$ (144,500)	$ 873,633	$ 1,011,639	$ (12

Amortization expense related to intangible assets was $9.9 million and $5.4 million for the three months ended June 30, 2008 and 2007, respectively. For the six months ended June 30, 2008 and 2007, amortization expense related to intangible assets was $19.2 million and $9.8 million, respectively.

The estimated amortization expense related to intangible assets for each of the five succeeding fiscal years and thereafter as of June 30, 2008 is as follows:

Fiscal Year Ending December 31,	
Remainder of 2008	$ 17,278
2009	36,967
2010	36,188
2011	35,909
2012	34,664

2013		33,680
Thereafter		370,384
Total	$	565,070

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

4. STOCKHOLDERS' EQUITY

Changes in stockholders' equity for the six months ended June 30, 2008 were as follows:

	Shares of Common Stock Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumu Oth Comp hens Income
Balance, December 31, 2007	194,040	$ 2,137	$ 2,210,825	$ 2,057,744	$
Net income				300,935	
Currency translation					
Market valuation, net of tax benefit of $2,269					
Deferred loss, less reclassifications					
Comprehensive income					
Dividends declared				(38,949)	
Issuance of common stock under benefit plans	693	4	(21)		
Stock-based compensation expense			30,909		
Exercise of stock options	397		(8,023)		
Shares to cover employee payroll tax withholdings on stock issued under benefit plans	(50)		(687)		
Tax benefits associated with stock-based compensation plans			4,009		
Other			334		
Balance, June 30, 2008	195,080	$ 2,141	$ 2,237,346	$ 2,319,730	$

For the three months ended June 30, 2008, total comprehensive income was $157 million.

The market valuation adjustment represents unrealized holding losses on investments, net of taxes. The deferred loss primarily represents deferred losses on the Company's interest rate swap agreements, net of amounts reclassified to interest expense. Foreign currency translation adjustments are not adjusted for income taxes since they relate to indefinite investments in non-U.S. subsidiaries.

For the three and six months ended June 30, 2008, the Company reissued 0.3 million shares and 0.7 million shares, respectively, for employee benefit plans. The Company did not purchase any shares of its common stock during the three or six months ended June 30, 2008. Since the inception of the share repurchase program in May 2003 through June 30, 2008, the Company has repurchased 44.1 million shares of its common stock at an average price of $45.35 for approximately $2 billion. At June 30, 2008, $104 million of the share repurchase authorizations remained available.

During each of the quarters of 2008 and 2007, the Company's Board of Directors has declared a quarterly cash dividend of $0.10 per common share.

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

Changes in stockholders' equity for the six months ended June 30, 2007 were as follows:

	Shares of Common Stock Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accum Oth Com hens Income
Balance, December 31, 2006	193,949	$ 2,138	$ 2,185,073	$ 1,800,255	$
Net income				247,225	
Currency translation					
Market valuation, net of tax benefit of $69					
Deferred loss, less reclassifications					
Comprehensive income					
Dividends declared				(38,539)	
Issuance of common stock under benefit plans	230		(1,313)		
Stock-based compensation expense			31,608		
Exercise of stock options	886		(16,154)		
Shares to cover employee payroll tax withholdings on stock issued under benefit plans	(18)	(1)	(918)		
Tax benefits associated with stock-based compensation plans			6,813		
Purchases of treasury stock	(2,060)				
Adjustments upon adoption of FASB Interpretation No. 48			(10,441)	(5,146)	
Other			2,345		
Balance, June 30, 2007	192,987	$ 2,137	$ 2,197,013	$ 2,003,795	$

For the three months ended June 30, 2007, total comprehensive income was $146 million.

During the second quarter of 2007, the Company received reimbursement of $2.3 million from Corning Incorporated related to tax benefits on indemnified billing-related claims, as reflected in "Other" in the table above.

During the first quarter of 2007, the Company repurchased 2.1 million shares of its common stock at an average price of $50.98 per share for $105 million. For the three and six months ended June 30, 2007, the Company reissued 0.4 million shares and 1.1 million shares, respectively, for employee benefit plans.

15

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

5. SUPPLEMENTAL CASH FLOW & OTHER DATA

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Depreciation expense	$ 57,509	$ 49,548	$ 113,504	$ 95,423
Interest expense	(46,876)	(40,683)	(96,521)	(68,773)
Interest income	1,444	1,525	3,472	3,088
Interest expense, net	(45,432)	(39,158)	(93,049)	(65,685)
Interest paid	40,702	58,810	99,631	79,084
Income taxes paid	168,371	130,989	193,213	140,240
Businesses acquired:				
Fair value of assets acquired	$ -	$ 2,356,750	$ -	$ 2,886,712
Fair value of liabilities assumed	-	1,145,590	-	1,333,888

6. DISCONTINUED OPERATIONS

During the fourth quarter of 2005, NID instituted its second voluntary product hold within a six-month period due to quality issues, which adversely impacted the operating performance of NID. As a result, the Company evaluated a number of strategic options for NID. On April 19, 2006, the Company decided to discontinue NID's operations. During the third quarter of 2006, the Company completed its wind down of NID and classified the operations of NID as discontinued operations. Results of operations for NID have been reported as discontinued operations in the accompanying consolidated statements of operations and related disclosures for all periods presented.

The government investigation of NID continues (see Note 8). During the third quarter of 2007, the government and the Company began settlement discussions. In the course of those discussions, the government disclosed to the Company certain of the government's legal theories regarding the amount of damages allegedly incurred by the government. The Company analyzed the government's position and presented its own analysis which argued against many of the government's claims. In light of that analysis and based on the status of settlement discussions, the Company established a reserve, in accordance with generally accepted accounting principles, reflected in discontinued operations, of $241 million during the second half of 2007 in connection with these claims. The Company estimates that the amount reserved represents the minimum expected probable loss with respect to this matter. See Note 8 for further details.

Summarized financial information for the discontinued operations of NID is set forth below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net revenues	$ -	$ -	$ -	$ -
Loss from discontinued operations before income				

taxes	(1,500)	(1,111)	(3,093)	(3,766)
Income tax benefit	(610)	(464)	(1,116)	(1,497)
Loss from discontinued operations, net of taxes	$ (890)	$ (647)	$ (1,977)	$ (2,269)

Results for the three and six months ended June 30, 2008 and 2007 reflect expenses associated with the ongoing government investigation of NID. The $241 million reserve established in 2007 in connection with various

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

government claims is included in “accounts payable and accrued expenses” in the consolidated balance sheets at June 30, 2008 and December 31, 2007. The deferred tax asset recorded in connection with establishing the reserve is included in “deferred income taxes” in the consolidated balance sheets at June 30, 2008 and December 31, 2007. The remaining balance sheet information related to NID was not material at June 30, 2008 and December 31, 2007.

7. DEBT

In June 2008, the Company amended its existing receivables securitization facility (the “Secured Receivables Credit Facility”) and increased it from $375 million to $400 million. The Secured Receivables Credit Facility is supported by back-up facilities provided on a committed basis by two banks: (a) $125 million, which matures on December 13, 2008 and (b) $275 million, which matures on June 10, 2009. Interest on the Secured Receivables Credit Facility is based on rates that are intended to approximate commercial paper rates for highly rated issuers. Borrowings outstanding under the Secured Receivables Credit Facility, if any, are classified as a current liability on the Company's consolidated balance sheet. At June 30, 2008, there were no borrowings outstanding under the Secured Receivables Credit Facility.

In June 2008, the Company repaid $168 million of borrowings under the Term Loan due 2012. As of June 30, 2008, total borrowings outstanding under the Term Loan due 2012 were $1.2 billion.

8. COMMITMENTS AND CONTINGENCIES

The Company has lines of credit with two financial institutions totaling $95 million for the issuance of letters of credit (the “letter of credit lines”). The letter of credit lines, which are renewed annually, mature on November 30, 2008 and December 31, 2008 and are guaranteed by the Subsidiary Guarantors.

In support of its risk management program, to ensure the Company’s performance or payment to third parties, $83 million were outstanding on the letter of credit lines at June 30, 2008. The letters of credit primarily represent collateral for current and future automobile liability and workers’ compensation loss payments.

Contingent Lease Obligations

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 Lab*One*, 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 2007 Annual Report on Form 10-K for further details.

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

NID Investigation

NID and the Company each received a subpoena from the United States Attorney’s Office for the Eastern District of New York during the fourth quarter of 2004. The subpoenas requested a wide range of business records, including documents regarding parathyroid hormone (“PTH”) test kits manufactured by NID and PTH testing performed by the Company. The Company has voluntarily and actively cooperated with the investigation, providing information, witnesses and business records of NID and the Company, including documents related to PTH tests and test kits, as well as other tests and test kits. In the second and third quarters of 2005, the FDA conducted an inspection of NID and issued a Form 483 listing the observations made by the FDA during the course of the inspection. NID responded to the Form 483.

During the fourth quarter of 2005, NID instituted its second voluntary product hold within a six-month period due to quality issues, which adversely impacted the operating performance of NID. As a result, the Company evaluated a number of strategic options for NID, and on April 19, 2006, decided to cease operations at NID. Upon completion of the wind down of operations in the third quarter of 2006, the operations of NID were classified as discontinued operations.

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

During the third quarter of 2006, the government issued two additional subpoenas, one to NID and one to the Company. The subpoenas covered various records, including records related to tests and test kits in addition to PTH.

During the third quarter of 2007, the government and the Company began settlement discussions. In the course of those discussions, the government disclosed to the Company certain of the government's legal theories regarding the amount of damages allegedly incurred by the government, which include alleged violations of civil and criminal statutes including the False Claims Act and the Food, Drug and Cosmetics Act. Violations of these statutes and related regulations could lead to a warning letter, injunction, fines or penalties, exclusion from federal healthcare programs and/or criminal prosecution, as well as claims by third parties. The Company analyzed the government's position and presented its own analysis which argued against many of the government's claims. In light of that analysis and based on the status of settlement discussions, the Company has established a reserve, in accordance with generally accepted accounting principles, reflected in discontinued operations, of $241 million in connection with these claims. Of the total reserve, $51 million and $190 million were recorded in the third and fourth quarters, respectively, of 2007. The Company estimates that the amount reserved represents the minimum expected probable loss with respect to this matter. The Company does not believe that a reasonable estimate for these losses in excess of the established reserve can be made at this time. The Company has recorded a deferred tax benefit associated with that portion of the reserve that it expects will be tax deductible. Eventual losses related to these matters may substantially exceed the reserve, and the impact could be material to the Company's results of operations, cash flows and financial condition in the period that such matters are determined or paid.

The Company continues to engage in discussions with the United States Attorney's Office and those discussions potentially could lead to an agreement in principle to resolve some or all of the matters in the near future. There can be no assurance, however, when or whether a settlement may be reached, or as to its terms. If the Company cannot reach an acceptable settlement agreement with the United States Attorney's Office, the Company would defend itself and NID and could incur significant costs in doing so.

Other Matters

The Company has in the past entered into several settlement agreements with various government and private payers relating to industry-wide billing and marketing practices that had been substantially discontinued. The federal or state governments may bring additional 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 alleging inappropriate billing practices. The Company is aware of certain pending lawsuits, including a class action lawsuit, and has received several subpoenas related to billing practices.

During the second quarter of 2005, the Company received a subpoena from the United States Attorney's Office for the District of New Jersey. The subpoena seeks the production of business and financial records regarding capitation and risk sharing arrangements with government and private payers for the years 1993 through 1999. Also, during the third quarter of 2005, the Company received a subpoena from the U.S. Department of Health and Human Services, Office of the Inspector General. The subpoena seeks the production of various business records including records regarding the Company's relationship with health maintenance organizations, independent physician associations, group purchasing organizations, and preferred provider organizations relating back to as early as 1995. The Company is cooperating with the United States Attorney's Office and the Office of the Inspector General.

During the second quarter of 2006, each of the Company and its subsidiary, Specialty Laboratories, Inc. ("Specialty"), received a subpoena from the California Attorney General's Office. The subpoenas seek various documents including documents relating to billings to MediCal, the California Medicaid program. The subpoenas seek documents from various time frames ranging from three to ten years. The Company and Specialty are

cooperating with the California Attorney General's Office.

In the first quarter of 2008, the U.S. Department of Justice informally requested records from the Company regarding AmeriPath's billing practices for flow cytometry testing panels performed on blood, bone marrow and lymph node specimens. The inquiry seeks to determine whether AmeriPath may have billed for laboratory tests that were not medically necessary. The Company is cooperating fully with the inquiry.

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

The Company understands that there may be 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. The Company also is aware of certain pending individual or class action lawsuits 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.

Several of these other matters are in their early stages of development and involve responding to and cooperating with various government investigations and related subpoenas. While the Company believes that at least a reasonable possibility exists that losses may have been incurred, based on the nature and status of the investigations, the losses are either currently not probable or cannot be reasonably estimated.

Management has established reserves in accordance with generally accepted accounting principles for the other matters discussed above. Such reserves totaled less than $5 million as of June 30, 2008. Although management cannot predict the outcome of such matters, management does not anticipate that the ultimate outcome of such matters will have a material adverse effect on the Company's financial condition but 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. However, there may be pending qui tam claims brought by former employees or other "whistle blowers", or other pending claims as to which the Company has not been provided with a copy of the complaint and accordingly cannot determine the extent of any potential liability.

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 coverage for 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 are established by considering actuarially determined losses based upon the Company's historical and projected loss experience. Management believes that present insurance coverage and reserves are sufficient to cover currently estimated exposures. Although management cannot predict the outcome of any claims made against the Company, 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 but 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.

9. BUSINESS SEGMENT INFORMATION

Clinical testing is an essential element in the delivery of healthcare services. Physicians use tests to assist in the detection, diagnosis, evaluation, monitoring and treatment of diseases and other medical conditions. Clinical laboratory testing is generally categorized as clinical testing and anatomic pathology testing. Clinical testing is performed on body fluids, such as blood and urine. Anatomic pathology testing is performed on tissues, including 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 2008 and 2007.

All other operating segments include the Company's non-clinical testing businesses and consist of its risk assessment services business, its clinical trials testing business, its healthcare information technology business, MedPlus, and its diagnostics products businesses. The Company's risk assessment business provides underwriting support services to the life insurance industry including teleunderwriting, paramedical examinations, laboratory testing and medical record retrieval. The Company's clinical trials testing business provides clinical testing performed in connection with clinical research trials on new drugs and vaccines. MedPlus is a developer and integrator of clinical connectivity and data management solutions for healthcare organizations, physicians and clinicians. The Company's diagnostics products business manufactures and markets diagnostic test kits, hand-held instruments and testing systems.

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 6).

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

During the the first quarter of 2007, the Company acquired HemoCue, and in the second quarter of 2007, it acquired AmeriPath (see Note 2). HemoCue is included in the Company's other operating segments. AmeriPath's operations are included in the Company's clinical testing business.

At June 30, 2008, substantially all of the Company's services are provided within the United States, and substantially all of the Company's assets are located within the United States.

The following table is a summary of segment information for the three and six months ended June 30, 2008 and 2007. Segment asset information is not presented since it is not reported to or 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. General management and administrative corporate expenses, including amortization of intangible assets, 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 2007 Annual Report on Form 10-K and Note 1 to the interim consolidated financial statements.

	Three Months Ended June 30,		Six Months Ended June 30,		
	2008	2007	2008	2007	
Net revenues:					
Clinical testing business	$ 1,676,491	$ 1,492,177	$ 3,305,310	$ 2,883,451	
All other operating segments	161,410	148,979	317,228	283,913	
Total net revenues	$ 1,837,901	$ 1,641,156	$ 3,622,538	$ 3,167,364	
Operating earnings (loss):					
Clinical testing business	$ 337,938	$ 297,810	$ 643,902	$ 533,909	(a)
All other operating segments	14,050	13,059	22,692	10,579	(b) (c)
General corporate expenses	(43,865)	(38,460)	(78,210)	(71,209)	
Total operating income	308,123	272,409	588,384	473,279	
Non-operating expenses, net	(45,118)	(38,577)	(92,827)	(62,322)	
Income from continuing operations before income taxes	263,005	233,832	495,557	410,957	
Income tax expense	100,787	91,853	192,645	161,463	
Income from continuing operations	162,218	141,979	302,912	249,494	
Loss from discontinued operations, net of taxes	(890)	(647)	(1,977)	(2,269)	
Net income	$ 161,328	$ 141,332	$ 300,935	$ 247,225	

(a) During the six months ended June 30, 2007, operating income included $9.9 million of first quarter charges, associated with workforce reductions in response to reduced volume levels.

(b) During the six months ended June 30, 2007, operating income included a $4 million first quarter charge related to the expensing of in-process research and development associated with the acquisition of HemoCue (see Note 2).

(c) During the six months ended June 30, 2007, operating income included $0.8 million of first quarter charges, associated with workforce reductions in response to reduced volume levels.

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

10. SUMMARIZED FINANCIAL INFORMATION

The Company's 5.125% senior notes due 2010, 7.5% senior notes due 2011, 5.45% senior notes due 2015, 6.40% senior notes due 2017 and 6.95% senior notes due 2037 are fully and unconditionally guaranteed by certain of the Company's wholly owned subsidiaries that have operations in the United States (the "Subsidiary Guarantors"). With the exception of Quest Diagnostics Receivables Incorporated (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, Quest Diagnostics Receivables Incorporated ("QDRI"). The Company and certain of its Subsidiary Guarantors transfer all private 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. HemoCue and AmeriPath have been included in the accompanying condensed consolidating financial data, subsequent to the closing of the acquisitions, as Subsidiary Guarantors.

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

Condensed Consolidating Statement of Operations
Three Months Ended June 30, 2008

	Parent	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Elim
Net revenues	$ 210,309	$ 1,518,732	$ 160,313	$
Operating costs and expenses:				
Cost of services	129,935	892,634	60,912	
Selling, general and administrative	55,002	305,632	83,430	
Amortization of intangible assets	58	7,807	2,051	
Royalty (income) expense	(107,694)	107,694	-	
Other operating expense (income), net	4	(49)	(1,611)	
Total operating costs and expenses	77,305	1,313,718	144,782	
Operating income	133,004	205,014	15,531	
Non-operating expenses, net	(39,262)	(44,510)	(6,772)	
Income from continuing operations before taxes .	93,742	160,504	8,759	
Income tax expense	32,462	64,408	3,917	
Income from continuing operations	61,280	96,096	4,842	
Loss from discontinued operations, net of taxes	-	(889)	(1)	
Equity earnings from subsidiaries	100,048	-	-	
Net income	$ 161,328	$ 95,207	$ 4,841	$

Condensed Consolidating Statement of Operations
Three Months Ended June 30, 2007

	Parent	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Elim
Net revenues	$ 203,886	$ 1,332,434	$ 185,680	$
Operating costs and expenses:				
Cost of services	121,406	782,923	64,413	
Selling, general and administrative	47,482	269,454	84,078	
Amortization of intangible assets	50	4,009	1,291	
Royalty (income) expense	(99,091)	99,091	-	
Other operating expense (income), net	51	(288)	(213)	
Total operating costs and expenses	69,898	1,155,189	149,569	
Operating income	133,988	177,245	36,111	
Non-operating expenses, net	(35,361)	(73,435)	(4,716)	
Income from continuing operations before taxes .	98,627	103,810	31,395	
Income tax expense	37,246	41,534	13,073	
Income from continuing operations	61,381	62,276	18,322	

Loss from discontinued operations, net of taxes	-	(656)	9	
Equity earnings from subsidiaries	79,951	-	-	
Net income	$ 141,332	$ 61,620	$ 18,331	$

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

Condensed Consolidating Statement of Operations
Six Months Ended June 30, 2008

	Parent	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Elim
Net revenues	$ 407,728	$ 2,999,331	$ 330,469	$
Operating costs and expenses:				
Cost of services	249,737	1,768,897	123,474	
Selling, general and administrative	97,244	618,406	169,381	
Amortization of intangible assets	113	15,725	3,342	
Royalty (income) expense	(212,334)	212,334	-	
Other operating expense (income), net	4	(150)	(103)	
Total operating costs and expenses	134,764	2,615,212	296,094	
Operating income	272,964	384,119	34,375	
Non-operating expenses, net	(87,096)	(98,102)	(10,703)	
Income from continuing operations before taxes .	185,868	286,017	23,672	
Income tax expense	67,598	114,798	10,249	
Income from continuing operations	118,270	171,219	13,423	
Loss from discontinued operations, net of taxes	-	(1,624)	(353)	
Equity earnings from subsidiaries	182,665	-	-	
Net income	$ 300,935	$ 169,595	$ 13,070	$

Condensed Consolidating Statement of Operations
Six Months Ended June 30, 2007

	Parent	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Elim
Net revenues	$ 415,769	$ 2,554,757	$ 356,565	$
Operating costs and expenses:				
Cost of services	244,840	1,530,962	124,725	
Selling, general and administrative	100,062	523,782	167,732	
Amortization of intangible assets	135	6,562	3,113	
Royalty (income) expense	(194,228)	194,228	-	
Other operating expense (income), net	44	(282)	4,088	
Total operating costs and expenses	150,853	2,255,252	299,658	
Operating income	264,916	299,505	56,907	
Non-operating expenses, net	(63,698)	(139,570)	(7,103)	
Income from continuing operations before taxes .	201,218	159,935	49,804	
Income tax expense	76,204	64,147	21,112	
Income from continuing operations	125,014	95,788	28,692	

Loss from discontinued operations, net of taxes	-	(2,176)	(93)	
Equity earnings from subsidiaries	122,211	-	-	
Net income	$ 247,225	$ 93,612	$ 28,599	$

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

Condensed Consolidating Balance Sheet
June 30, 2008

	Parent	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Eliminations
Assets				
Current assets:				
Cash and cash equivalents	$ 97,829	$ 11,180	$ 34,389	$ -
Accounts receivable, net	16,986	262,224	643,303	-
Other current assets	53,370	199,510	105,518	(7,221)
Total current assets	168,185	472,914	783,210	(7,221)
Property, plant and equipment, net	214,246	632,874	45,953	-
Goodwill and intangible assets, net	153,374	5,397,992	542,037	-
Intercompany receivable (payable)	850,804	(494,125)	(356,679)	-
Investment in subsidiaries	5,315,631	-	-	(5,315,631)
Other assets	173,343	43,958	43,899	(97,731)
Total assets	$ 6,875,583	$ 6,053,613	$ 1,058,420	$ (5,420,583)
Liabilities and Stockholders' Equity				
Current liabilities:				
Accounts payable and accrued expenses	$ 473,646	$ 567,228	$ 46,583	$ (7,221)
Short-term borrowings and current portion of long-term debt	-	47,637	2,727	-
Total current liabilities	473,646	614,865	49,310	(7,221)
Long-term debt	2,635,856	248,142	325,300	-
Other liabilities	98,427	475,329	83,456	(97,731)
Stockholders' equity	3,667,654	4,715,277	600,354	(5,315,631)
Total liabilities and stockholders' equity	$ 6,875,583	$ 6,053,613	$ 1,058,420	$ (5,420,583)

Condensed Consolidating Balance Sheet
December 31, 2007

	Parent	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Eliminations
Assets				
Current assets:				
Cash and cash equivalents	$ 111,610	$ 14,847	$ 41,137	$ -
Accounts receivable, net	27,309	234,532	620,126	-
Other current assets	46,986	183,505	101,055	(6,750)
Total current assets	185,905	432,884	762,318	(6,750)
Property, plant and equipment, net	215,062	654,341	42,595	-
Goodwill and intangible assets, net	153,848	5,422,270	530,719	-
Intercompany receivable (payable)	859,841	(610,371)	(249,470)	-
Investment in subsidiaries	5,149,196	-	-	(5,149,196)

Other assets	167,105	48,433	38,054	(81,091)
Total assets	$ 6,730,957	$ 5,947,557	$ 1,124,216	$ (5,237,037)
Liabilities and Stockholders' Equity				
Current liabilities:				
Accounts payable and accrued expenses	$ 451,944	$ 634,079	$ 45,443	$ (6,750)
Short-term borrowings and current portion of long-term debt	-	62,386	101,195	-
Total current liabilities	451,944	696,465	146,638	(6,750)
Long-term debt	2,829,927	247,573	299,712	-
Other liabilities	124,844	457,837	74,352	(81,091)
Stockholders' equity	3,324,242	4,545,682	603,514	(5,149,196)
Total liabilities and stockholders' equity	$ 6,730,957	$ 5,947,557	$ 1,124,216	$ (5,237,037)

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

Condensed Consolidating Statement of Cash Flows
Six Months Ended June 30, 2008

	Parent	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Elim
Cash flows from operating activities:				
Net income	$ 300,935	$ 169,595	$ 13,070	$ (
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation and amortization	25,736	97,370	9,578	
Provision for doubtful accounts	5,788	57,873	103,907	
Other, net	(161,572)	16,914	1,619	
Changes in operating assets and liabilities	137,626	(270,297)	(136,932)	
Net cash provided by (used in) operating activities	308,513	71,455	(8,758)	
Net cash (used in) provided by investing activities	(124,134)	(57,283)	18,857	
Net cash used in financing activities	(198,160)	(17,839)	(16,847)	
Net change in cash and cash equivalents	(13,781)	(3,667)	(6,748)	
Cash and cash equivalents, beginning of period	111,610	14,847	41,137	
Cash and cash equivalents, end of period	$ 97,829	$ 11,180	$ 34,389	$

Condensed Consolidating Statement of Cash Flows
Six Months Ended June 30, 2007

	Parent	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Elim
Cash flows from operating activities:				
Net income	$ 247,225	$ 93,612	$ 28,599	$ (
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	24,767	72,667	7,799	
Provision for doubtful accounts	6,544	24,126	108,055	
Other, net	(111,979)	34,439	2,063	
Changes in operating assets and liabilities	35,899	(171,163)	(122,307)	
Net cash provided by operating activities	202,456	53,681	24,209	
Net cash used in investing activities	(1,616,132)	(1,227,499)	(313,110)	1,
Net cash provided by financing activities	1,353,431	1,195,565	300,057	(1,
Net change in cash and cash equivalents	(60,245)	21,747	11,156	
Cash and cash equivalents, beginning of period	134,598	7,661	7,381	
Cash and cash equivalents, end of period	$ 74,353	$ 29,408	$ 18,537	$

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 requires us to make estimates and assumptions and select accounting policies that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. 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 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 total operating 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, 2007.

Recent Acquisitions

Acquisition of AmeriPath

On May 31, 2007, we completed the acquisition of AmeriPath Group Holdings, Inc. ("AmeriPath"), in an all-cash transaction valued at approximately $2 billion, including approximately $780 million of assumed debt and related accrued interest. AmeriPath is a leading provider of anatomic pathology, including dermatopathology, and esoteric testing which generates annual revenues of approximately $800 million.

Through the acquisition, we acquired all of AmeriPath's operations. AmeriPath, with its team of approximately 400 board certified pathologists, operates 40 outpatient anatomic pathology laboratories and provides inpatient anatomic pathology and medical director services for approximately 200 hospitals throughout the country. We financed the all-cash purchase price and related transaction costs, together with the repayment of approximately $780 million of principal and related accrued interest representing substantially all of AmeriPath's debt, as well as the refinancing of the $450 million term loan used to finance the acquisition of HemoCue with $1.6 billion of borrowings under a new five-year term loan facility, $780 million of borrowings under a new one-year bridge loan, and cash on-hand. In June 2007, we completed an $800 million senior notes offering. The net proceeds of the senior notes offering were used to repay the $780 million borrowed under the bridge loan. The acquisition was accounted for under the purchase method of accounting.

Acquisition of HemoCue

On January 31, 2007, we acquired POCT Holding AB ("HemoCue"), a Sweden-based company specializing in point-of-care testing, in an all-cash transaction valued at approximately $450 million, including $113 million of assumed debt of HemoCue. The transaction was financed through an interim credit facility, which was refinanced during the second quarter of 2007 in connection with the financing of the AmeriPath acquisition. In January 2008, we received a payment of approximately $23 million from an escrow fund established at the time of the acquisition.

HemoCue is the leading international provider in point-of-care testing for hemoglobin, with a growing share in professional glucose and microalbumin testing. HemoCue received Food and Drug Administration ("FDA") clearance in October 2007 for a test to determine white blood cell counts and has applied to receive Clinical Laboratories Improvement Amendments of 1988 ("CLIA")-waived status. Additionally, in June 2008, HemoCue was granted a CLIA waiver for its Albumin 201 System, which will screen patients for microalbuminuria and allow physicians to begin treatment based on the test's results during a single office visit.

This acquisition complements our point-of-care testing for infectious disease and cancer, including new tests for colorectal cancer screening and Herpes Simplex Type 2. The acquisition increases our presence in the growing point-of-care testing market and we plan to leverage HemoCue's international presence to reach new

markets around the world. HemoCue generated annual revenues of approximately $80 million at the time of acquisition.

Results of Operations

Our clinical testing business currently represents our one reportable business segment. The clinical testing business accounted for more than 90% of net revenues from continuing operations in both 2008 and 2007. Our other operating segments consist of our risk assessment services business, our clinical trials testing business, our healthcare information technology business, MedPlus, and our diagnostic products business. Our business segment information is disclosed in Note 9 to the interim consolidated financial statements.

Three and Six Months Ended June 30, 2008 Compared with Three and Six Months Ended June 30, 2007

Continuing Operations

Income from continuing operations for the three months ended June 30, 2008 was $162 million, or $0.83 per diluted share, compared to $142 million, or $0.73 per diluted share, in 2007. Income from continuing operations for the six months ended June 30, 2008 was $303 million, or $1.55 per diluted share, compared to $249 million, or $1.28 per diluted share, in 2007. These increases in income from continuing operations were principally driven by revenue growth and actions we have taken to reduce our cost structure. In addition, the favorable resolution of certain tax contingencies increased diluted earnings per share by $0.01 in the quarter and six months ended June 30, 2008.

During the first quarter of 2007, the Company became a non-contracted provider to United Healthcare Group Inc., (“UNH”). As a result of the change in status, the Company’s revenues and earnings were significantly impacted for the first quarter and full year 2007. However, the ongoing profit impact was successfully mitigated by the end of 2007 as a result of actions taken to reduce costs and higher reimbursement for the testing we continued to perform for UNH members as a non-contracted provider.

Results for the six months ended June 30, 2007 include first quarter pre-tax charges of $10.7 million, or $0.03 per share, associated with workforce reductions in response to reduced volume levels, and a first quarter pre-tax charge of $4.0 million, or $0.01 per share, related to in-process research and development expense associated with the HemoCue acquisition.

Net Revenues

Net revenues for the three months ended June 30, 2008 grew by 12% over the prior year level to $1.8 billion. Net revenues for the six months ended June 30, 2008 were $3.6 billion, 14% above the prior year level. The acquisition of AmeriPath contributed approximately 8.1% and 10.5% to revenue growth for the three and six months ended June 30, 2008, respectively. While the UNH contract change took effect as of January 1, 2007, much of the loss of volume and change in revenues took place over the course of the first quarter last year. Therefore, there continues to be a carry-over impact in comparing the three and six months ended June 30, 2008 volume and revenues to that of the prior year. We estimate that the carry-over impact of our change in status with UNH reduced 2008 revenue growth for the three and six months ended June 30, 2008 by just over 1%.

Our clinical testing business, which accounts for over 90% of our net revenues, grew 12.4% above the prior year level for the three months ended June 30, 2008, with AmeriPath contributing 8.9% growth. Volume, measured by the number of requisitions, increased 4.9% for the three months ended June 30, 2008, with 3.9% due to the impact of the AmeriPath acquisition. We estimate that the impact of our change in status with UNH reduced volume growth for the three months ended June 30, 2008 by approximately 0.8% . After adjusting for the impact of the UNH contract change, we estimate the underlying volume growth to be between one and two percent. This is despite an almost 10% decline in pre-employment drug testing volume which accounted for approximately 7% of our total volume. We believe the volume decrease in pre-employment drug testing is principally due to slower hiring by the employers served by this business. Revenue per requisition increased 7.1% for the three months ended June 30, 2008 and was impacted by the results of AmeriPath, which contributed 4.5% to the improvement. The balance of the increase was primarily driven by a positive test mix, partially offset by price reductions on various health plan contracts.

For the six months ended June 30, 2008, clinical testing revenues grew 14.6% above the prior year level with AmeriPath contributing 11.5% growth. Volume, measured by the number of requisitions, increased 5.3%

primarily due to the impact of the AmeriPath acquisition, which contributed about 5% volume growth. We estimate that the impact of our change in status with UNH reduced volume growth by approximately 1.2% . After adjusting for the impact of the UNH contract change, results for the six months ended June 30, 2008 reflect underlying volume growth of between one and two percent. Revenue per requisition increased 8.9% for the six months ended June 30, 2008 and was impacted by the results of AmeriPath, which contributed 6.1% to the improvement. The balance of the increase was primarily driven by a positive test mix, partially offset by price reductions on various health plan contracts.

Our businesses other than clinical testing accounted for approximately 9% of our net revenues for the three and six months ended June 30, 2008. These businesses include our risk assessment services business, our clinical trials testing business, our healthcare information technology business, MedPlus, and our diagnostic products business. The revenues for these businesses as a group grew 8% and 12% for the three and six months ended June 30, 2008, respectively, with the increase primarily driven by a strong performance of our healthcare information technology, point-of-care and clinical trials testing businesses.

Operating Costs and Expenses

Total operating costs and expenses for the three and six months ended June 30, 2008 increased $161 million and $340 million, respectively, from the prior year periods. For the three and six months ended June 30, 2008, these increases are primarily due to costs associated with the acquired operations of AmeriPath, and increased costs associated with annual compensation adjustments. These increases were partially offset by actions taken to improve our operating efficiency and reduce the size of our workforce.

Results for the six months ended June 30, 2007 reflect first quarter costs of $10.7 million associated with workforce reductions ($3.9 million included in cost of services and $6.8 million included in selling, general and administrative) and $4 million of in-process research and development costs associated with the acquisition of HemoCue, which was recorded in “other operating (income) expense, net”.

Cost of services, which includes the costs of obtaining, transporting and testing specimens, was 59.0% of net revenues for the three months ended June 30, 2008, similar to the prior year period. For the six months ended June 30, 2008, cost of services, as a percentage of net revenues, was 59.1% of net revenues, decreasing from 60.0% of net revenues in the prior year period. The improvement over the prior year reflects actions taken to reduce our cost structure and higher revenue per requisition.

Selling, general and administrative expenses, which include the costs of the sales force, billing operations, bad debt expense, and general management and administrative support, were 23.8% of net revenues for the three months ended June 30, 2008, compared to 24.1% in the prior year period. For the six months ended June 30, 2008, selling, general and administrative expenses, as a percentage of net revenues, decreased to 24.1% from 24.6% in the prior year period. These improvements were primarily due to actions taken to reduce our cost structure and higher revenue per requisition, partially offset by the impact of the acquired operations of AmeriPath. In addition, selling, general and administrative expenses for the six months ended June 30, 2007 contained first quarter costs associated with efforts to retain business and clarify for patients, physicians and employers misinformation regarding the UNH contract change.

For the three months ended June 30, 2008 and 2007, bad debt expense was 4.4% and 4.3% of net revenues, respectively. For the six months ended June 30, 2008, bad debt expense was 4.6% compared to 4.4% of net revenues in 2007. The increase for the three and six months ended June 30, 2008 was driven by the inclusion of AmeriPath, which carries a higher bad debt rate than the rest of our business, primarily due to its revenue and customer mix, and increased the consolidated bad debt rate by approximately half a percent for both periods.

Amortization of intangible assets for the three and six months ended June 30, 2008 increased $4.6 million and $9.4 million, respectively, over the prior year periods. These increases were primarily due to the amortization of intangible assets acquired in conjunction with the acquisition of AmeriPath.

Other operating (income) expense, net represents miscellaneous income and expense items related to operating activities, including gains and losses associated with the disposal of operating assets and provisions for restructurings and other special charges. For the six months ended June 30, 2007, other operating (income) expense, net includes a $4.0 million first quarter charge related to in-process research and development expense

recorded in connection with the acquisition of HemoCue.

Operating Income

Operating income for the three months ended June 30, 2008 was $308 million, or 16.8% of net revenues, compared to $272 million, or 16.6% of net revenues, in the prior year period. For the six months ended June 30, 2008, operating income was $588 million, or 16.2% of net revenues, compared to $473 million, or 14.9% of net revenues in the prior year period. The increases in operating income were primarily due to actions we have taken to reduce our cost structure, partially offset by the impact of the acquired operations of AmeriPath. In addition, the operating income percentage for the three and six months ended June 30, 2008, reflects the impact of the various items which served to reduce cost of services and selling, general and administrative expenses as a percentage of net revenues.

Other Income (Expense)

Interest expense, net for the three and six months ended June 30, 2008 increased $6.3 million and $27.4 million, respectively, over the prior year periods. These increases were primarily due to additional interest expense associated with borrowings used to fund the acquisition of AmeriPath.

Income Tax Expense

The effective income tax rate for the three and six months ended June 30, 2008 decreased 1.0% and 0.4%, respectively, compared to the prior year periods. These decreases were primarily due to the favorable resolution of certain tax contingencies in the second quarter of 2008.

Discontinued Operations

Loss from discontinued operations, net of taxes, for the three months ended June 30, 2008 was $0.9 million, or $0.01 per diluted share, compared to $0.6 million, with no impact to diluted earnings per share in the prior year. Loss from discontinued operations, net of taxes, for the six months ended June 30, 2008 was $2.0 million, or $0.01 per diluted share, compared to $2.2 million, or $0.01 per diluted share in the prior year. Results for the three and six months ended June 30, 2008 and 2007 reflect expenses associated with the on-going government investigation of NID, which is more fully described in Notes 6 and 8 to the interim consolidated financial statements.

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 may include the use of derivative financial instruments. We do not hold or issue derivative financial instruments for trading purposes. We do not believe that our foreign exchange exposure is material to our financial condition or results of operations. See Note 11 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K for additional discussion of our financial instruments and hedging activities.

At June 30, 2008 and December 31, 2007, the fair value of our debt was estimated at approximately $3.2 billion and $3.6 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 June 30, 2008, the carrying value exceeded the estimated fair value of the debt by approximately $13.6 million and at December 31, 2007, the estimated fair value exceeded the carrying value of the debt by $59.1 million. A hypothetical 10% increase in interest rates on our total debt portfolio (representing approximately 55 and 61 basis points at June 30, 2008 and December 31, 2007, respectively) would potentially reduce the estimated fair value of our debt by approximately $75 million and $78 million at June 30, 2008 and December 31, 2007, respectively.

Borrowings under our senior unsecured revolving credit facility, our secured receivables credit facility, our term loan due December 2008, and our term loan due May 2012, 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 rates on our senior unsecured revolving credit facility, term loan due December 2008 and term loan due May 2012 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. As of June 30, 2008, the borrowing rates under these credit facilities were: for our senior unsecured credit facility, LIBOR plus 0.40%; for our term loan due December 2008,

LIBOR plus 0.55%; and for our term loan due May 2012, LIBOR plus 0.50% . At June 30, 2008, the LIBOR rate was 2.46% . At June 30, 2008, there was $1.2 billion outstanding under our term loan due May 2012, $45 million outstanding under our term loan due December 2008; and no borrowings outstanding under our secured receivables credit facility and our $750 million senior unsecured revolving credit facility.

During the third quarter ended September 30, 2007, we entered into various variable-to-fixed interest rate swap agreements, whereby we fixed the interest rates on $500 million of our term loan due May 2012 for periods ranging from October 2007 through October 2009. The fixed interest rates range from 5.095% to 5.267% . Based on our net exposure to interest rate changes, a hypothetical 10% change in interest rates on our variable rate indebtedness (representing approximately 29 basis points) would impact annual net interest expense by approximately $2.3 million, assuming no changes to the debt outstanding at June 30, 2008.

The fair value of the interest rate swap agreements at June 30, 2008 was a liability of $7.3 million. A hypothetical 10% decrease in interest rates on our term loan (representing approximately 34 basis points) would potentially increase the fair value of the liability of these instruments by approximately $1.4 million. A hypothetical 10% increase in interest rates would potentially decrease the fair value of the liability of these instruments by approximately $1.4 million. For details regarding our outstanding debt and our financial instruments, see Notes 10 and 11 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2007 and Note 7 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 $16 million at June 30, 2008.

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.

Fair Value Measurements

On January 1, 2008, we adopted Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS 157"). Adoption of this accounting standard did not have a material effect on our financial position, results of operations or cash flows. See Note 1 to the interim consolidated financial statements for further details.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159") became effective for the Company on January 1, 2008. As of January 1, 2008 and for the period ended June 30, 2008, the Company has elected not to apply the fair value option to any of its financial assets or financial liabilities on-hand because the Company does not believe that application of SFAS 159's fair value option is appropriate given the nature of its business operations. See Note 1 to the interim consolidated financial statements for further details.

Liquidity and Capital Resources

Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2008 totaled $143 million compared to $168 million at December 31, 2007. Cash flows from operating activities in 2008 were $371 million, which were used to fund investing and financing activities of $69 million and $326 million, respectively. Cash and cash equivalents at June 30, 2007 totaled $122 million, compared to $150 million at December 31, 2006. Cash flows from operating activities in 2007 were $280 million, which together with cash flows from financing activities of $1.3 billion and cash on-hand, were used to fund investing activities of $1.6 billion.

30

Cash Flows from Operating Activities

Net cash provided by operating activities for the six months ended June 30, 2008 was $371 million compared to $280 million in the prior year period. This increase was principally due to higher earnings in the current year. Net cash provided by operating activities for the six months ended June 30, 2007 was reduced by $57 million of fees and other expenses paid in connection with the acquisition of AmeriPath. Days sales outstanding, a measure of billing and collection efficiency, were 46 days at June 30, 2008 compared to 48 days at December 31, 2007.

Cash Flows from Investing Activities

Net cash used in investing activities for the six months ended June 30, 2008 was $69 million, consisting principally of capital expenditures of $95 million, partially offset by $23 million related to the receipt of a payment from an escrow fund established at the time of the acquisition of HemoCue, and a decrease in investments of $6 million.

Net cash used in investing activities for the six months ended June 30, 2007 was $1.6 billion, consisting principally of $1.2 billion related to the acquisition of AmeriPath, $307 million related to the acquisition of HemoCue and capital expenditures of $89 million.

Cash Flows from Financing Activities

Net cash used in financing activities for the six months ended June 30, 2008 was $326 million, consisting primarily of net reductions of debt of $284 million, which included the repayment of $120 million on our Secured Receivables Credit Facility, $15 million on our Term Loan due December 31, 2008 and $168 million on our term loan due May 31, 2012, offset partially by borrowings of $20 million on our Secured Receivables Credit Facility. In addition, cash flows from financing activities include dividend payments of $39 million.

Since the completion of the AmeriPath acquisition in May 2007, we have reduced our total debt by $700 million.

Net cash provided by financing activities for the six months ended June 30, 2007 was $1.3 billion, primarily associated with new borrowings and repayments related to the acquisitions of AmeriPath and HemoCue.

Dividend Program

During each of the quarters of 2008 and 2007, our Board of Directors declared a quarterly cash dividend of $0.10 per common share. On May 21, 2008, our Board of Directors declared a quarterly cash dividend per common share of $0.10, paid on July 18, 2008. 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 Repurchase Plan

We did not purchase any shares of our common stock during the six months ended June 30, 2008. Through June 30, 2008, we have repurchased approximately 44.1 million shares of our common stock at an average price of $45.35 for $2 billion under our share repurchase program. At June 30, 2008, the total available for repurchases under the remaining authorizations was $104 million.

31

Contractual Obligations and Commitments

The following table summarizes certain of our contractual obligations as of June 30, 2008:

		Payments due by period (in thousands)			
Contractual Obligations	**Total**	**Remainder of 2008**	**1-3 years**	**3 –5 years**	**After 5 years**
Long-term debt	$ 3,238,458	$ 48,755	$ 418,439	$ 1,474,669	$ 1,296,595
Capital lease obligations	21,204	543	2,362	2,592	15,707
Interest payments on outstanding debt	1,586,030	91,737	346,988	227,546	919,759
Operating leases	694,529	95,479	291,127	160,671	147,252
Purchase obligations	91,337	37,498	41,646	11,646	547
Total contractual obligations	$ 5,631,558	$ 274,012	$ 1,100,562	$ 1,877,124	$ 2,379,860

Interest payments on our long-term debt have been calculated after giving effect to our interest rate swap agreements, using the interest rates as of June 30, 2008 applied to the June 30, 2008 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 2007 Annual Report on Form 10-K. A full discussion and analysis regarding our minimum rental commitments under noncancelable operating leases and noncancelable commitments to purchase products or services at December 31, 2007 is contained in Note 15 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K. Also refer to Note 7 to the interim consolidated financial statements for an update of our indebtedness.

As of June 30, 2008, our total liabilities for unrecognized tax benefits were approximately $96 million, which were excluded from the table above. Based upon the expiration of statutes of limitations, settlements and/or the conclusion of tax examinations, we believe it is reasonably possible that this amount may decrease by up to $42 million within the next twelve months. 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 2007 Annual Report on Form 10-K for information regarding our contingent tax liability reserves.

Our credit agreements relating to our senior unsecured revolving credit facility, our term loan due December 2008 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. 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 between $240 million and $260 million during 2008 for capital expenditures to support and expand our existing operations, principally related to investments in information technology, equipment, and facility upgrades. During the first six months of 2008, we continued to make investments in support of our plans to develop and deploy standard systems across both the AmeriPath practices

and our clinical laboratories. We have completed the enhancements to the AmeriPath laboratory and billing systems and have begun deployment of the enhanced systems during the second quarter of 2008. These investments will enable significant productivity gains and improved customer service.

In June 2008, we amended our existing receivables securitization facility (the "Secured Receivables Credit Facility") and increased it from $375 million to $400 million. The Secured Receivables Credit Facility is supported by back-up facilities provided on a committed basis by two banks: (a) $125 million, which matures on December 13, 2008 and (b) $275 million, which matures on June 10, 2009. Interest on the Secured Receivables Credit Facility is based on rates that are intended to approximate commercial paper rates for highly rated issuers. As of June 30, 2008, we had no borrowings outstanding under this facility.

As of June 30, 2008, $1.2 billion of borrowing capacity was available under our existing credit facilities, including $400 million available under our Secured Receivables Credit Facility.

We believe that cash from operations and our borrowing capacity under our credit facilities will provide sufficient financial flexibility to meet seasonal working capital requirements and to fund capital expenditures, debt service requirements, 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 June 2008, the Financial Accounting Standards Board ("FASB") issued FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities". In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles and in March 2008, the FASB issued SFAS No. 161, "Disclosures About Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133". The impact of these accounting standards is discussed in Note 1 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 significantly 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" in Part I, Item 1, "Risk Factors" and "Cautionary Factors That May Affect Future Results" in Item I, Part 1A, "Legal Proceedings" in Part I, Item 3, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II, Item 7 and "Quantitative and Qualitative Disclosures About Market Risk" in Part II, Item 7A in our 2007 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 2008 Quarterly Reports on Form 10-Q and other items throughout the 2007 Form 10-K and our 2008 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

(a) Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934,

33

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.

(b) During the second quarter of 2008, 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 8 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

We did not purchase any shares of our common stock during the quarter and six months ended June 30, 2008.

Item 4. Submission of Matters to a Vote of Security Holders

(a) The Annual Meeting of Shareholders of the Company was held on May 16, 2008. At the meeting, the matters described below were approved by the shareholders.

(b) The following nominees for the office of director were elected for terms expiring at the 2011 Annual Meeting of Shareholders, by the following votes:

	For	Withheld
William F. Buehler	169,241,790	3,266,520
Rosanne Haggerty	169,308,393	3,199,917
Daniel C. Stanzione, Ph.D.	167,872,738	4,635,572

The following persons continue as directors:

John C. Baldwin, Ph.D.
Jenne K. Britell, Ph. D.
Surya N. Mohapatra, Ph.D.
Gary M. Pfeiffer
Gail R. Wilensky, Ph.D.
John B. Ziegler

(c) The ratification of the appointment of PricewaterhouseCoopers LLP as the independent registered public accounting firm to audit the financial statements of the Company and its subsidiaries for the fiscal year ending December 31, 2008, was approved by the following number of shareholder votes for, against, and abstained:

For: 169,235,593 Against: 1,943,037 Abstained: 1,329,533

Item 6. Exhibits

Exhibits:

10.1 Amendment No. 6 dated as of May 23, 2008 to Third Amended and Restated Credit and Security Agreement dated as of April 20, 2004, among Quest Diagnostics Receivables Inc., as Borrower, the Company, as Servicer, each of the lenders party thereto and Wachovia Bank, National Association, as Administrative Agent.

10.2 Amendment No. 7 dated as of June 11, 2008 to Third Amended and Restated Credit and Security Agreement dated as of April 20, 2004, among Quest Diagnostics Receivables Inc., as Borrower, the Company, as Servicer, each of the lenders party thereto and Wachovia Bank, National Association, as Administrative Agent.

10.3 Fourth Amended and Restated Credit and Security Agreement dated as of June 11, 2008, among Quest Diagnostics Receivables Inc., as Borrower, the Company, as Servicer, each of the lenders party thereto and The Bank of Tokyo-Mitsubishi, UFJ, Ltd., New York Branch, individually, as

35

Gotham Agent and as Administrative Agent.

10.4 Form of Equity Award Agreement, dated as of March 4, 2008.

10.5 Form of Equity Award Agreement, dated as of March 4, 2008, between the Company and Surya N. Mohapatra.

10.6 Amendment No. 2 to Letter Agreement between SmithKline Beecham Corporation and the Company.

10.7 Amendment No. 3 to Letter Agreement between SmithKline Beecham Corporation and the Company.

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Signatures

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

July 24, 2008
Quest Diagnostics Incorporated

By /s/ Surya N. Mohapatra
Surya N. Mohapatra, Ph.D.
Chairman, President and
Chief Executive Officer

By /s/ Robert A. Hagemann
Robert A. Hagemann
Senior Vice President and
Chief Financial Officer