QUEST DIAGNOSTICS INC
Form 10-Q
July 25, 2017

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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, 2017
Commission file number 001-12215

Quest Diagnostics Incorporated

Three Giralda Farms
Madison, NJ 07940
(973) 520-2700

Delaware
(State of Incorporation)

16-1387862
(I.R.S. Employer Identification Number)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x
As of July 13, 2017, there were outstanding 136,405,503 shares of the registrant’s common stock, $.01 par value.

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PART I - FINANCIAL INFORMATION

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2017 AND 2016
(unaudited)
(in millions, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net revenues	$1,943	$1,906	$3,842	$3,769
Operating costs and expenses and other operating income:				
Cost of services	1,170	1,155	2,335	2,299
Selling, general and administrative	437	430	874	872
Amortization of intangible assets	18	17	35	36
Gain on disposition of business	—	(118)	—	(118)
Other operating (income) expense, net	(1)	—	—	1
Total operating costs and expenses, net	1,624	1,484	3,244	3,090
Operating income	319	422	598	679
Other income (expense):				
Interest expense, net	(38)	(34)	(74)	(70)
Other income (expense), net	11	(5)	14	(54)
Total non-operating expenses, net	(27)	(39)	(60)	(124)
Income before income taxes and equity in earnings of equity method investees	292	383	538	555
Income tax expense	(94)	(183)	(172)	(250)
Equity in earnings of equity method investees, net of taxes	9	9	16	19
Net income	207	209	382	324
Less: Net income attributable to noncontrolling interests	14	14	25	26
Net income attributable to Quest Diagnostics	$193	$195	$357	$298
Earnings per share attributable to Quest Diagnostics' common stockholders:				
Basic	$1.40	$1.38	$2.59	$2.10
Diluted	$1.37	$1.37	$2.53	$2.08
Weighted average common shares outstanding:				
Basic	137	140	137	141
Diluted	140	142	140	143
Dividends per common share	$0.45	$0.40	$0.90	$0.80

The accompanying notes are an integral part of these statements.

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2017 AND 2016
(unaudited)
(in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	$207	$209	$382	$324
Other comprehensive income (loss):				
Currency translation	8	(15)	12	(18)
Market valuation, net of taxes	—	(1)	—	(1)
Net deferred loss on cash flow hedges, net of taxes	—	—	—	1
Other comprehensive income (loss)	8	(16)	12	(18)
Comprehensive income	215	193	394	306
Less: Comprehensive income attributable to noncontrolling interests	14	14	25	26
Comprehensive income attributable to Quest Diagnostics	$201	$179	$369	$280

The accompanying notes are an integral part of these statements.

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
JUNE 30, 2017 AND DECEMBER 31, 2016
(unaudited)
(in millions, except per share data)

	June 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$314	$ 359
Accounts receivable, net of allowance for doubtful accounts of $291 and $265 as of June 30, 2017 and December 31, 2016, respectively	947	926
Inventories	83	82
Prepaid expenses and other current assets	156	164
Total current assets	1,500	1,531
Property, plant and equipment, net	1,045	1,029
Goodwill	6,080	6,000
Intangible assets, net	949	949
Investment in equity method investees	451	443
Other assets	146	148
Total assets	$10,171	$ 10,100
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$912	$ 975
Current portion of long-term debt	5	6
Total current liabilities	917	981
Long-term debt	3,732	3,728
Other liabilities	709	654
Commitments and contingencies		
Redeemable noncontrolling interest	80	77
Stockholders' equity:		
Quest Diagnostics stockholders' equity:		
Common stock, par value $0.01 per share; 600 shares authorized as of both June 30, 2017 and December 31, 2016; 216 shares issued as of both June 30, 2017 and December 31, 2016	2	2
Additional paid-in capital	2,565	2,545
Retained earnings	6,847	6,613
Accumulated other comprehensive loss	(60)	(72)
Treasury stock, at cost; 80 shares and 79 shares as of June 30, 2017 and December 31, 2016, respectively	(4,657)	(4,460)
Total Quest Diagnostics stockholders' equity	4,697	4,628
Noncontrolling interests	36	32
Total stockholders' equity	4,733	4,660
Total liabilities and stockholders' equity	$10,171	$ 10,100

The accompanying notes are an integral part of these statements.

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2017 AND 2016
(unaudited)
(in millions)

	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	$382	$324
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	128	123
Provision for doubtful accounts	165	167
Deferred income tax provision	79	(4)
Stock-based compensation expense	37	36
Gain on disposition of business	—	(118)
Other, net	(8)	9
Changes in operating assets and liabilities:		
Accounts receivable	(185)	(249)
Accounts payable and accrued expenses	(93)	23
Income taxes payable	(3)	141
Other assets and liabilities, net	(12)	12
Net cash provided by operating activities	490	464
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(112)	(135)
Disposition of businesses	1	275
Escrow proceeds associated with disposition of business	25	—
Capital expenditures	(107)	(104)
Decrease (increase) in investments and other assets	1	(9)
Net cash (used in) provided by investing activities	(192)	27
Cash flows from financing activities:		
Proceeds from borrowings	—	1,869
Repayments of debt	(3)	(1,720)
Purchases of treasury stock	(300)	(390)
Exercise of stock options	97	38
Employee payroll tax withholdings on stock issued under stock-based compensation plans	(23)	(9)
Dividends paid	(124)	(111)
Distributions to noncontrolling interests	(20)	(19)
Other financing activities, net	30	1
Net cash used in financing activities	(343)	(341)
Net change in cash and cash equivalents	(45)	150
Cash and cash equivalents, beginning of period	359	133
Cash and cash equivalents, end of period	$314	$283

The accompanying notes are an integral part of these statements.

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2017 AND 2016
(unaudited)
(in millions)

	Quest Diagnostics Stockholders' Equity								
	Shares of Common Stock Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Compre-hensive Loss	Treasury Stock, at Cost	Non-controlling Interests	Total Stock-holders' Equity	Redeemable Non-controlling Interest
Balance, December 31, 2016	137	$2	$2,545	$6,613	$(72)	$(4,460)	$32	$4,660	$77
Net income				357			22	379	3
Other comprehensive income, net of taxes					12			12	
Dividends declared				(123)				(123)	
Distributions to noncontrolling interests							(20)	(20)	
Issuance of common stock under benefit plans	—		6			6		12	
Stock-based compensation expense			35			2		37	
Exercise of stock options	2		2			95		97	
Shares to cover employee payroll tax withholdings on stock issued under stock-based compensation plans			(23)					(23)	
Purchases of treasury stock	(3)					(300)		(300)	
Other							2	2	
Balance, June 30, 2017	136	$2	$2,565	$6,847	$(60)	$(4,657)	$36	$4,733	$80
Balance, December 31, 2015	143	$2	$2,481	$6,199	$(38)	$(3,960)	$29	$4,713	$70
Net income				298			22	320	4
Other comprehensive loss, net of taxes					(18)			(18)	
Dividends declared				(113)				(113)	
Distributions to noncontrolling interests							(19)	(19)	
Issuance of common stock under benefit plans			3			8		11	
Stock-based compensation expense			34			2		36	
Exercise of stock options	1		1			37		38	
Shares to cover employee payroll tax withholdings on stock issued under stock-based compensation plans			(9)					(9)	

Purchases of treasury stock	(5)		(38)			(352)		(390)	
Balance, June 30, 2016	139	$2	$ 2,472	$6,384	$ (56)	$(4,265)	$ 32	$4,569	$ 74

The accompanying notes are an integral part of these statements.

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)
(in millions, except per share data)

1. DESCRIPTION OF BUSINESS

Background

Quest Diagnostics Incorporated and its subsidiaries ("Quest Diagnostics" or the "Company") empower people to take action to improve health outcomes. The Company uses its extensive database of clinical lab results to derive diagnostic insights that reveal new avenues to identify and treat disease, inspire healthy behaviors and improve healthcare management. The Company's diagnostic information services business ("DIS") provides insights through clinical testing and related services to a broad range of customers, including patients, clinicians, hospitals, integrated delivery networks ("IDNs"), health plans, employers and accountable care organizations ("ACOs"). The Company offers the broadest access in the United States to diagnostic information services through its nationwide network of laboratories, patient service centers and phlebotomists in physician offices. The Company is the world's leading provider of diagnostic information services, which includes providing clinical testing services such as routine testing, non-routine (including advanced diagnostics) testing, and anatomic pathology services, as well as related services and insights. The Company provides interpretive consultation with one of the largest medical and scientific staffs in the industry and hundreds of M.D.s and Ph.D.s, many of whom are recognized leaders in their fields. The Company's Diagnostic Solutions ("DS") businesses offer a variety of solutions for life insurers and healthcare providers. The Company is the leading provider of risk assessment services for the life insurance industry. In addition, the Company offers healthcare organizations and clinicians robust information technology solutions. Prior to the sale of the Focus Diagnostics products business on May 13, 2016, the Company's diagnostics products business manufactured and marketed diagnostic products.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The interim unaudited consolidated financial statements reflect all adjustments which in the opinion of management are necessary for a fair statement of results of operations, comprehensive income, financial condition, cash flows and stockholders' equity for the periods presented. Except as otherwise disclosed, all such adjustments are of a normal recurring nature. Operating results for the interim periods are not necessarily indicative of the results that may be expected for the full year. These interim unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company’s 2016 Annual Report on Form 10-K. The year-end balance sheet data was derived from the audited financial statements as of December 31, 2016, but does not include all the disclosures required by accounting principles generally accepted in the United States (“GAAP”).

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Earnings Per Share

The Company's unvested restricted stock units that contain non-forfeitable rights to dividends are participating securities and, therefore, are included in the earnings allocation in computing earnings per share using the two-class method. Basic earnings per common share is calculated by dividing net income, adjusted for earnings allocated to participating securities, by the weighted average number of common shares outstanding. Diluted earnings per common share is calculated by dividing net income, adjusted for earnings allocated to participating securities, by the weighted average number of common shares outstanding after giving effect to all potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include the dilutive effect of outstanding stock options and performance share units granted under the Company's Amended and Restated Employee Long-Term Incentive Plan and its Amended and Restated Non-Employee Director Long-Term Incentive Plan. Earnings allocable to participating securities include the portion of dividends declared as well as the portion of undistributed earnings during the period allocable to participating securities.

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New Accounting Pronouncements

Adoption of New Accounting Standards

On January 1, 2017, the Company adopted a new accounting standard issued by the Financial Accounting Standards Board ("FASB") that simplifies the transition to the equity method of accounting by requiring adoption as of the date the investment becomes qualified for equity method accounting. Therefore, upon qualifying for the equity method of accounting as a result of an increase in the level of ownership interest or degree of influence, no retroactive adjustment of the investment is required. The adoption of this standard did not have a material impact on the Company's results of operations, financial position and cash flows.

New Accounting Standards To Be Adopted

In May 2014, the FASB issued an accounting standard update ("ASU") on revenue recognition. This ASU outlines a single comprehensive model to use in accounting for revenue arising from contracts with customers. This standard supersedes existing revenue recognition requirements and eliminates most industry-specific guidance from GAAP. The core principle of the revenue recognition standard is to require an entity to recognize as revenue the amount that reflects the consideration to which it expects to be entitled in exchange for goods or services as it transfers control to its customers. In August 2015, the FASB deferred the effective date of this ASU to the first quarter of 2018, with early adoption permitted beginning in the first quarter of 2017. The ASU can be applied using a full retrospective method or a modified retrospective method of adoption. The Company expects to adopt the ASU in the first quarter of 2018 using the full retrospective method and continues to assess the impact of this ASU on its results of operations, financial position and cash flows. Based on its preliminary assessment, the Company expects the adoption of this ASU will result in:

- the majority of the amounts that have historically been classified as bad debt expense, primarily related to patient responsibility, will be reflected as a reduction of the transaction price and therefore as a reduction in revenue; and
- increased disclosure, including qualitative and quantitative disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

However, the adoption of this ASU is not expected to have a material impact on the Company's financial position and cash flows.

In January 2016, the FASB issued an ASU on the recognition and measurement of financial assets and financial liabilities. This ASU requires that all equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) be measured at fair value with changes in fair value recognized in net income. However, companies may elect to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. In addition, the ASU eliminates the requirement to disclose the method and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet. The ASU is effective for the Company in the first quarter of 2018. The Company does not expect the adoption of this ASU to have a material impact on its results of operations, financial position and cash flows.

In February 2016, the FASB issued an ASU that amends accounting for leases. Under the new guidance, a lessee will recognize assets and liabilities for most leases on its balance sheet but will recognize expense on its statement of operations similar to current lease accounting. The ASU is effective for the Company in the first quarter of 2019 with early adoption permitted. The new guidance must be adopted using a modified retrospective transition approach, and provides for certain practical expedients. The adoption of this ASU will result in a significant increase to the Company's balance sheet for lease liabilities and right-of-use assets, which has not yet been quantified. The Company is currently assessing the impact of the adoption of this ASU on the Company's results of operations, financial position and cash flows.

In June 2016, the FASB issued an ASU that changes the impairment model for most financial instruments, including trade receivables, from an incurred loss method to a new forward-looking approach, based on expected losses. The estimate of expected credit losses will require entities to incorporate considerations of historical information, current information and reasonable and supportable forecasts. This ASU is effective for the Company in the first quarter of 2020 and must be adopted using a modified retrospective transition approach. The Company is currently assessing the impact of the adoption of this ASU on the Company's results of operations, financial position and cash flows.

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED
(unaudited)
(in millions, except per share data)

In August 2016, the FASB issued an ASU that clarifies how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The ASU is effective for the Company in the first quarter of 2018 with early adoption permitted and must be applied retrospectively to all periods presented. Upon adoption cash payments for debt retirement costs would be reclassified from operating cash outflows to financing cash outflows in the consolidated statements of cash flows.

In November 2016, the FASB issued an ASU that clarifies the presentation and classification of restricted cash in the statement of cash flows. The ASU requires that amounts generally described as restricted cash and restricted cash equivalents be presented with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The ASU is effective for the Company in the first quarter of 2018 with early adoption permitted and must be applied retrospectively to all periods presented. The Company does not expect the adoption of this ASU to have a material impact on its cash flows.

In January 2017, the FASB issued an ASU that provides guidance on evaluating when a set of transferred assets and activities (set) is a business. If an entity determines that substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets, then the asset is not a business. If this threshold is not met, then the entity needs to evaluate whether the asset includes, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. The ASU is effective for the Company in the first quarter of 2018 with early adoption permitted and must be applied prospectively. The future impact of the adoption of this ASU on the Company's results of operations, financial position and cash flows will be dependent upon the nature of any future acquisitions or dispositions made by the Company.

In January 2017, the FASB issued an ASU that simplifies the quantitative test for goodwill impairment. The guidance eliminates step two in the current two-step process so that any goodwill impairment is measured as the amount by which the reporting unit's carrying amount exceeds its fair value. The ASU is effective for the Company in the first quarter of 2020 with early adoption permitted and must be applied prospectively. The Company does not expect the adoption of this ASU to have a material impact on its results of operations, financial position and cash flows.

3. EARNINGS PER SHARE

The computation of basic and diluted earnings per common share was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Amounts attributable to Quest Diagnostics' common stockholders:				
Net income attributable to Quest Diagnostics	$193	$195	$357	$298
Less: Earnings allocated to participating securities	—	1	1	1
Earnings available to Quest Diagnostics' common stockholders – basic and diluted	$193	$194	$356	$297

Weighted average common shares outstanding – basic	137	140	137	141
Effect of dilutive securities:				
Stock options and performance share units	3	2	3	2
Weighted average common shares outstanding – diluted	140	142	140	143
Earnings per share attributable to Quest Diagnostics' common stockholders:				
Basic	$1.40	$1.38	$2.59	$2.10
Diluted	$1.37	$1.37	$2.53	$2.08

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED
(unaudited)
(in millions, except per share data)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Stock options	2	—	1	2

4. RESTRUCTURING ACTIVITIES

Invigorate Program

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

In January 2015, the Company adopted a program to further reduce its cost structure through 2017. This multi-year program continues to focus on the flagship program themes and additional key themes such as: standardizing processes, information technology systems, equipment and data; enhancing electronic enabling services; and enhancing reimbursement for work performed.

Restructuring Charges

The following table provides a summary of the Company's pre-tax restructuring charges for the three and six months ended June 30, 2017 and 2016:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Employee separation costs	$ 2	$ 3	$ 5	$ 6
Facility-related costs	1	—	1	—
Total restructuring charges	$ 3	$ 3	$ 6	$ 6

The restructuring charges incurred for the three and six months ended June 30, 2017 were primarily associated with various workforce reduction initiatives as the Company continues to simplify and restructure its organization. Of the total restructuring charges incurred during the three months ended June 30, 2017, $2 million and $1 million were recorded in cost of services and selling, general and administrative expenses, respectively. Of the total restructuring charges incurred during the six months ended June 30, 2017, $4 million and $2 million were recorded in cost of services and selling, general and administrative expenses, respectively.

The restructuring charges incurred for the three and six months ended June 30, 2016 were primarily associated with various workforce reduction initiatives as the Company continued to simplify and restructure its organization. Of the total restructuring charges incurred during the three months ended June 30, 2016, $2 million and $1 million were recorded in cost of services and selling, general and administrative expenses, respectively. Of the total restructuring charges incurred during the six months ended June 30, 2016, $3 million and $3 million were recorded in cost of services and selling, general and administrative expenses, respectively.

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

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED
(unaudited)
(in millions, except per share data)

The restructuring liability as of June 30, 2017 and December 31, 2016, which is included in accounts payable and accrued expenses, was $7 million and $9 million, respectively.

5. BUSINESS ACQUISITIONS

On May 1, 2017, the Company completed the acquisition of the outreach laboratory service business of PeaceHealth ("PHL"), in an all-cash transaction for $102 million. PHL is a healthcare system that provides clinical testing services to physicians, hospitals, and clinics in Oregon, Washington and Alaska. The assets acquired principally consist of $72 million of tax deductible goodwill and $30 million of customer-related intangible assets. The intangible assets are being amortized over a useful life of 15 years. The goodwill recorded primarily includes the expected synergies resulting from combining the operations of PHL with those of the Company and the value associated with an assembled workforce and other intangible assets that do not qualify for separate recognition. The acquired outreach laboratory service business of PHL is included in the Company's DIS business. For further details regarding business segment information, see Note 12.

Supplemental pro forma combined financial information has not been presented as the impact of the PHL acquisition is not material to the Company's consolidated financial statements.

For details regarding the Company's 2016 acquisitions, see Note 5 to the consolidated financial statements in the Company's 2016 Annual Report on Form 10-K.

6. FAIR VALUE MEASUREMENTS

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

		Basis of Fair Value Measurements		
		Quoted Prices in Active Markets for Identical Assets / Liabilities	Significant Other Observable Inputs	Significant Unobservable Inputs
June 30, 2017	Total	Level 1	Level 2	Level 3
Assets:				
Trading securities	$54	$54	$ —	$ —

Cash surrender value of life insurance policies	34	—	34	—
Available-for-sale equity securities	3	3	—	—
Total	$91	$57	$ 34	$ —
Liabilities:				
Deferred compensation liabilities	$96	$—	$ 96	$ —
Interest rate swaps	77	—	77	—
Contingent consideration	1	—	—	1
Total	$174	$—	$ 173	$ 1

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED
(unaudited)
(in millions, except per share data)

		Basis of Fair Value Measurements		
December 31, 2016	Total	Level 1	Level 2	Level 3
Assets:				
Trading securities	$51	$51	$—	$ —
Cash surrender value of life insurance policies	32	—	32	—
Available-for-sale equity securities	3	3	—	—
Total	$86	$54	$32	$ —
Liabilities:				
Deferred compensation liabilities	$91	$—	$91	$ —
Interest rate swaps	88	—	88	—
Contingent consideration	3	—	—	3
Total	$182	$—	$179	$ 3

A full description regarding the Company's fair value measurements is contained in Note 7 to the consolidated financial statements in the Company's 2016 Annual Report on Form 10-K.

The Company offers certain employees the opportunity to participate in non-qualified supplemental deferred compensation plans. A participant's deferrals, together with Company matching credits, are invested in a variety of participant-directed stock and bond mutual funds that are classified as trading securities. The trading securities are classified within Level 1 because the changes in the fair value of these securities are measured using quoted prices in active markets based on the market price per unit multiplied by the number of units held, exclusive of any transaction costs. A corresponding adjustment for changes in fair value of the trading securities is also reflected in the changes in fair value of the deferred compensation obligation. The deferred compensation liabilities are classified within Level 2 because their inputs are derived principally from observable market data by correlation to the trading securities.

The Company offers certain employees the opportunity to participate in a non-qualified deferred compensation program. A participant's deferrals, together with Company matching credits, are “invested” at the direction of the employee in a hypothetical portfolio of investments which are tracked by an administrator. The Company purchases life insurance policies, with the Company named as beneficiary of the policies, for the purpose of funding the program's liability. Changes in the cash surrender value of the life insurance policies are based upon earnings and changes in the value of the underlying investments. Changes in the fair value of the deferred compensation obligation are derived using quoted prices in active markets based on the market price per unit multiplied by the number of units. The cash surrender value and the deferred compensation obligations are classified within Level 2 because their inputs are derived principally from observable market data by correlation to the hypothetical investments.

The fair value measurements of the Company's interest rate swaps classified within Level 2 of the fair value hierarchy are model-derived valuations as of a given date in which all significant inputs are observable in active markets including certain financial information and certain assumptions regarding past, present and future market conditions.

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

In April 2014, and as further discussed in Note 5 to the consolidated financial statements in the Company's 2016 Annual Report on Form 10-K, the Company completed the acquisition of Steward Health Care Systems, LLC's laboratory outreach business. In connection with the acquisition, the Company initially recorded a contingent consideration liability of $4 million. The contingent consideration liability was classified within Level 3 measured at fair value using a probability weighted and discounted cash flow method. This measurement was based on externally obtained inputs and management's probability assessments of the occurrence of triggering events, appropriately discounted considering the uncertainties associated with the obligations, as well as the likelihood of the seller's compliance with a non-compete agreement. The initial probability estimate of the occurrence of such triggering events associated with the amounts the Company could be obligated to pay in future periods was between 5% and 95%.

(in millions, except per share data)

The probability-weighted cash flows were then discounted using a discount rate of 2.8%. The remaining $1 million of contingent consideration is expected to be paid in 2018.

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable and accrued expenses approximate fair value based on the short maturities of these instruments. As of June 30, 2017 and December 31, 2016, the fair value of the Company’s debt was estimated at $4.0 billion and $3.9 billion, respectively. Principally all of the Company's debt is classified within Level 1 of the fair value hierarchy because the fair value of the debt is estimated based on rates currently offered to the Company with identical terms and maturities, using quoted active market prices and yields, taking into account the underlying terms of the debt instruments.

7. GOODWILL AND INTANGIBLE ASSETS

The changes in goodwill for the six months ended June 30, 2017 and for the year ended December 31, 2016 were as follows:

	June 30, 2017	December 31, 2016
Balance, beginning of period	$ 6,000	$ 5,905
Goodwill acquired during the period	80	95
Balance, end of period	$ 6,080	$ 6,000

Principally all of the Company’s goodwill as of June 30, 2017 and December 31, 2016 was associated with its DIS business.

For the six months ended June 30, 2017, goodwill acquired during the period was principally associated with the PHL acquisition (see Note 5). For the year ended December 31, 2016, goodwill acquired was principally associated with the acquisition of the outreach laboratory service business of Clinical Laboratory Partners, LLC. For details regarding the Company's 2016 acquisitions, see Note 5 to the consolidated financial statements in the Company's 2016 Annual Report on Form 10-K.

Intangible assets at June 30, 2017 and December 31, 2016 consisted of the following:

	Weighted Average Amortization Period (in years)	June 30, 2017			December 31, 2016		
		Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Amortizing intangible assets:							
Customer-related	18	$1,004	$ (373)	$631	$971	$ (346)	$625
Non-compete agreements	6	7	(5)	2	6	(4)	2
Technology	18	94	(42)	52	93	(40)	53
Other	9	103	(75)	28	103	(70)	33
Total	18	1,208	(495)	713	1,173	(460)	713

Intangible assets not subject to amortization:

Trade names	235	—	235	235	—	235
Other	1	—	1	1	—	1
Total intangible assets	$1,444	$ (495)	$949	$1,409	$ (460)	$949

Amortization expense related to intangible assets was $18 million and $17 million for the three months ended June 30, 2017 and 2016, respectively. For the six months ended June 30, 2017 and 2016, amortization expense related to intangible assets was $35 million and $36 million, respectively.

(in millions, except per share data)

The estimated amortization expense related to amortizable intangible assets for each of the five succeeding fiscal years and thereafter as of June 30, 2017 is as follows:

Year Ending December 31,	
Remainder of 2017	$36
2018	67
2019	67
2020	66
2021	60
2022	57
Thereafter	360
Total	$713

8. FINANCIAL INSTRUMENTS

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

Interest Rate Risk

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

Interest Rate Derivatives – Cash Flow Hedges

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

In May 2016, the Company entered into interest rate lock agreements with several financial institutions for a total notional amount of $250 million which were accounted for as cash flow hedges. These agreements were entered into to hedge a portion of the Company’s interest rate exposure associated with variability in future cash flows attributable to changes in the ten-year treasury rates related to the planned issuance of senior notes in 2016. In connection with the issuance of senior notes in 2016, these agreements were settled, and the Company paid $1 million. These losses are deferred in stockholders' equity, net of income taxes, as a component of accumulated other comprehensive loss, and amortized as an adjustment to interest expense, net over the term of the respective senior notes.

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The total net loss, net of taxes, recognized in accumulated other comprehensive loss, related to the Company's cash flow hedges as of both June 30, 2017 and December 31, 2016 was $10 million. The loss recognized on the Company's cash flow hedges for the three and six months ended June 30, 2017 and 2016, as a result of ineffectiveness, was not material. The net amount of deferred losses on cash flow hedges that is expected to be reclassified from accumulated other comprehensive loss into interest expense, net within the next twelve months is $3 million.

Interest Rate Derivatives – Fair Value Hedges

The Company maintains various fixed-to-variable interest rate swaps to convert a portion of the Company's long-term debt into variable interest rate debt. A summary of the notional amounts of these interest rate swaps as of June 30, 2017 and December 31, 2016 was as follows:

Debt Instrument	Notional Amount	
	June 30, 2017	December 31, 2016
4.25% Senior Notes due April 2024	250	250
3.50% Senior Notes due March 2025	600	600
3.45% Senior Notes due June 2026	350	350
	$1,200	$ 1,200

The fixed-to-variable interest rate swap agreements in the table above have variable interest rates ranging from one-month LIBOR plus 2.2% to one-month LIBOR plus 3.0%.

As of December 31, 2015, the Company had entered into various fixed-to-variable interest rate swap agreements with an aggregate notional amount of $1.2 billion and variable interest rates ranging from one-month LIBOR plus 1.4% to one-month LIBOR plus 3.6%. In July 2016, the Company terminated those interest rate swaps agreements. As a result of the termination, the Company received proceeds of $60 million, which included $6 million of accrued interest. The remaining basis adjustment on the respective debt obligation of $54 million will be amortized as a reduction of interest expense over the remaining terms of the hedged debt instrument. Immediately after the termination of these interest rate swaps, the Company entered into new fixed-to-variable interest rate swap agreements, which are reflected in the table above.

Since inception, the fair value hedges have been effective or highly effective; therefore, there was no impact on earnings for the three and six months ended June 30, 2017 and 2016 as a result of hedge ineffectiveness.

Interest Rate Derivatives - Economic Hedges

In connection with the retirement of debt in the first quarter of 2016, which is further discussed in Note 13 to the consolidated financial statements in the Company's 2016 Annual Report on Form 10-K, the Company entered into reverse interest rate lock agreements with several financial institutions which were not designated for hedge accounting. The Company entered into these agreements to hedge the variability in cash flows associated with $75 million of the $200 million principal amount of debt that was retired in the first quarter of 2016. These agreements were settled during the first quarter of 2016 resulting in a gain of $1 million which was recognized in other income (expense), net.

A summary of the fair values of derivative instruments in the consolidated balance sheets was as follows:

	June 30, 2017		December 31, 2016	
	Balance Sheet Classification	Fair Value	Balance Sheet Classification	Fair Value
Derivatives Designated as Hedging Instruments				
Liability Derivatives:				
Interest rate swaps	Other liabilities	$ 77	Other liabilities	$ 88

A full description regarding the Company's use of derivative financial instruments is contained in Note 14 to the consolidated financial statements in the Company's 2016 Annual Report on Form 10-K.

9. STOCKHOLDERS’ EQUITY AND REDEEMABLE NONCONTROLLING INTEREST

Stockholders' Equity

Components of Comprehensive Income (Loss)

Comprehensive income (loss) includes: foreign currency translation adjustments; market value adjustments, which represent unrealized holding gains (losses) on available-for-sale securities, net of taxes; and net deferred loss on cash flow hedges, which represents deferred losses, net of taxes on interest rate related derivative financial instruments designated as cash flow hedges, net of amounts reclassified to interest expense (see Note 8). For the three and six months ended June 30, 2017 and 2016, the tax effects related to the deferred losses on cash flow hedges and market valuation adjustments were not material. Foreign currency translation adjustments are not adjusted for income taxes since they relate to indefinite investments in non-U.S. subsidiaries.

Dividend Program

During the first and second quarters of 2017, the Company's Board of Directors declared a quarterly cash dividend of $0.45 per common share. During each of the first three quarters of 2016, the Company's Board of Directors declared a quarterly cash dividend of $0.40 per common share. During the fourth quarter of 2016, the Company's Board of Directors declared a quarterly cash dividend of $0.45 per common share.

Share Repurchase Program

As of June 30, 2017, $1.1 billion remained available under the Company’s share repurchase authorizations. The share repurchase authorization has no set expiration or termination date.

Share Repurchases

For the six months ended June 30, 2017, the Company repurchased 3.0 million shares of its common stock for $300 million.

For the six months ended June 30, 2016, the Company repurchased 4.8 million shares of its common stock for $352 million, including 2.8 million shares repurchased under an accelerated share repurchase agreement ("ASR") as follows:

In May 2016, the Company entered into an ASR with a financial institution to repurchase $250 million of the Company's common stock as part of the Company's share repurchase program. The ASR was structured as a combination of two transactions: (1) a treasury stock repurchase; and (2) a forward contract, which permitted the Company to purchase shares immediately with the final purchase price of those shares determined by the volume weighted average price of the Company's common stock during the repurchase period, less a fixed discount. Under the

ASR, the Company paid $250 million to the financial institution and received 3.1 million shares of common stock, resulting in a final price per share of $81.04. The Company initially received 2.8 million shares of its common stock during the second quarter of 2016 and received an additional 0.3 million shares upon completion of the ASR during the third quarter of 2016. As of June 30, 2016, the Company recorded this transaction as an increase to treasury stock for $212 million, and recorded the remaining $38 million as a decrease to additional paid-in capital. Upon completion of the ASR in the third quarter of 2016, the Company reclassified the $38 million to treasury stock from additional paid-in capital.

Shares Reissued from Treasury Stock

For the six months ended June 30, 2017 and 2016, the Company reissued 1.8 million shares and 0.9 million shares, respectively, from treasury stock for employee benefit plans.

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Redeemable Noncontrolling Interest

In connection with the sale of an 18.9% noncontrolling interest in a subsidiary to UMass Memorial Medical Center ("UMass") on July 1, 2015, the Company granted UMass the right to require the Company to purchase all of its interest in the subsidiary at fair value commencing July 1, 2020. The subsidiary performs diagnostic information services in a defined territory within the state of Massachusetts. Since the redemption of the noncontrolling interest is outside of the Company's control, it has been presented outside of stockholders' equity at the greater of its carrying amount or its fair value. The Company will record changes in the fair value of the noncontrolling interest immediately as they occur. As of June 30, 2017, the redeemable noncontrolling interest was presented at its fair value.

10. SUPPLEMENTAL CASH FLOW & OTHER DATA

Supplemental cash flow and other data for the three and six months ended June 30, 2017 and 2016 was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Depreciation expense	$48	$44	$93	$87
Amortization expense	18	17	35	36
Depreciation and amortization expense	$66	$61	$128	$123
Interest expense	$(38)	$(35)	$(75)	$(71)
Interest income	—	1	1	1
Interest expense, net	$(38)	$(34)	$(74)	$(70)
Interest paid	$31	$22	$77	$75
Income taxes paid	$105	$117	$113	$121
Accounts payable associated with capital expenditures	$13	$12	$13	$12
Dividends payable	$62	$56	$62	$56
Businesses acquired:				
Fair value of assets acquired	$113	$—	$114	$135
Fair value of liabilities assumed	—	—	—	—
Fair value of net assets acquired	$113	$—	$114	$135
Merger consideration paid (payable), net	(2)	—	(2)	—
Cash paid for business acquisitions	111	—	112	135
Less: Cash acquired	—	—	—	—
Business acquisitions, net of cash acquired	$111	$—	$112	$135

The escrow proceeds associated with disposition of business received in 2017 related to the sale of the Company's Focus Diagnostics products business on May 13, 2016. A full description regarding the Company's dispositions is contained in Note 6 to the consolidated financial statements in the Company's 2016 Annual Report on Form 10-K.

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11. COMMITMENTS AND CONTINGENCIES

Letters of Credit

The Company can issue letters of credit totaling $100 million under its secured receivables credit facility and $150 million under its senior unsecured revolving credit facility. For further discussion regarding the Company's secured receivables credit facility and senior unsecured revolving credit facility, see Note 13 to the consolidated financial statements in the Company's 2016 Annual Report on Form 10-K.

In support of its risk management program, to ensure the Company’s performance or payment to third parties, $71 million in letters of credit under the secured receivables credit facility were outstanding as of June 30, 2017. The letters of credit primarily represent collateral for current and future automobile liability and workers’ compensation loss payments.

Contingent Lease Obligations

The Company remains subject to contingent obligations under certain real estate leases, including leases that were entered into by certain predecessor companies of a subsidiary prior to the Company's acquisition of the subsidiary. No liability has been recorded for any of these potential contingent obligations. For further details, see Note 17 to the consolidated financial statements in the Company’s 2016 Annual Report on Form 10-K.

Settlements and Agreement in Principle

In June 2010, the Company received a subpoena from the Florida Attorney General's Office seeking documents relating to the Company's pricing and billing practices as they relate to Florida’s Medicaid program. The Company cooperated with the requests. In November 2013, the State of Florida intervened as a plaintiff in a civil lawsuit, Florida ex rel. Hunter Laboratories LLC v. Quest Diagnostics Incorporated, et al., filed in Florida Circuit Court. The suit, originally filed by a competitor laboratory, alleges that the Company overcharged Florida’s Medicaid program. The Company's motion to dismiss the state's amended complaint was denied. The Company filed a motion for summary judgment on the primary claim in the case; the motion was granted. The court found that the Company had properly billed the Medicaid program the Company’s “usual and customary charge.” The Company had filed a motion for summary judgment on the state’s remaining claim. The parties recently reached an agreement in principle to resolve this matter, subject to further negotiation of terms and conditions.

In April 2015, a qui tam civil lawsuit entitled United States ex rel. Mayes v. Berkeley HeartLab, Inc., et al., filed in the U.S. District Court for the District of South Carolina, was unsealed. The complaint alleges that certain alleged business practices of the defendants violate the False Claims Act, and seeks monetary relief. The United States has intervened as a plaintiff as to Berkeley HeartLab, Inc., a subsidiary of the Company and filed a complaint in intervention; the United States did not intervene as a plaintiff as to Quest Diagnostics Incorporated. The Company previously reported that the parties had reached an agreement in principle to resolve these matters. The parties have finalized the settlement agreement, and the case has been dismissed as to Berkeley HeartLab and Quest Diagnostics.

Legal Matters

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

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

The Company is also involved, from time to time, in other reviews, investigations and proceedings by governmental agencies regarding the Company's business, including, among other matters, operational matters, which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief. The number of these reviews, investigations and proceedings has increased in recent years with regard to many firms in the healthcare services industry, including the Company.

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

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

These matters are in different stages. Some of these matters are in their early stages. Matters may involve responding to and cooperating with various government investigations and related subpoenas. As of June 30, 2017, the Company does not believe that material losses related to legal matters described above are probable.

Reserves for legal matters, other than the matters described in Settlements and Agreement in Principle, totaled $2 million and $5 million as of June 30, 2017 and December 31, 2016, respectively.

Reserves for General and Professional Liability Claims

As a general matter, providers of clinical testing services may be subject to lawsuits alleging negligence or other similar legal claims. These suits could involve claims for substantial damages. Any professional liability litigation could also have an adverse impact on the Company's client base and reputation. The Company maintains various liability insurance coverages for, among other things, claims that could result from providing, or failing to provide, clinical testing services, including inaccurate testing results, and other exposures. The Company's insurance coverage limits its maximum exposure on individual claims; however, the Company is essentially self-insured for a significant portion of these claims. Reserves for such matters, including those associated with both asserted and incurred but not reported claims, are established by considering actuarially determined losses based upon the Company's historical and projected loss experience. Such reserves totaled $119 million and $117 million as of June 30, 2017 and December 31, 2016, respectively. Management believes that established reserves and present insurance coverage are sufficient to cover currently estimated exposures. Management cannot predict the outcome of any claims made against the Company. Although management does not anticipate that the ultimate outcome of any such proceedings or claims will have a material adverse effect on the Company's financial condition, given the high degree of judgment involved in establishing accruals for loss estimates related to these types of matters, the outcome may be material to the Company's results of operations or cash flows in the period in which the impact of such claims is determined or paid.

12. BUSINESS SEGMENT INFORMATION

The Company's DIS business provides insights through clinical testing and related services to a broad range of customers, including patients, clinicians, hospitals, IDNs, health plans, employers and ACOs. The Company is the world's leading provider of diagnostic information services, which includes providing clinical testing services such as routine testing, non-routine (including advanced diagnostics) testing, and anatomic pathology services, as well as related services and insights. The DIS business accounted for greater than 90% of net revenues in 2017 and 2016.

All other operating segments include the Company's DS businesses, which consists of its risk assessment services, healthcare information technology and diagnostic products (prior to disposition on May 13, 2016) businesses. The Company's DS businesses offer a variety of solutions for life insurers and healthcare providers.

As of June 30, 2017, substantially all of the Company’s services were provided within the United States, and substantially all of the Company’s assets were located within the United States.

The following table is a summary of segment information for the three and six months ended June 30, 2017 and 2016. Segment asset information is not presented since it is not used by the chief operating decision maker at the operating segment level. Operating earnings (loss) of each segment represents net revenues less directly identifiable expenses to arrive at operating income (loss) for the segment. General corporate activities included in the table below are comprised of general management and administrative corporate expenses, amortization and impairment of intangibles assets, gain on the disposition of business, and other operating income and expenses net of certain general corporate activity costs that are allocated to the DIS and DS businesses. The accounting policies of the segments are the same as those of the Company as set forth in Note 2 to the consolidated financial statements contained in the Company's 2016 Annual Report on Form 10-K and Note 2 to the interim unaudited consolidated financial statements.

(in millions, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net revenues:				
DIS business	$1,855	$1,809	$3,667	$3,565
All other operating segments	88	97	175	204
Total net revenues	$1,943	$1,906	$3,842	$3,769
Operating earnings (loss):				
DIS business	$347	$328	$653	$606
All other operating segments	17	17	30	38
General corporate activities	(45)	77	(85)	35
Total operating income	319	422	598	679
Non-operating expenses, net	(27)	(39)	(60)	(124)
Income before income taxes and equity in earnings of equity method investees	292	383	538	555
Income tax expense	(94)	(183)	(172)	(250)
Equity in earnings of equity method investees, net of taxes	9	9	16	19
Net income	207	209	382	324
Less: Net income attributable to noncontrolling interests	14	14	25	26
Net income attributable to Quest Diagnostics	$193	$195	$357	$298

13. RELATED PARTIES

The Company's equity method investees primarily consist of its clinical trials central laboratory services joint venture and its diagnostic information services joint ventures, which are accounted for under the equity method of accounting. During the three months ended June 30, 2017 and 2016, the Company recognized net revenues of $11 million and $8 million, respectively, associated with diagnostic information services provided to its equity method investees. During the six months ended June 30, 2017 and 2016, the Company recognized net revenues of $20 million and $16 million, respectively, associated with such services. As of June 30, 2017 and December 31, 2016, there was $13 million and $10 million, respectively, of accounts receivable from equity method investees related to such services.

During the three months ended June 30, 2017 and 2016, the Company recognized income of $5 million and $4 million, respectively, associated with the performance of certain corporate services, including transition services, for its equity method investees, classified within selling, general and administrative expenses. During each of the six months ended June 30, 2017 and 2016, the Company recognized income of $9 million associated with the performance of such services classified within selling, general and administrative expenses. As of June 30, 2017 and December 31, 2016, there was $14 million and $5 million, respectively, of other receivables from equity method investees included in prepaid expenses and other current assets related to these service agreements and other transition related items. In addition, accounts payable and accrued expenses as of June 30, 2017 and December 31, 2016 included $16 million and $9 million, respectively, due to equity method investees.

14. TAXES ON INCOME

For the three and six months ended June 30, 2017, the effective income tax rate was 32.1% and 32.0%, respectively. Income tax expense and the effective income tax rate for the three and six months ended June 30, 2017 benefited from $13 million and $29 million, respectively of excess tax benefits associated with stock-based compensation arrangements.

For the three and six months ended June 30, 2016, the effective income tax rate was 47.7% and 45.0%, respectively. Income tax expense for the three and six months ended June 30, 2016 included $2 million and $4 million, respectively of excess tax benefits associated with stock-based compensation arrangements. For both the three and six months ended June 30, 2016 income tax expense includes $84 million associated with the sale of the Focus Diagnostics products business, consisting of $91 million of current income taxes payable and a deferred tax benefit of $7 million. The income tax expense from the sale of the Focus Diagnostics products business resulted in a combined tax rate of 71.4%, which was significantly in excess of the statutory rate primarily due to a lower tax basis in the assets sold, specifically the goodwill associated with the disposition.

A full description regarding the Company's adoption of the ASU that simplified several aspects of the accounting for stock-based compensation award transactions, including the income tax consequences, classification of awards as either equity or liabilities, classification on the statement of cash flows and accounting for forfeitures is contained in Note 2 to the consolidated financial statements in the Company's 2016 Annual Report on Form 10-K.

15. SUBSEQUENT EVENTS

In June 2017, the Company entered into definitive agreements to acquire the laboratory businesses of Med Fusion and Clear Point for $150 million in an all-cash transaction which closed on July 14, 2017. Med Fusion and Clear Point provide precision medicine diagnostics to aid cancer treatment nationwide and the acquired businesses will form the basis for the Company's first national center of excellence in precision diagnostics for oncology. The final consideration is subject to post closing adjustments related to working capital.

The preliminary purchase price allocations for the Med Fusion and Clear Point acquisitions, which will be accounted for as business combinations, are not provided as the appraisals necessary to assess fair values of assets acquired and liabilities assumed are not yet complete, but a significant portion of the purchase price is expected to be allocated to intangible assets and goodwill.

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

Our Company

Diagnostic Information Services

Quest Diagnostics empowers people to take action to improve health outcomes. We use our extensive database of clinical lab results to derive diagnostic insights that reveal new avenues to identify and treat disease, inspire healthy behaviors and improve healthcare management. Our diagnostic information services business ("DIS") provides insights through clinical testing and related services to a broad range of customers, including patients, clinicians, hospitals, integrated delivery networks ("IDNs"), health plans, employers and accountable care organizations ("ACOs"). We offer the broadest access in the United States to diagnostic information services through our nationwide network of laboratories, patient service centers and phlebotomists in physician offices. We are the world's leading provider of diagnostic information services, which includes providing clinical testing services such as routine testing, non-routine (including advanced diagnostics) testing, and anatomic pathology services, as well as related services and insights. We provide interpretive consultation with one of the largest medical and scientific staffs in the industry. Our DIS business makes up over 90% of our consolidated net revenues.

Diagnostic Solutions

In our Diagnostic Solutions ("DS") businesses, which represents the balance of our consolidated net revenues, we offer a variety of solutions for life insurers and healthcare providers. We are the leading provider of risk assessment services for the life insurance industry. In addition, we offer healthcare organizations and clinicians robust information technology solutions. Prior to the sale of our Focus Diagnostics products business on May 13, 2016 ("Focus Sale"), our diagnostics products business manufactured and marketed diagnostic products.

Second Quarter Highlights

- Our total net revenues of $1.9 billion were 1.9% above the prior year period. The Focus Sale negatively impacted revenue growth by 0.4%.
- In our DIS business:
  - Revenues of $1.9 billion increased by 2.5% compared to the prior year period.
  - Volume, measured by the number of requisitions, increased 1.8% compared to the prior year period.
  - Revenue per requisition increased by 0.7% compared to the prior year period.
- DS revenues of $88 million were 9.0% below the prior year period primarily due to the Focus Sale.
- Net income attributable to Quest Diagnostics' stockholders was $193 million, or $1.37 per diluted share, in 2017, compared to $195 million, or $1.37 per diluted share, in 2016.
- Net cash provided by operating activities was $490 million in 2017, compared to $464 million in 2016.

Two Point Strategy

Our two point strategy is described in detail in "Item 1. Business: Our Strategy and Strengths" in our 2016 Annual Report on Form 10-K. During the six months ended June 30, 2017, we continued to execute on our strategy as follows:

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Acquisition of the Outreach Laboratory Service Business of PeaceHealth Laboratories

On May 1, 2017, we completed the acquisition of the outreach laboratory services operations of PeaceHealth Laboratories ("PeaceHealth"), in an all-cash transaction for $102 million. The acquired outreach laboratory service business of PeaceHealth is included in our DIS business. Under a professional laboratory services agreement, Quest will also manage 11 laboratories, which PeaceHealth will continue to own.

Acquisition of Med Fusion and Clear Point

In June 2017, we entered into definitive agreements to acquire the laboratory businesses of Med Fusion and Clear Point in an all-cash transaction which closed on July 14, 2017. Med Fusion and Clear Point provide precision medicine diagnostics to aid cancer treatment nationwide and the acquired businesses will form the basis for the Company's first national center of excellence in precision diagnostics for oncology.

For details regarding our acquisitions, see Note 5 to the interim unaudited consolidated financial statements and Note 5 to the consolidated financial statements in our 2016 Annual Report on Form 10-K.

Collaboration with Wal-Mart

In June 2017, we announced our collaboration with Wal-Mart Stores, Inc. ("Wal-Mart") to help improve access to care and, over time, help lower healthcare costs through providing basic healthcare services. The collaboration will initially launch with a select number of co-branded sites within Wal-Mart stores, which will initially provide laboratory testing services. Over time, service offerings are expected to expand to include other basic healthcare services.

Invigorate Program

We are engaged in a multi-year program called Invigorate, which is designed to reduce our cost structure. We delivered more than $700 million in run-rate savings as we exited 2014. In November 2014, we announced our goal to deliver total run-rate savings from the Invigorate program of $1.3 billion as we exit 2017, compared to 2011. We ended 2016 with more than $1.1 billion in run-rate savings and believe we are on track to achieve our $1.3 billion run-rate savings goal as we exit 2017. In November 2016, we announced that we expect to drive operational excellence and achieve additional cost savings beyond 2017.

Invigorate has consisted of several flagship programs, with structured plans in each, to drive savings and improve performance across the customer value chain. These flagship programs include: organization excellence; information technology excellence; procurement excellence; field and customer service excellence; lab excellence; and revenue services excellence. In addition to these programs, we identified key themes to change how we operate in order to meet our goal of delivering the $1.3 billion of run-rate savings as we exit 2017. These additional key themes include: standardizing our processes, information technology systems, equipment and data; enhancing electronic enabling services; and enhancing reimbursement for work we perform. We believe that our efforts to standardize our information technology systems, equipment and data also foster our efforts to strengthen our foundation for growth and support the value creation initiatives of our clinical franchises by enhancing our operational flexibility, empowering and enhancing the customer experience, facilitating the delivery of actionable insights and bolstering our large data platform.

In January 2015, we adopted a course of action related to this multi-year program. We developed a high-level estimate of the total pre-tax charges expected to be incurred in 2015 through 2017 in connection with the course of action for the program: $300 million. During 2015 and 2016, we incurred $89 million and $63 million, respectively, of charges in connection with the courses of action. In February 2017, we developed high-level estimates of the pre-tax charges expected to be incurred in connection with the new course of action under the program for 2017 totaling $60 million to $80 million, consisting of up to $10 million of employee separation costs and $60 million to $70 million of systems conversion and integration costs. For the six months ended June 30, 2017, we incurred $32 million in connection with the course of action.

All of the total estimated pre-tax charges expected to be incurred in 2017 will result in cash expenditures. The actual charges incurred in connection with the course of action in 2017 could be materially different from these estimates. As detailed plans to implement the course of action are approved and executed, it will result in charges to earnings.

From 2012 through 2014, the cumulative charges incurred in connection with the Invigorate program were $266 million, including $178 million of cumulative pre-tax employee separation costs and other restructuring related costs. From

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2015 through June 30, 2017, the cumulative charges incurred in connection with the Invigorate program were $184 million, including $53 million of cumulative pre-tax employee separation costs and other restructuring related costs.

For further details of the Invigorate program and associated costs, see Note 4 to the interim unaudited consolidated financial statements.

Critical Accounting Policies

There have been no significant changes to our critical accounting policies from those disclosed in our 2016 Annual Report on Form 10-K.

Results of Operations

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2017	2016	Increase (Decrease)	% Increase (Decrease)	2017	2016	Increase (Decrease)	% Increase (Decrease)
	(dollars in millions)							
Net revenues:								
DIS business	$1,855	$1,809	$ 46	2.5 %	$3,667	$3,565	$ 102	2.9 %
DS businesses	88	97	(9)	(9.0)	175	204	(29)	(14.3)
Total net revenues	$1,943	$1,906	$ 37	1.9 %	$3,842	$3,769	$ 73	1.9 %
Operating costs and expenses and other operating income:								
Cost of services	$1,170	$1,155	$ 15	1.3 %	$2,335	$2,299	$ 36	1.6 %
Selling, general and administrative	437	430	7	1.5	874	872	2	0.2
Amortization of intangible assets	18	17	1	NM	35	36	(1)	(4.0)
Gain on disposition of business	—	(118)	118	NM	—	(118)	118	NM
Other operating (income) expense, net	(1)	—	(1)	NM	—	1	(1)	NM
Total operating costs and expenses, net	$1,624	$1,484	$ 140	9.5 %	$3,244	$3,090	$ 154	5.0 %
Operating income	$319	$422	$ (103)	(24.6)%	$598	$679	$ (81)	(12.0)%

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	Three Months Ended June 30,				Six Months Ended June 30,			
	2017	2016	Increase (Decrease)	% Increase (Decrease)	2017	2016	Increase (Decrease)	% Increase (Decrease)
	(dollars in millions, except per share amounts)							
Other income (expense):								
Interest expense, net	$(38)	$(34)	$4	9.3 %	$(74)	$(70)	$4	4.5 %
Other income (expense), net	11	(5)	(16)	NM	14	(54)	(68)	NM
Total non-operating expenses, net	$(27)	$(39)	$(12)	(29.9)%	$(60)	$(124)	$(64)	(51.8)%
Income tax expense	$(94)	$(183)	$(89)	(48.8)%	$(172)	$(250)	$(78)	(31.1)%
Effective income tax rate	32.1 %	47.7 %	(15.6)%	NM	32.0 %	45.0 %	(13.0)%	NM
Equity in earnings of equity method investees, net of taxes	$9	$9	$ —	NM	$16	$19	$(3)	(14.4)%
Net income attributable to Quest Diagnostics	$193	$195	$(2)	(0.9)%	$357	$298	$59	19.8 %
Diluted earnings per common share attributable to Quest Diagnostics' common stockholders	$1.37	$1.37	$ —	— %	$2.53	$2.08	$0.45	21.6 %

NM - Not Meaningful

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net revenues:				
DIS business	95.4 %	94.9 %	95.4 %	94.6 %
DS businesses	4.6	5.1	4.6	5.4
Total net revenues	100.0%	100.0 %	100.0%	100.0 %
Operating costs and expenses and other operating income:				
Cost of services	60.2 %	60.6 %	60.8 %	61.0 %
Selling, general and administrative	22.5	22.6	22.7	23.1
Amortization of intangible assets	0.9	0.9	0.9	1.0
Gain on disposition of business	—	(6.2)	—	(3.1)
Other operating (income) expense, net	—	—	—	—
Total operating costs and expenses, net	83.6 %	77.9 %	84.4 %	82.0 %
Operating income	16.4 %	22.1 %	15.6 %	18.0 %
Bad debt expense	4.2 %	4.2 %	4.3 %	4.4 %

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Operating Results

Results for the three months ended June 30, 2017 were affected by certain items that on a net basis benefited earnings per share by $0.02 as follows:

- excess tax benefits associated with stock-based compensation arrangements of $13 million, or $0.10 per diluted share, recorded in income tax expense,
- pre-tax charges of $23 million ($9 million in cost of services, $13 million in selling, general and administrative expenses, and $1 million in equity in earnings of equity method investees, net of taxes), or $0.10 per diluted share, primarily associated with systems conversions and integration incurred in connection with further restructuring and integrating our business; and
- pre-tax gain of $7 million, or $0.03 per diluted share recorded in other income (expense), net related to the sale of an interest in an equity method investment, which was partially offset by $2 million, or $0.01 per diluted share in costs incurred related to certain legal matters recorded in selling, general and administrative expenses.

Results for the six months ended June 30, 2017 were affected by certain items that on a net basis benefited diluted earnings per share by $0.05 as follows:

- excess tax benefits associated with stock-based compensation arrangements of $29 million, or $0.21 per diluted share, recorded in income tax expense;
- pre-tax charges of $41 million ($19 million in cost of services, $21 million in selling, general and administrative expenses and $1 million in equity earnings of equity method investees), or $0.18 per diluted share, primarily associated with systems conversions and integration incurred in connection with further restructuring and integrating our business; and
- pre-tax gain of $7 million, or $0.03 per diluted share recorded in other income (expense), net related to the sale of an interest in an equity method investment, which was partially offset by $2 million, or $0.01 per diluted share in costs incurred related to certain legal matters recorded in selling, general and administrative expenses.

Results for the three months ended June 30, 2016 were affected by certain items that on a net basis benefited diluted earnings per share by $0.14 as follows:

- pre-tax gain of $118 million, or $0.24 per diluted share, related to the Focus Sale recorded in gain on disposition of business;
- pre-tax charges of $19 million ($10 million in cost of services, $8 million in selling, general and administrative expenses and $1 million in equity in earnings of equity method investees, net of taxes), or $0.08 per diluted share, primarily associated with systems conversions and integration costs in connection with further restructuring and integrating our business;
- net pre-tax costs of $8 million ($3 million in selling, general and administrative expenses, $(1) million in other operating (income) expense, net and $6 million in other expense, net), or $0.04 per diluted share, related to winding down subsidiaries, non-cash asset impairment charges and costs incurred related to certain legal matters; and
- excess tax benefits associated with stock-based compensation arrangements of $2 million, or $0.02 per diluted share, recorded in income tax expense.

Results for the six months ended June 30, 2016 were affected by certain items that on a net basis reduced diluted earnings per share by $0.17 as follows:

- pre-tax gain of $118 million, or $0.24 per diluted share, related to the Focus Sale recorded in gain on disposition of business;

- pre-tax charges of $48 million, or $0.21 per diluted share, related to the loss on retirement of debt associated with the March 2016 cash tender offer recorded in other income (expense), net;
- pre-tax charges of $40 million ($17 million in cost of services, $20 million in selling, general and administrative expenses and $3 million in equity in earnings of equity method investees, net of taxes), or $0.17 per diluted share, primarily associated with systems conversions and integration costs in connection with further restructuring and integrating our business;

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- net pre-tax costs of $14 million ($6 million in selling, general and administrative expenses, $1 million in other operating (income) expense, net and $7 million in other expense, net), or $0.06 per diluted share, related to winding down subsidiaries, non-cash asset impairment charges and costs incurred related to certain legal matters; and
- excess tax benefits associated with stock-based compensation arrangements of $4 million, or $0.03 per diluted share, recorded in income tax expense.

Net Revenues

Net revenues for the three months ended June 30, 2017 increased by 1.9% compared to the prior year period. The Focus Sale negatively impacted revenue growth by 0.4%.

DIS revenues for the three months ended June 30, 2017 increased by 2.5% compared to the prior year period, which reflects continuing expansion of hospital health system relationships and growth in non-routine (including advanced diagnostics) testing. Organic growth (growth excluding the impact of acquisitions) and acquisitions contributed approximately 2.1% and 0.4%, respectively, to DIS revenue growth. DIS volume, measured by the number of requisitions, increased 1.8%, with organic growth and acquisitions contributing approximately 1.4% and 0.4%, respectively, to DIS volume growth. Revenue per requisition increased by 0.7% compared to the prior year period. Revenue per requisition benefited from favorable test mix partially offset by moderate pricing pressure of less than 1% and lower revenue per requisition associated with our growth in professional lab services engagements.

Combined revenues in our DS businesses for the three months ended June 30, 2017, decreased by 9.0% compared to the prior year period primarily due to the Focus Sale.

Net revenues for the six months ended June 30, 2017 increased by 1.9% compared to the prior year period. The Focus Sale negatively impacted revenue growth by 0.7%.

DIS revenues for the six months ended June 30, 2017 increased by 2.9% compared to the prior year period, which reflects continuing expansion of hospital health system relationships and growth in non-routine (including advanced diagnostics) testing. Organic growth and acquisitions contributed approximately 2.4% and 0.5%, respectively, to DIS revenue growth. DIS volume, measured by the number of requisitions, increased 2.6%, with organic growth and acquisitions contributing approximately 2.1% and 0.5%, respectively, to DIS volume growth. Revenue per requisition increased by 0.2% compared to the prior year period. Revenue per requisition benefited from favorable test mix partially offset by moderate pricing pressure of less than 1% and lower revenue per requisition associated with our growth in professional lab services engagements.

Combined revenues in our DS businesses for the six months ended June 30, 2017, decreased by 14.3% compared to the prior year period primarily due to the Focus Sale.

Cost of Services

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

Cost of services increased $15 million for the three months ended June 30, 2017 compared to the prior year period. The increase was primarily driven by higher compensation and benefits and supplies expense related to increased testing volume.

Cost of services increased $36 million for the six months ended June 30, 2017 compared to the prior year period. The increase was primarily driven by higher compensation and benefits and supplies expense related to increased testing volume, partially offset by lower costs as a result of the Focus Sale.

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

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

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SG&A increased $7 million for the three months months ended June 30, 2017 compared to the prior year period primarily driven by higher costs associated with our Invigorate program. Bad debt expense for the three months months ended June 30, 2017 was consistent with the prior year period.

SG&A for the six months ended June 30, 2017 was consistent with the prior year period. Bad debt expense decreased $2 million for the six months months ended June 30, 2017 compared to the prior year period.

Gain on Disposition of Business

The gain on disposition of business for the three and six months ended June 30, 2016 is a result of the Focus Sale.

Interest Expense, net

Interest expense, net increased for the three and six months ended June 30, 2017 compared to the prior year period primarily driven by higher outstanding debt balances as a result of the issuance of senior notes in 2016 and higher interest rates associated with our variable rate indebtedness.

Other Income (Expense), net

Other income (expense), net represents miscellaneous income and expense items related to non-operating activities, such as gains and losses associated with investments, other non-operating assets and early retirement of debt.

Other income (expense), net for the three and six months ended June 30, 2017, included a $7 million gain on the sale of an interest in an equity method investment.

Other income (expense), net for the six months ended June 30, 2016, included the loss on retirement of debt of $48 million associated with the March 2016 cash tender offer.

Income Tax Expense

Both income tax expense and the effective income tax rate decreased for the three months ended June 30, 2017 compared to the prior year period. The decrease was primarily driven by the Focus Sale in 2016 combined with an increase of $11 million in excess tax benefits associated with stock-based compensation arrangements over the prior year period.

Both income tax expense and the effective income tax rate decreased for the six months ended June 30, 2017 compared to the prior year period. The decrease was primarily driven by the Focus Sale in 2016 combined with an increase of $25 million in excess tax benefits associated with stock-based compensation arrangements over the prior year period. The decrease in the income tax expense was partially offset by other increases in pre-tax income.

The Focus Sale resulted in $84 million of income tax expense recorded in 2016 and had a combined tax rate of 71.4%, which was significantly in excess of the statutory rate primarily due to a lower tax basis in the assets sold, specifically the goodwill associated with the disposition.

Quantitative and Qualitative Disclosures About Market Risk

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

As of June 30, 2017 and December 31, 2016, the fair value of our debt was estimated at approximately $4.0 billion and $3.9 billion, respectively, using quoted prices in active markets and yields for the same or similar types of borrowings, taking into account the underlying terms of the debt instruments. As of June 30, 2017 and December 31, 2016, the estimated fair value exceeded the carrying value of the debt by $230 million and $165 million, respectively. A hypothetical 10% increase

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in interest rates (representing 41 basis points as of June 30, 2017 and 39 basis points as of December 31, 2016) would potentially reduce the estimated fair value of our debt by approximately $94 million and $102 million as of June 30, 2017 and December 31, 2016, respectively.

Borrowings under our secured receivables credit facility and our senior unsecured revolving credit facility are subject to variable interest rates. Interest on our secured receivables credit facility is based on rates that are intended to approximate commercial paper rates for highly rated issuers. Interest on our senior unsecured revolving credit facility is subject to a pricing schedule that can fluctuate based on changes in our credit ratings. As such, our borrowing cost under this credit arrangement will be subject to both fluctuations in interest rates and changes in our credit ratings. As of June 30, 2017, the borrowing rates under these debt instruments were: for our secured receivables credit facility, commercial paper rates for highly rated issuers plus 0.66%; and for our senior unsecured revolving credit facility, LIBOR plus 1.125%. As of June 30, 2017, the weighted average LIBOR was 1.2%. As of June 30, 2017, there were no borrowings outstanding under our $600 million secured receivables credit facility and no borrowings outstanding under our $750 million senior unsecured revolving credit facility.

The notional amount of fixed-to-variable interest rate swaps outstanding as of both June 30, 2017 and December 31, 2016 was $1.2 billion. The aggregate fair value of the fixed-to-variable interest rate swaps was $77 million, in a liability position, as of June 30, 2017.

Based on our net exposure to interest rate changes, a hypothetical 10% change to the variable rate component of our variable rate indebtedness (representing 12 basis points) would not impact annual interest expense materially, assuming no changes to the debt outstanding as of June 30, 2017. A hypothetical 10% change in the forward one-month LIBOR curve (representing a 21 basis point change in the weighted average yield) would potentially change the fair value of our derivative liabilities by $18 million.

For further details regarding our outstanding debt, see Note 13 to the consolidated financial statements included in our 2016 Annual Report on Form 10-K. For details regarding our financial instruments and hedging activities, see Note 8 to the interim unaudited consolidated financial statements and Note 14 to the consolidated financial statements included in our 2016 Annual Report on Form 10-K.

Risk Associated with Investment Portfolio

Our investment portfolio includes equity investments comprised primarily of strategic equity holdings in privately and publicly held companies. These securities are exposed to price fluctuations and are generally concentrated in the life sciences industry. We regularly evaluate the fair value measurements of our equity investments to determine if losses in value are other than temporary and if an impairment loss has been incurred. The carrying value of our equity investments (excluding investments accounted for under the equity method) was $12 million as of June 30, 2017.

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

Liquidity and Capital Resources

	Six Months Ended June 30,		Increase (Decrease)
	2017	2016	

	(dollars in millions)		
Net cash provided by operating activities	$490	$464	$ 26
Net cash (used in) provided by investing activities	(192)	27	(219)
Net cash used in financing activities	(343)	(341)	(2)
Net change in cash and cash equivalents	$(45)	$150	$ (195)

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid short-term investments. Cash and cash equivalents as of June 30, 2017 totaled $314 million, compared to $359 million as of December 31, 2016.

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As of June 30, 2017, approximately 21% of our $314 million of consolidated cash and cash equivalents were held outside of the United States. These funds are considered indefinitely reinvested to be used to expand operations either organically or through acquisitions outside the United States. Further, our current plans do not demonstrate a need to repatriate foreign funds in order to fund U.S. operations. If the foreign cash and cash items are needed for operations in the United States, or we otherwise elect to repatriate the funds, we may be required to accrue and pay United States taxes on a significant portion of these amounts.

Cash Flows from Operating Activities

Net cash provided by operating activities for the six months ended June 30, 2017 was $490 million, compared to $464 million for the six months ended June 30, 2016. This $26 million increase in net cash provided by operating activities was primarily a result of improved collections through management of days sales outstanding in 2017 combined with $47 million of payments made in 2016 related to the retirement of debt and improved operating performance in 2017. These increases were partially offset by payments associated with an additional payroll cycle in 2017.

Days sales outstanding, a measure of billing and collection efficiency, was 43 days as of June 30, 2017, 47 days as of December 31, 2016 and 47 days as of June 30, 2016.

Cash Flows from Investing Activities

Net cash (used in) provided by investing activities for the six months ended June 30, 2017 was ($192 million), compared to $27 million for the six months ended June 30, 2016. This $219 million increase in cash used in investing activities was primarily a result of:

- a $274 million decrease in proceeds from the disposition of businesses, primarily a result of the Focus Sale in 2016; partially offset by
- a $25 million release of escrow proceeds received in 2017 associated with the Focus Sale; and
- a $23 million decrease in cash paid for business acquisitions.

Cash Flows from Financing Activities

Net cash used in financing activities for the six months ended June 30, 2017 and 2016 was $343 million and $341 million, respectively and was primarily impacted by:

- $3 million in net repayments (proceeds from borrowings less repayments of debt) in 2017, compared to $149 million in net borrowings in 2016; offset by
- a $90 million decrease in repurchases of our common stock (see "Share Repurchases" for further details) in 2017; and
- a $59 million increase in proceeds from the exercise of stock options, which was a result of an increase in the volume of stock options exercised due to the increase in our stock price over the past year.

During the six months ended June 30, 2017, there were no borrowings under either our secured receivables credit facility or senior unsecured revolving credit facility.

In 2016, we completed the issuance of the $500 million principal amount of 3.45% senior notes due June 2026, the March 2016 cash tender offer in which we retired $200 million of aggregate principal amount of our senior notes due 2037 and 2040, and repaid the remaining $150 million outstanding under the 3.2% Senior Notes due April 2016. In addition, we borrowed $1.2 billion under our secured receivables receivables credit facility and $155 million under our senior unsecured revolving credit facility, all of which was repaid as of June 30, 2016.

Dividend Program

During the first and second quarters of 2017, our Board of Directors declared a quarterly cash dividend of $0.45 per common share. During each of the first three quarters of 2016, our Board of Directors declared a quarterly cash dividend of $0.40 per common share. During the fourth quarter of 2016, our Board of Directors declared a quarterly cash dividend of $0.45 per common share. We expect to fund future dividend payments with cash flows from operations.

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Share Repurchase Program

As of June 30, 2017, $1.1 billion remained available under our share repurchase authorizations. The share repurchase authorization has no set expiration or termination date.

Share Repurchases

For the six months ended June 30, 2017, we repurchased 3.0 million shares of our common stock for $300 million.

For the six months ended June 30, 2016, we repurchased 4.8 million shares of our common stock for $352 million.

Contractual Obligations and Commitments

The following table summarizes certain of our contractual obligations as of June 30, 2017:

Contractual Obligations	Payments due by period				
	Total	Remainder of 2017	1-3 years	3-5 years	After 5 years
	(dollars in millions)				
Outstanding debt	$3,775	$ —	$300	$1,350	$2,125
Capital lease obligations	10	3	6	1	—
Interest payments on outstanding debt	1,590	78	307	235	970
Operating leases	641	95	262	128	156
Purchase obligations	1,987	143	495	418	931
Merger consideration obligations	4	3	1	—	—
Total contractual obligations	$8,007	$ 322	$1,371	$2,132	$4,182

A full description of the terms of our indebtedness and related debt service requirements and our future payments of our outstanding debt is contained in Note 13 to the consolidated financial statements in our 2016 Annual Report on Form 10-K.

Interest payments on our outstanding debt have been calculated after giving effect to our interest rate swap agreements, using the interest rates as of June 30, 2017 applied to the June 30, 2017 balances, which are assumed to remain outstanding through their maturity dates.

A full discussion and analysis regarding our minimum rental commitments under noncancelable operating leases is contained in Note 17 to the consolidated financial statements in our 2016 Annual Report on Form 10-K.

Purchase obligations include our noncancelable commitments to purchase products or services as described in Note 17 to the consolidated financial statements in our 2016 Annual Report on Form 10-K.

Merger consideration obligation includes consideration owed on our business acquisitions. For details regarding our acquisitions, see Note 5 to the interim unaudited consolidated financial statements and Note 5 to the consolidated financial statements in our 2016 Annual Report on Form 10-K.

As of June 30, 2017, our total liabilities associated with unrecognized tax benefits were approximately $97 million, which were excluded from the table above. We expect that these liabilities may decrease by less than $9 million within the next twelve months, primarily as a result of payments, settlements, expiration of statutes of limitations and/or the conclusion of tax examinations on certain tax positions. For the remainder, we cannot make reasonably reliable estimates of the timing of the future payments of these liabilities. See Note 8 to the consolidated financial statements in our 2016 Annual Report on Form 10-K for information regarding our contingent tax liability reserves.

In connection with the sale of an 18.9% noncontrolling interest in a subsidiary to UMass Memorial Medical Center ("UMass"), we granted UMass the right to require us to purchase all of its interest in the subsidiary at fair value commencing July 1, 2020. As of June 30, 2017, the fair value of the redeemable noncontrolling interest on the interim unaudited consolidated balance sheet was $80 million, which was excluded from the table above. Since the redemption of the noncontrolling interest is outside of our control, we cannot make a reasonably reliable estimate of the timing of the future

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payment, if any, of the redeemable noncontrolling interest. For further details regarding the redeemable noncontrolling interest, see Note 9 to the interim unaudited consolidated financial statements and Note 15 to the consolidated financial statements in our 2016 Annual Report on Form 10-K.

Our credit agreements contain various covenants and conditions, including the maintenance of certain financial ratios, that could impact our ability to, among other things, incur additional indebtedness. As of June 30, 2017, we were in compliance with the various financial covenants included in our credit agreements and we do not expect these covenants to adversely impact our ability to execute our growth strategy or conduct normal business operations.

Equity Method Investees

Our equity method investees primarily consist of our clinical trials central laboratory services joint venture and our diagnostic information services joint ventures, which are accounted for under the equity method of accounting. Our investment in equity method investees equals less than 5% of our consolidated total assets. Our proportionate share of income before income taxes associated with our equity method investees equals less than 5% of our consolidated income before income taxes and equity in earnings of equity method investees. We have no material unconditional obligations or guarantees to, or in support of, our equity method investees and their operations.

For further details regarding related party transactions with our equity method investees, see Note 13 to the interim unaudited consolidated financial statements and Note 20 to the consolidated financial statements in our 2016 Annual Report on Form 10-K.

Requirements and Capital Resources

We estimate that we will invest approximately $250 million to $300 million during 2017 for capital expenditures, to support and grow our existing operations, principally related to investments in information technology, laboratory equipment and facilities, including specific initiatives associated with our Invigorate and other programs, and to enable the relocation of our headquarters to a lower cost location.

As of June 30, 2017, $1.3 billion of borrowing capacity was available under our existing credit facilities consisting of $529 million available under our secured receivables credit facility and $750 million available under our senior unsecured revolving credit facility.

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

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

Impact of New Accounting Standards

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

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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 sta are based on our current plans and expectations and are subject to a number of risks and uncertainties that could cause our plans and expectations, including actual results, to differ materially from the forward-looking statements. Risks and uncertainties that may affect our future results include, but are not limited to, adverse results from pending or future government investigations, lawsuits or private actions, the competitive environment, changes in government regulations, changing relationships with customers, payers, suppliers and strategic partners and other factors discussed in our most recently filed Annual Report on Form 10-K and subsequently filed Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, including those discussed in the “Business,” “Risk Factors,” “Cautionary Factors that May Affect Future Results” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” sections of those reports.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Item 4. Controls and Procedures

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

During the second quarter of 2017, 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.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

See Note 11 to the interim unaudited consolidated financial statements for information regarding the status of legal proceedings involving the Company.

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

The table below sets forth the information with respect to purchases made by or on behalf of the Company of its common stock during the second quarter of 2017.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)
April 1, 2017 – April 30, 2017				
Share Repurchase Program (A)	—	$—	—	$ 1,232,116
Employee Transactions (B)	22	$ 98.74	N/A	N/A
May 1, 2017 – May 31, 2017				
Share Repurchase Program (A)	925,424	$ 106.66	925,424	$ 1,133,414
Employee Transactions (B)	5,021	$ 105.82	N/A	N/A
June 1, 2017 – June 30, 2017				
Share Repurchase Program (A)	471,926	$ 108.70	471,926	$ 1,082,116
Employee Transactions (B)	71	$ 108.89	N/A	N/A
Total				
Share Repurchase Program (A)	1,397,350	$ 107.35	1,397,350	$ 1,082,116
Employee Transactions (B)	5,114	$ 105.84	N/A	N/A

(A) Since the share repurchase program's inception in May 2003, our Board of Directors has authorized $8 billion of share repurchases of our common stock through June 30, 2017. The share repurchase authorization has no set expiration or termination date.

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

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Item 6. Exhibits

Exhibits:

31.1	Rule 13a-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a) Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer
32.2	Section 1350 Certification of Chief Financial Officer
101.INS	dgx-20170630.xml
101.SCH	dgx-20170630.xsd
101.CAL	dgx-20170630_cal.xml
101.DEF	dgx-20170630_def.xml
101.LAB	dgx-20170630_lab.xml
101.PRE	dgx-20170630_pre.xml

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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 25, 2017

Quest Diagnostics Incorporated

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

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