

## Quest Diagnostics

## Core operating margin expanding, but multiple headwinds temper EPS growth

Reiterate Rating: BUY | PO: 150.00 USD | Price: 127.17 USD

## 4Q results 2% ahead; Adj. OpM soft on one-time expenses

Quest Diagnostics (DGX) reported 4Q23 results modestly ahead of expectations ([See our First Look report for details](#)). Base business volume grew 5.2% yoy and revenue per requisition was up 0.2%. Adj. EBITA margin (14.8%, +60bps yoy) was lower due to higher employee healthcare utilization, investments (e.g. IT), and deferred compensation expenses.

## Inline FY24 sales guide supported by both volume, price

FY24 total sales guidance was in-line, as volumes and pricing stay healthy, driving underlying organic growth of ~3%. Previously announced M&A contributes ~50bps of growth. Mgmt. expects pricing to be flat-to-slightly up yoy, after completing health plan renegotiations in 2023. On volumes, hospital reference testing has been growing faster as health plans redirect more testing to national labs like DGX. However, DGX now sees a decline in higher margin COVID (C19) related revenues of ~\$175mn vs prior \$150mn.

## FY'24 Adj. OpM expands but Adj. EPS sees pressure

The call focused on '24 margin assumptions as the midpt of the EPS guide was -3% below consensus. Mgmt. expects the core adj. OpM to expand yoy, mainly driven by volume leverage, but did not quantify. DGX sees similar inflationary pressures to 2023, much of which will be offset by the Invigorate savings program which is on track. On the bottom-line, the base business is expected to contribute incremental \$0.92-1.18 to Adj. EPS. However, this is being largely offset by ~49-51c headwind from lower C19 sales, a 5-7c hit from bad January weather, ~20c dilution from Haystack dilution, and ~25c from higher interest expense. On the regulatory front, the FDA's LDT reform rule is progressing and would affect ~10% of DGX's tests, but any final rule will likely be challenged in court by the lab industry.

## Adjusting estimates; Stay constructive on DGX shares

Overall, we see these headwinds as transient and expect the company to deliver on the EPS growth targets outlined at the 2023 analyst day. We trim our ests and our PO drops to \$150 (was \$160), still based on 11x our 2024 EV/EBITDA est. We reiterate our Buy rating given lower exposure to the macro headwinds impacting our Life Sciences & Biopharma Services coverage universe and reasonable valuation.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	9.95	8.72	8.80	9.45	10.20
GAAP EPS	7.92	7.51	7.67	8.41	9.10
EPS Change (YoY)	-30.1%	-12.4%	0.9%	7.4%	7.9%
Consensus EPS (Bloomberg)			8.98	9.59	10.43
DPS	2.64	2.79	2.96	3.18	3.43
Valuation (Dec)					
P/E	12.8x	14.6x	14.5x	13.5x	12.5x
GAAP P/E	16.1x	16.9x	16.6x	15.1x	14.0x
Dividend Yield	2.1%	2.2%	2.3%	2.5%	2.7%
EV / EBITDA*	9.3x	10.7x	10.1x	9.6x	9.1x
Free Cash Flow Yield*	9.2%	6.0%	6.4%	10.4%	11.5%

\* For full definitions of *IQmethod™* measures, see page 4.

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**Refer to important disclosures on page 5 to 7. Analyst Certification on page 3. Price Objective Basis/Risk on page 3.**

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01 February 2024

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	160.00	150.00
2024E EPS	8.90	8.80
2025E EPS	9.55	9.45
2026E EPS	NA	10.20
2024E EBITDA (m)	1,929.2	1,880.4
2025E EBITDA (m)	2,004.9	1,985.9
2026E EBITDA (m)	NA	2,090.2

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## Stock Data

Price	127.17 USD
Price Objective	150.00 USD
Date Established	1-Feb-2024
Investment Opinion	B-1-7
52-Week Range	119.59 USD - 150.57 USD
Mkt Val (mn) / Shares Out (mn)	14,298 USD / 112.4
Free Float	99.1%
Average Daily Value (mn)	121.33 USD
BofA Ticker / Exchange	DGX / NYS
Bloomberg / Reuters	DGX US / DGX.N
ROE (2024E)	14.6%
Net Dbt to Eqty (Dec-2023A)	65.6%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent

# iQprofile<sup>SM</sup> Quest Diagnostics

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	10.9%	8.7%	8.5%	8.8%	8.9%
Return on Equity	19.0%	16.2%	14.6%	13.9%	13.9%
Operating Margin	16.4%	14.6%	15.2%	15.7%	16.2%
Free Cash Flow	1,313	864	913	1,482	1,645

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.5x	1.3x	1.3x	1.8x	1.8x
Asset Replacement Ratio	1.3x	1.2x	1.2x	1.2x	1.2x
Tax Rate	21.4%	22.0%	24.5%	25.0%	25.5%
Net Debt-to-Equity Ratio	64.0%	65.6%	45.1%	38.9%	31.4%
Interest Cover	11.8x	8.9x	7.6x	8.5x	9.5x

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	9,883	9,252	9,415	9,735	10,025
% Change	-8.4%	-6.4%	1.8%	3.4%	3.0%
Gross Profit	3,467	3,069	3,070	3,206	NA
% Change	-18.3%	-11.5%	0%	4.4%	NA
EBITDA	2,059	1,787	1,880	1,986	2,090
% Change	-28.1%	-13.2%	5.2%	5.6%	5.3%
Net Interest & Other Income	(130)	(104)	(190)	(195)	(180)
<b>Net Income (Adjusted)</b>	<b>1,179</b>	<b>992</b>	<b>999</b>	<b>1,064</b>	<b>1,138</b>
<b>% Change</b>	<b>-35.4%</b>	<b>-15.8%</b>	<b>0.7%</b>	<b>6.4%</b>	<b>7.0%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	1,014	910	919	994	1,063
Depreciation & Amortization	437	438	446	454	468
Change in Working Capital	119	(146)	(571)	(92)	(26)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	147	70	533	545	561
Capital Expenditure	(404)	(408)	(414)	(419)	(421)
<b>Free Cash Flow</b>	<b>1,313</b>	<b>864</b>	<b>913</b>	<b>1,482</b>	<b>1,645</b>
<b>% Change</b>	<b>-28.3%</b>	<b>-34.2%</b>	<b>5.7%</b>	<b>62.4%</b>	<b>11.0%</b>
Share / Issue Repurchase	(1,285)	(203)	(508)	(80)	(88)
Cost of Dividends Paid	(305)	(314)	(336)	(358)	(383)
Change in Debt	(2)	748	(50)	(50)	(50)

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	315	685	626	872	1,271
Trade Receivables	1,195	1,210	1,552	1,605	1,652
Other Current Assets	388	476	506	522	536
Property, Plant & Equipment	1,766	1,816	1,894	1,972	2,042
Other Non-Current Assets	9,173	9,834	9,303	9,438	9,546
<b>Total Assets</b>	<b>12,837</b>	<b>14,021</b>	<b>13,881</b>	<b>14,408</b>	<b>15,048</b>
Short-Term Debt	155	456	456	456	456
Other Current Liabilities	1,396	1,359	1,155	1,126	1,158
Long-Term Debt	3,978	4,410	3,502	3,502	3,502
Other Non-Current Liabilities	1,341	1,419	1,419	1,419	1,419
<b>Total Liabilities</b>	<b>6,870</b>	<b>7,644</b>	<b>6,532</b>	<b>6,503</b>	<b>6,535</b>
<b>Total Equity</b>	<b>5,967</b>	<b>6,377</b>	<b>7,383</b>	<b>7,940</b>	<b>8,548</b>
<b>Total Equity &amp; Liabilities</b>	<b>12,837</b>	<b>14,021</b>	<b>13,916</b>	<b>14,443</b>	<b>15,083</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 4.

## Company Sector

Healthcare Technology & Distribution

## Company Description

DGX is the largest provider of clinical diagnostic testing and related services in the U.S., delivered through a national network of full-service clinical laboratories and over 2,200 patient service centers (PSCs).

## Investment Rationale

We are positive on DGX's positioning, improving visibility and opportunity to further consolidate the clinical lab market. It is insulated from the macro, Pharma, and international headwinds impacting our broader Life Sciences Tools and Biopharma Services coverage. Organic volume growth and pricing trends are steady. Expansion into genomics-based testing could further help accelerate sales, though these may take longer than expected to mature and put additional pressure on margins.

## Stock Data

Average Daily Volume 954,076

## Quarterly Earnings Estimates

	2023	2024
Q1	2.04A	1.88E
Q2	2.30A	2.39E
Q3	2.22A	2.33E
Q4	2.15A	2.21E

FDA: Food and Drug Administration

LDT: laboratory developed test

## Price objective basis & risk

### Quest Diagnostics (DGX)

Our \$150 price objective is based on an EV/EBITDA multiple of about 11x our 2024 estimate. Our multiple is in-line with DGX's historic range of 8-12x, which we view as appropriate as core growth has improved but near-term margin expansion is limited.

Upside risks to our PO are higher specialty mix, additional capital deployment, deeper cost cutting, more favorable regulatory developments, and better than expected deal performance.

Downside risks to our PO are greater-than-expected pricing headwinds, inflationary pressures, lower-than-expected test volume growth, higher US corporate tax rates, competition, execution risk, integration risk, data privacy risk, and regulatory risk.

## Analyst Certification

I, Derik de Bruin, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Life Science, Diagnostic Tools and Animal Health Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Avantor, Inc.	AVTR	AVTR US	Michael Ryskin
	Bruker Corporation	BRKR	BRKR US	Derik de Bruin
	Certara	CERT	CERT US	Michael Ryskin
	Charles River Laboratories	CRL	CRL US	Derik de Bruin
	Elanco Animal Health	ELAN	ELAN US	Michael Ryskin
	Exact Sciences	EXAS	EXAS US	Derik de Bruin
	Guardant Health	GH	GH US	Derik de Bruin
	ICON plc	ICLR	ICLR US	Derik de Bruin
	IQVIA Holdings Inc	IQV	IQV US	Derik de Bruin
	LabCorp	LH	LH US	Derik de Bruin
	Maravai	MRVI	MRVI US	Michael Ryskin
	Qiagen	QGEN	QGEN US	Derik de Bruin
	Qiagen N.V.	XQGNF	QIA GY	Derik de Bruin
	Quest Diagnostics	DGX	DGX US	Derik de Bruin
	Stevanato Group S.p.A.	STVN	STVN US	Derik de Bruin
	Thermo Fisher Scientific	TMO	TMO US	Derik de Bruin
	West Pharmaceutical Services	WST	WST US	Derik de Bruin
	Zoetis Inc.	ZTS	ZTS US	Michael Ryskin
<b>NEUTRAL</b>				
	10x Genomics, Inc.	TXG	TXG US	Michael Ryskin
	Agilent Technologies	A	A US	Derik de Bruin
	Danaher Corporation	DHR	DHR US	Michael Ryskin
	Evotec SE	EVO	EVO US	Michael Ryskin
	Hologic, Inc.	HOLX	HOLX US	Derik de Bruin
	IDEXX Laboratories	IDXX	IDXX US	Michael Ryskin
	Mettler-Toledo	MTD	MTD US	Derik de Bruin
	NeoGenomics Inc.	NEO	NEO US	Derik de Bruin
	Revvity Inc	RVTY	RVTY US	Derik de Bruin
	Schrodinger, Inc.	SDGR	SDGR US	Michael Ryskin
	Waters Corp.	WAT	WAT US	Derik de Bruin



## US - Life Science, Diagnostic Tools and Animal Health Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>UNDERPERFORM</b>	Align Technology	ALGN	ALGN US	Michael Ryskin
	Catalent, Inc.	CTLT	CTLT US	Derik de Bruin
	Fortrea	FTRE	FTRE US	Derik de Bruin
	Ginkgo Bioworks Holdings, Inc	DNA	DNA US	Derik de Bruin
	Illumina, Inc.	ILMN	ILMN US	Michael Ryskin
	Myriad Genetics	MYGN	MYGN US	Derik de Bruin
	Phibro Animal Health	PAHC	PAHC US	Michael Ryskin

**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity  
Operating Margin  
Earnings Growth  
Free Cash Flow

**Quality of Earnings**

Cash Realization Ratio  
Asset Replacement Ratio  
Tax Rate  
Net Debt-To-Equity Ratio  
Interest Cover

**Valuation Toolkit**

Price / Earnings Ratio  
Price / Book Value  
Dividend Yield  
Free Cash Flow Yield  
Enterprise Value / Sales

EV / EBITDA

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income  
Operating Profit  
Expected 5 Year CAGR From Latest Actual  
Cash Flow From Operations – Total Capex

**Numerator**

Cash Flow From Operations  
Capex  
Tax Charge  
Net Debt = Total Debt – Cash & Equivalents  
EBIT

**Numerator**

Current Share Price  
Current Share Price  
Annualised Declared Cash Dividend  
Cash Flow From Operations – Total Capex  
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities  
Enterprise Value

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill  
Amortization  
Shareholders' Equity  
Sales  
N/A  
N/A

**Denominator**

Net Income  
Depreciation  
Pre-Tax Income  
Total Equity  
Interest Expense

**Denominator**

Diluted Earnings Per Share (Basis As Specified)  
Shareholders' Equity / Current Basic Shares  
Current Share Price  
Market Cap = Current Share Price × Current Basic Shares  
Sales

Basic EBIT + Depreciation + Amortization

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Quest Diagnostics (DGX) Price Chart



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Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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