Quest Diagnostics Inc. (DGX)

Updated July 31st, 2022 by Felix Martinez

Key Metrics

Current Price:	$137	**5 Year CAGR Estimate:**	4.8%	**Market Cap:**	$15.92 B
Fair Value Price:	$135	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	10/04/22[1]
% Fair Value:	101%	**5 Year Valuation Multiple Estimate:**	-0.2%	**Dividend Payment Date:**	10/20/22
Dividend Yield:	1.9%	**5 Year Price Target**	$157	**Years Of Dividend Growth:**	11
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Rating:**	Hold

Overview & Current Events

Quest Diagnostics Inc. is the world's leading provider of diagnostic information services. The company offers diagnostic testing services for cancer, cardiovascular disease, infectious disease, neurological disorders, COVID-19, and employment and court-ordered drug testing. Quest operates in the United States, Puerto Rico, Mexico, and Brazil. The company was initially founded as Metropolitan Pathology Laboratory, Inc., in 1967 by Paul A. Brown, MD. Through acquisitions and spinoffs, Quest Diagnostics Inc. was formed on December 31, 1996. Quest annually serves one in three adult Americans, half the physicians and hospitals in the United States, and nearly 50,000 employees. The company trades under the ticker DGX on the New York Stock Exchange. The company has a market cap of $15.92 billion and has eleven consecutive years of dividend growth. The most recent dividend increase was on February 3, 2022, when the company increased its dividend by 6.5%, from $0.62 per share per quarter to $0.66 per share per quarter.

On July 21st, 2022, Quest Diagnostics reported second-quarter and first six months of financial results for Fiscal Year (FY)2022. Total revenue for the second quarter was $2.45 billion, which is (3.8)% lower than what the company made in 2Q2021. The decrease in revenue was due to a reduction in COVID-19 testing revenues. The base business revenue was an increase of 2.9% year-over-year. Operating income is down (27.2)% for the quarter compared to the second quarter of 2021. Earnings per share were down (25.8)% for the quarter from $3.18 per share in 2Q2021 to $2.36 per share in the quarter. For the year's first half, total revenue is down slightly by (3.9)%. This decrease is also due to the reduction in COVID-19 testing revenues. Operating income and net income are done (24.5)% and (46.4)% year-over-year, respectively. Overall, earnings for the first six months of the fiscal year are down (19.8)% from $6.96 per share for the first half of 2021. To earnings now at $5.58 per share.

The management team provided the full-year 2022 outlook. They expect the company to make $9.5 billion to $9.75 billion in net revenues for the year, an (11.9)% to (9.6)% decrease compared to 2021. As for adjusted diluted EPS, management expects the company to make between $9.55 per share and $9.95 per share for the year. Thus, we will use $9.65 per share as our fair value calculation.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$4.36	$4.00	$4.50	$4.77	$5.15	$5.67	$6.31	$6.56	$11.18	$14.24	***$9.65***	***$11.19***
DPS	$0.81	$1.20	$1.32	$1.52	$1.65	$1.80	$2.03	$2.12	$2.24	$2.48	***$2.60***	***$3.65***
Shares[2]	160.0	153.0	145.0	145.0	142.0	140.0	139.0	136.0	136.0	128.0	***128.0***	***128.0***

Quest Diagnostics has a market-leading position in several testing fields, and the company targets continued growth through Health Plan expansion, increased Hospital Health market share, advanced diagnostics, and increased shares of Direct-to-Consumer testing methods. COVID-19 testing will continue to help drive the company's growth and has made COVID-19 tests a permanent part of its services. However, we estimate that earnings will grow at 3% for the next five years, giving an EPS of $11.19 per share for 2027.

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[1] Ex-Dividend and Dividend Date are estimates.

[2] Share count is in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	13.4	13.4	14.9	14.9	17.9	17.4	13.2	16.3	10.7	12.2	***14.2***	***14.0***
Avg. Yld.	1.4%	2.2%	2.0%	2.1%	1.8%	1.8%	2.4%	2.0%	1.9%	1.4%	***1.9%***	***2.3%***

The company has a PE of 14.2 as of this report, which is slightly lower than its ten-year average of 14.5 and lower than its five-year average of 15.1. However, we think that a fair PE multiple of 14 is reasonable. This provides a multiple headwind compression of 0.2%. The current dividend yield is in line with its ten-year average and the five-year average, 1.9% and 2.0%, respectively.

Safety, Quality, Competitive Advantage, & Recession Resiliency

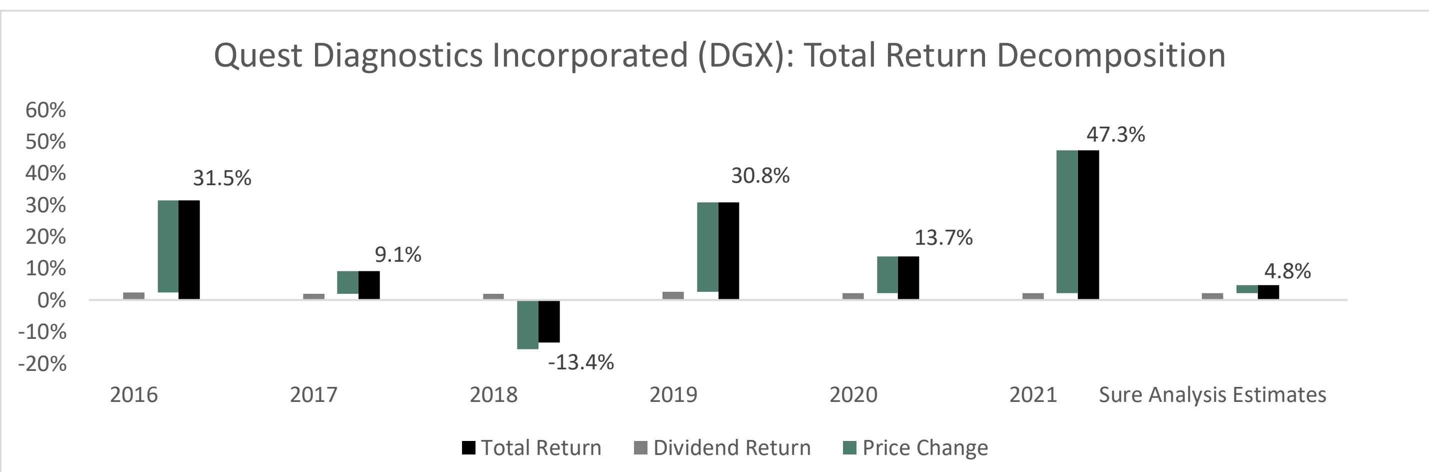
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	18.6%	30.0%	29.3%	31.9%	32.0%	31.7%	32.2%	32.3%	20.0%	17.4%	***27%***	***33%***

Quest's competitive advantage is that it is a mature and market leader Company in the diagnostic information services industry. While this field is technically more susceptible to competition, it will require a lot of capital to build lab capacities. During the Great Recession, Quest grew earnings during that period. In 2008 EPS was $3.23 per share, and in 2009 it rose 20% to $3.88 per share. During the COVID-19 pandemic, earnings saw a tremendous growth of 70% as the company provided most of the COVID-19 tests. Quest has a BBB+ credit rating, which is an investment grade. The debt/equity ratio is 0.7, which is excellent, and the company has interest coverage of 17.1. Overall, the balance sheet is very healthy. The dividend payout ratio is low, and the company has had a dividend growth rate of 7.6% over the past five years. So, the dividend will continue to grow at a high rate.

Final Thoughts & Recommendation

Overall, Quest Diagnostic Inc. is a well-run company with a history of steady growth in earnings. The risk with purchasing shares of this company would be the post-pandemic normalization. As COVID-19 testing decreases, it will also decrease the company earnings to the 2018-2019 level. We estimate an 4.8% total annualized rate of return for the next five years. Most of it comes from earnings growth and dividend. Thus, we rate the stock a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	7,383	7,146	7,435	7,493	7,214	7,402	7,531	7,726	9,437	10,788
Gross Profit	3,018	2,820	2,798	2,836	2,598	2,683	2,605	2,689	3,633	4,209
Gross Margin	40.9%	39.5%	37.6%	37.8%	36.0%	36.2%	34.6%	34.8%	38.5%	39.0%
SG&A Exp.	1,745	1,704	1,728	1,679	1,380	1,443	1,424	1,457	1,550	1,727
D&A Exp.	287	283	314	304	249	270	309	329	361	408
Operating Profit	1,201	1,001	983	1,065	1,159	1,165	1,101	1,231	1,971	2,381
Operating Margin	16.3%	14.0%	13.2%	14.2%	16.1%	15.7%	14.6%	15.9%	20.9%	22.1%
Net Profit	556	849	556	709	645	772	736	858	1,431	1,995
Net Margin	7.5%	11.9%	7.5%	9.5%	8.9%	10.4%	9.8%	11.1%	15.2%	18.5%
Free Cash Flow	1,005	421	636	558	823	923	817	843	1,587	1,830
Income Tax	402	500	262	373	429	241	182	247	460	597

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	9,284	8,948	9,857	9,962	10,100	10,503	11,003	12,843	14,026	13,611
Cash & Equivalents	296	187	192	133	359	137	135	1,192	1,158	872
Accounts Receivable	867	852	932	901	926	924	1,012	1,063	1,520	1,438
Inventories	93	91	110	84	82	95	99	123	223	208
Goodwill & Int. Ass.	6,408	6,545	7,103	6,889	6,949	7,454	7,770	7,740	8,040	8,262
Total Liabilities	5,098	4,975	5,527	5,249	5,440	5,548	5,736	7,156	7,217	7,128
Accounts Payable	204	258	257	279	231	224	222	263	446	
Long-Term Debt	3,364	3,332	3,742	3,651	3,764	3,855	3,991	4,858	4,168	4,012
Shareholder's Equity	4,163	3,948	4,301	4,684	4,628	4,921	5,216	5,641	6,759	6,444
LTD/E Ratio	0.81	0.84	0.87	0.78	0.81	0.78	0.77	0.86	0.62	0.62

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	6.0%	9.3%	5.9%	7.2%	6.4%	7.5%	6.8%	7.2%	10.7%	14.4%
Return on Equity	14.2%	20.9%	13.5%	15.8%	13.9%	16.2%	14.5%	15.8%	23.1%	30.2%
ROIC	7.3%	11.4%	7.2%	8.6%	7.7%	9.0%	8.1%	8.7%	13.3%	18.6%
Shares Out.	160.0	153.0	145.0	145.0	142.0	140.0	139.0	136.0	136.0	128.0
Revenue/Share	46.14	46.71	51.28	51.68	50.80	52.87	54.18	56.81	69.39	84.28
FCF/Share	6.28	2.75	4.39	3.85	5.80	6.59	5.88	6.20	11.67	14.30

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.