Quest Diagnostics Inc. (DGX)

Updated November 7th, 2023 by Felix Martinez

Key Metrics

Current Price:	$133	**5 Year CAGR Estimate:**	3.6%	**Market Cap:**	$15.1 B
Fair Value Price:	$122	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	01/17/24[1]
% Fair Value:	109%	**5 Year Valuation Multiple Estimate:**	-1.7%	**Dividend Payment Date:**	02/02/24
Dividend Yield:	2.1%	**5 Year Price Target**	$141	**Years Of Dividend Growth:**	12
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Rating:**	Sell

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 $15.1 billion and has twelve consecutive years of dividend growth. The most recent dividend increase was on February 2, 2023, when the company increased its dividend by 7.6%, from $0.66 per share per quarter to $0.71 per share per quarter.

On October 24th, 2023, Quest Diagnostics reported third quarter results for Fiscal Year (FY)2023. The company reported total revenues of $2.30 billion, reflecting a 7.7% decrease compared to 2022. The reported diluted earnings per share (EPS) for the same period were $1.96, marking a 9.7% decline from 2022. Adjusted diluted EPS, which excludes certain factors, stood at $2.22, down 5.9% from the previous year. Despite the overall decrease in revenues, the company experienced a 4.6% increase in base business revenues, amounting to $2.27 billion for the third quarter. Quest Diagnostics also highlighted a positive trend in its physician and hospital channels, contributing to the growth of its base business revenues. Additionally, the company successfully renewed all its strategic health plan contracts for the year, indicating a stable and strengthened position in the market.

Looking ahead, Quest Diagnostics revised its full-year 2023 revenue expectations to be between $9.19 billion and $9.24 billion. The reported diluted EPS for the entire year is now projected to range from $7.61 to $7.71, with adjusted diluted EPS anticipated to fall between $8.65 and $8.75. These revisions reflect the company's adjusted forecasts based on its performance in the third quarter and its strategic initiatives for the remainder of the year.

Quest Diagnostics' CEO and President, Jim Davis, expressed confidence in the company's future growth prospects. He emphasized the organization's robust pipeline of professional lab services and merger and acquisition opportunities, indicating a positive trajectory for Quest Diagnostics in the coming quarters.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$4.00	$4.50	$4.77	$5.15	$5.67	$6.31	$6.56	$11.18	$14.24	$9.95	***$8.71***	***$10.10***
DPS	$1.20	$1.32	$1.52	$1.65	$1.80	$2.03	$2.12	$2.24	$2.48	$2.60	***$2.79***	***$3.91***
Shares[2]	153.0	145.0	145.0	142.0	140.0	139.0	136.0	136.0	128.0	118.0	***115.0***	***110.0***

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

[1] Ex-Dividend and Dividend Payment dates are estimates.
[2] Share count is in millions.
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Direct-to-Consumer testing methods. However, we estimate that earnings will grow at 3% for the next five years, giving an EPS of $10.10 per share for 2028.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	13.4	14.9	14.9	17.9	17.4	13.2	16.3	10.7	12.2	15.7	***15.3***	***14.0***
Avg. Yld.	2.2%	2.0%	2.1%	1.8%	1.8%	2.4%	2.0%	1.9%	1.4%	1.7%	***2.1%***	***2.8%***

The company has a PE of 15.3x as of this report, which is higher with its ten-year average of 14.7, and higher than its five-year average of 13.6. However, we think that a fair PE multiple of 14x is reasonable. This provides a multiple headwind compression of (1.7)%. 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

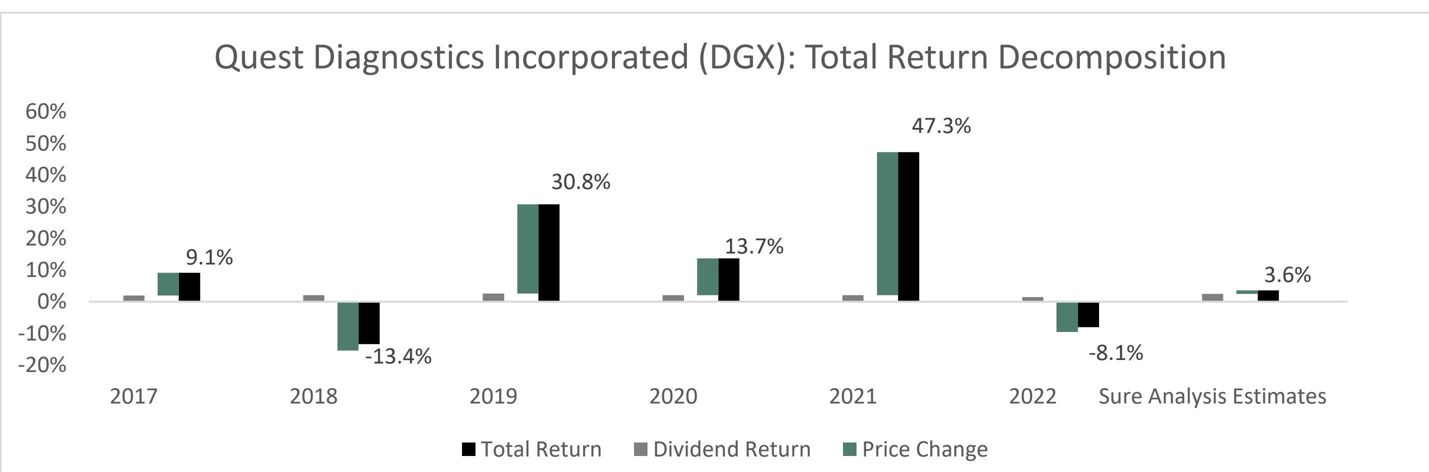
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	30.0%	29.3%	31.9%	32.0%	31.7%	32.2%	32.3%	20.0%	17.4%	26.1%	***32%***	***39%***

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 0.8, which is excellent, and the company has interest coverage of 7.6. Overall, the balance sheet is very healthy. The dividend payout ratio is low, and the company has had a dividend growth rate of 6.7% 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 a 3.6% total annualized rate of return for the next five years. Most of it comes from earnings growth and the dividend. Thus, we rate the stock a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	7,146	7,435	7,493	7,214	7,402	7,531	7,726	9,437	10,788	9,883
Gross Profit	2,820	2,798	2,836	2,598	2,683	2,605	2,689	3,633	4,209	3,433
Gross Margin	39.5%	37.6%	37.8%	36.0%	36.2%	34.6%	34.8%	38.5%	39.0%	34.7%
SG&A Exp.	1,704	1,728	1,679	1,380	1,443	1,424	1,457	1,550	1,727	1,874
D&A Exp.	283	314	304	249	270	309	329	361	408	437
Operating Profit	1,001	983	1,065	1,159	1,165	1,101	1,231	1,971	2,381	1,428
Operating Margin	14.0%	13.2%	14.2%	16.1%	15.7%	14.6%	15.9%	20.9%	22.1%	14.4%
Net Profit	849	556	709	645	772	736	858	1,431	1,995	946
Net Margin	11.9%	7.5%	9.5%	8.9%	10.4%	9.8%	11.1%	15.2%	18.5%	9.6%
Free Cash Flow	421	636	558	823	923	817	843	1,587	1,830	1,314
Income Tax	500	262	373	429	241	182	247	460	597	264

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	8,948	9,857	9,962	10,100	10,503	11,003	12,843	14,026	13,611	12,837
Cash & Equivalents	187	192	133	359	137	135	1,192	1,158	872	315
Accounts Receivable	852	932	901	926	924	1,012	1,063	1,520	1,438	1,195
Inventories	91	110	84	82	95	99	123	223	208	192
Goodwill & Int. Ass.	6,545	7,103	6,889	6,949	7,454	7,770	7,740	8,040	8,262	8,312
Total Liabilities	4,975	5,527	5,249	5,440	5,548	5,736	7,156	7,217	7,128	6,830
Accounts Payable	258	257	279	231	224	222	263	446		
Long-Term Debt	3,332	3,742	3,651	3,764	3,855	3,991	4,858	4,168	4,012	3,980
Shareholder's Equity	3,948	4,301	4,684	4,628	4,921	5,216	5,641	6,759	6,444	5,893
LTD/E Ratio	0.84	0.87	0.78	0.81	0.78	0.77	0.86	0.62	0.62	0.68

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	9.3%	5.9%	7.2%	6.4%	7.5%	6.8%	7.2%	10.7%	14.4%	7.2%
Return on Equity	20.9%	13.5%	15.8%	13.9%	16.2%	14.5%	15.8%	23.1%	30.2%	15.3%
ROIC	11.4%	7.2%	8.6%	7.7%	9.0%	8.1%	8.7%	13.3%	18.6%	9.2%
Shares Out.	153.0	145.0	145.0	142.0	140.0	139.0	136.0	136.0	128.0	118.0
Revenue/Share	46.71	51.28	51.68	50.80	52.87	54.18	56.81	69.39	84.28	83.75
FCF/Share	2.75	4.39	3.85	5.80	6.59	5.88	6.20	11.67	14.30	11.14

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