Quest Diagnostics Inc. (DGX)

Updated February 17th, 2024 by Felix Martinez

Key Metrics

Current Price:	$124	**5 Year CAGR Estimate:**	5.3%	**Market Cap:**	$13.9 B
Fair Value Price:	$123	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	04/05/24
% Fair Value:	101%	**5 Year Valuation Multiple Estimate:**	-0.2%	**Dividend Payment Date:**	04/22/24
Dividend Yield:	2.4%	**5 Year Price Target**	$142	**Years Of Dividend Growth:**	12
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 $15.1 billion and has twelve consecutive years of dividend growth. The most recent dividend increase was on February 1, 2024, when the company increased its dividend by 5.6%, from $0.71 per share per quarter to $0.75 per share per quarter.

On February 1st, 2024, Quest Diagnostics reported fourth quarter results for Fiscal Year (FY)2023. The company reported a notable shift in its financial performance. While net revenues for the quarter amounted to $2.29 billion, marking a 1.9% dip from the comparable period in 2022, the reported diluted earnings per share (EPS) surged impressively by 95.4% to $1.70. Furthermore, the adjusted diluted EPS stood at $2.15, showcasing an 8.6% increase from the prior year.

A key highlight for the fourth quarter was the robust growth in base business revenues, which reached $2.25 billion, reflecting a 4.7% uptick compared to 2022. In contrast, COVID-19 testing revenues experienced a significant downturn of 79.8%, amounting to $37 million for the quarter.

For the entire fiscal year 2023, Quest Diagnostics reported total revenues of $9.25 billion, indicating a 6.4% decrease from the previous year. The reported diluted EPS for the full year was $7.49, reflecting a 6.0% decrease, while the adjusted diluted EPS was $8.71, down by 12.5% from 2022. Despite the overall decline, the base business revenues for the full year showcased resilience, increasing by 7.1% to reach $9.03 billion. However, COVID-19 testing revenues for the same period experienced a substantial drop of 84.7%, totaling $223 million.

Looking ahead to 2024, Quest Diagnostics is optimistic about a return to overall revenue growth. The reported diluted EPS for the full year 2024 is projected to be between $7.69 and $7.99, with adjusted diluted EPS expected to fall between $8.60 and $8.90. The company remains committed to its long-term financial outlook, aspiring for mid-single-digit revenue growth and high-single-digit earnings growth beyond 2024. Quest Diagnostics' leadership, including Chairman, CEO, and President Jim Davis, expressed gratitude to their dedicated colleagues for contributing to the company's purpose of creating a healthier world.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$4.50	$4.77	$5.15	$5.67	$6.31	$6.56	$11.18	$14.24	$9.95	$8.71	***$8.75***	***$10.14***
DPS	$1.32	$1.52	$1.65	$1.80	$2.03	$2.12	$2.24	$2.48	$2.60	$2.79	***$2.96***	***$4.15***
Shares[1]	145.0	145.0	142.0	140.0	139.0	136.0	136.0	128.0	118.0	113.0	***113.0***	***113.0***

[1] Share count is in millions.

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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. However, we estimate that earnings will grow at 3% for the next five years, giving an EPS of $10.14 per share for 2029.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	14.9	14.9	17.9	17.4	13.2	16.3	10.7	12.2	15.7	15.8	***14.2***	***14.0***
Avg. Yld.	2.0%	2.1%	1.8%	1.8%	2.4%	2.0%	1.9%	1.4%	1.7%	2.0%	***2.4%***	***2.9%***

The company has a PE of 14.2x as of this report, which is lower with its ten-year average of 14.9, but higher than its five-year average of 14.1. However, we think that a fair PE multiple of 14x is reasonable. This provides a multiple headwind compression of (0.2)%. The current dividend yield is higher then its ten-year average and the five-year average, 1.9% and 1.8%, respectively.

Safety, Quality, Competitive Advantage, & Recession Resiliency

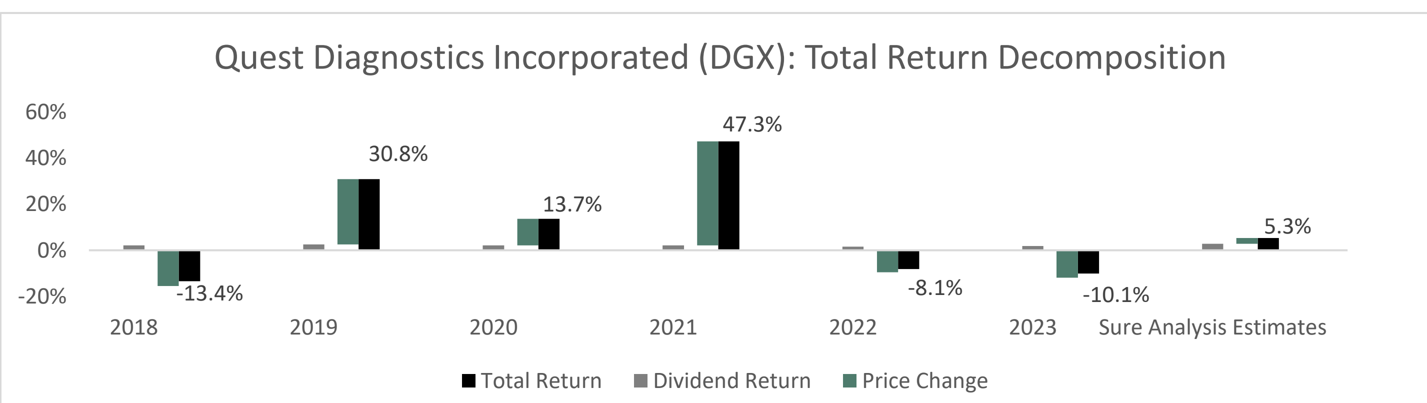
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	29.3%	31.9%	32.0%	31.7%	32.2%	32.3%	20.0%	17.4%	26.1%	32.0%	***34%***	***41%***

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 6.9% 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 5.3% 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 hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	7,435	7,493	7,214	7,402	7,531	7,726	9,437	10,788	9,883	9,252
Gross Profit	2,798	2,836	2,598	2,683	2,605	2,689	3,633	4,209	3,433	3,053
Gross Margin	37.6%	37.8%	36.0%	36.2%	34.6%	34.8%	38.5%	39.0%	34.7%	
SG&A Exp.	1,728	1,679	1,380	1,443	1,424	1,457	1,550	1,727	1,874	1,642
D&A Exp.	314	304	249	270	309	329	361	408	437	439
Operating Profit	983	1,065	1,159	1,165	1,101	1,231	1,971	2,381	1,428	1,262
Operating Margin	13.2%	14.2%	16.1%	15.7%	14.6%	15.9%	20.9%	22.1%	14.4%	
Net Profit	556	709	645	772	736	858	1,431	1,995	946	854
Net Margin	7.5%	9.5%	8.9%	10.4%	9.8%	11.1%	15.2%	18.5%	9.6%	
Free Cash Flow	636	558	823	923	817	843	1,587	1,830	1,314	864
Income Tax	262	373	429	241	182	247	460	597	264	248

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	9,857	9,962	10,100	10,503	11,003	12,843	14,026	13,611	12,837	14,020
Cash & Equivalents	192	133	359	137	135	1,192	1,158	872	315	686
Accounts Receivable	932	901	926	924	1,012	1,063	1,520	1,438	1,195	1,210
Inventories	110	84	82	95	99	123	223	208	192	190
Goodwill & Int. Ass.	7,103	6,889	6,949	7,454	7,770	7,740	8,040	8,262	8,312	8,899
Total Liabilities	5,527	5,249	5,440	5,548	5,736	7,156	7,217	7,128	6,830	7,604
Accounts Payable	257	279	231	224	222	263	446			378
Long-Term Debt	3,742	3,651	3,764	3,855	3,991	4,858	4,168	4,012	3,980	4,842
Shareholder's Equity	4,301	4,684	4,628	4,921	5,216	5,641	6,759	6,444	5,893	6,307
LTD/E Ratio	0.87	0.78	0.81	0.78	0.77	0.86	0.62	0.62	0.68	0.77

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	5.9%	7.2%	6.4%	7.5%	6.8%	7.2%	10.7%	14.4%	7.2%	6.4%
Return on Equity	13.5%	15.8%	13.9%	16.2%	14.5%	15.8%	23.1%	30.2%	15.3%	13.8%
ROIC	7.2%	8.6%	7.7%	9.0%	8.1%	8.7%	13.3%	18.6%	9.2%	8.0%
Shares Out.	145.0	145.0	142.0	140.0	139.0	136.0	136.0	128.0	118.0	113.0
Revenue/Share	51.28	51.68	50.80	52.87	54.18	56.81	69.39	84.28	83.75	81.88
FCF/Share	4.39	3.85	5.80	6.59	5.88	6.20	11.67	14.30	11.14	7.65

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