QUEST DIAGNOSTICS INC
Form 10-Q
October 24, 2013
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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 September 30, 2013
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, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting 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

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 October 18, 2013, there were outstanding 145,426,953 shares of the registrant's common stock, $.01 par value.

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PART I - FINANCIAL INFORMATION

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012
(unaudited)
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net revenues	$1,787,140	$1,821,748	$5,389,527	$5,608,797
Operating costs and expenses:				
Cost of services	1,088,503	1,081,017	3,274,013	3,292,105
Selling, general and administrative	422,963	416,854	1,289,370	1,324,191
Amortization of intangible assets	20,158	18,577	59,198	56,210
Gain on sale of royalty rights	(474,138)	—	(474,138)	—
Other operating expense, net	40,177	680	35,892	500
Total operating costs and expenses	1,097,663	1,517,128	4,184,335	4,673,006
Operating income	689,477	304,620	1,205,192	935,791
Other income (expense):				
Interest expense, net	(39,968)	(40,809)	(119,754)	(124,661)
Equity earnings in unconsolidated joint ventures	4,904	4,662	18,303	19,643
Other income, net	2,922	2,502	6,571	6,003
Total non-operating expenses, net	(32,142)	(33,645)	(94,880)	(99,015)
Income from continuing operations before taxes	657,335	270,975	1,110,312	836,776
Income tax expense	245,874	103,978	413,702	320,266
Income from continuing operations	411,461	166,997	696,610	516,510
Income from discontinued operations, net of taxes	2,406	4,541	35,497	10,016
Net income	413,867	171,538	732,107	526,526
Less: Net income attributable to noncontrolling interests	8,724	8,456	25,717	26,621
Net income attributable to Quest Diagnostics	$405,143	$163,082	$706,390	$499,905
Amounts attributable to Quest Diagnostics' stockholders:				
Income from continuing operations	$402,737	$158,541	$670,893	$489,889
Income from discontinued operations, net of taxes	2,406	4,541	35,497	10,016
Net income	$405,143	$163,082	$706,390	$499,905
Earnings per share attributable to Quest Diagnostics' common stockholders - basic:				
Income from continuing operations	$2.68	$0.99	$4.36	$3.07
Income from discontinued operations	0.02	0.03	0.23	0.07
Net income	$2.70	$1.02	$4.59	$3.14

Earnings per share attributable to Quest Diagnostics' common stockholders - diluted:				
Income from continuing operations	$2.66	$0.98	$4.32	$3.04
Income from discontinued operations	0.02	0.03	0.23	0.07
Net income	$2.68	$1.01	$4.55	$3.11
Weighted average common shares outstanding:				
Basic	149,625	158,783	153,477	158,518
Diluted	150,920	160,702	154,795	160,064
Dividends per common share	$0.30	$0.17	$0.90	$0.51

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 NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012
(unaudited)
(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	$413,867	$171,538	$732,107	$526,526
Other comprehensive income (loss):				
Currency translation	4,592	22,288	(26,059)	21,321
Market valuation, net of tax	(31)	(161)	274	84
Net deferred loss on cash flow hedges, net of tax	210	210	630	630
Other, net of tax	10	—	2,847	—
Other comprehensive income (loss)	4,781	22,337	(22,308)	22,035
Comprehensive income	418,648	193,875	709,799	548,561
Less: Comprehensive income attributable to noncontrolling interests	8,724	8,456	25,717	26,621
Comprehensive income attributable to Quest Diagnostics	$409,924	$185,419	$684,082	$521,940

The accompanying notes are an integral part of these statements.

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(in thousands, except per share data)

	September 30, 2013 (unaudited)	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$158,280	$295,586
Accounts receivable, net of allowance for doubtful accounts of $238,865 and $235,747 at September 30, 2013 and December 31, 2012, respectively	920,833	867,010
Inventories	85,187	93,050
Deferred income taxes	152,831	174,209
Prepaid expenses and other current assets	108,517	90,950
Current assets held for sale	—	40,192
Total current assets	1,425,648	1,560,997
Property, plant and equipment, net	749,355	755,831
Goodwill	5,628,808	5,535,848
Intangible assets, net	903,899	872,172
Other assets	219,829	204,631
Non-current assets held for sale	—	354,384
Total assets	$8,927,539	$9,283,863
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$994,292	$1,016,191
Short-term borrowings and current portion of long-term debt	244,703	9,404
Current liabilities held for sale	—	22,008
Total current liabilities	1,238,995	1,047,603
Long-term debt	3,122,208	3,354,173
Other liabilities	694,741	635,558
Non-current liabilities held for sale	—	60,800
Stockholders' equity:		
Quest Diagnostics stockholders' equity:		
Common stock, par value $0.01 per share; 600,000 shares authorized at both September 30, 2013 and December 31, 2012; 215,364 shares and 215,075 shares issued at September 30, 2013 and December 31, 2012, respectively	2,154	2,151
Additional paid-in capital	2,306,433	2,370,677
Retained earnings	5,259,665	4,690,378
Accumulated other comprehensive (loss) income	(7,988)	14,320
Treasury stock, at cost; 69,972 shares and 56,744 shares at September 30, 2013 and December 31, 2012, respectively	(3,717,583)	(2,914,479)
Total Quest Diagnostics stockholders' equity	3,842,681	4,163,047
Noncontrolling interests	28,914	22,682
Total stockholders' equity	3,871,595	4,185,729
Total liabilities and stockholders' equity	$8,927,539	$9,283,863

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 NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012
(unaudited)
(in thousands)

	Nine Months Ended September 30, 2013	2012
Cash flows from operating activities:		
Net income	$732,107	$526,526
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	210,983	215,300
Provision for doubtful accounts	204,101	208,360
Deferred income tax (benefit) provision	(3,098)	139
Stock-based compensation expense	24,107	43,087
Excess tax benefits from stock-based compensation arrangements	(3,566)	(3,810)
Gain on sale of royalty rights	(474,138)	—
Loss on sale of businesses, net	17,400	—
Other, net	(668)	(5,350)
Changes in operating assets and liabilities:		
Accounts receivable	(252,441)	(231,375)
Accounts payable and accrued expenses	(76,798)	(56,134)
Income taxes payable	76,967	32,311
Termination of interest rate swap agreements	—	71,820
Other assets and liabilities, net	(13,308)	5,881
Net cash provided by operating activities	441,648	806,755
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(179,895)	(50,574)
Proceeds from sale of businesses	296,333	—
Proceeds from sale of royalty rights	474,279	—
Capital expenditures	(155,467)	(122,318)
Increase in investments and other assets	(1,610)	(2,098)
Net cash provided by (used in) investing activities	433,640	(174,990)
Cash flows from financing activities:		
Proceeds from borrowings	789,623	715,000
Repayments of debt	(757,234)	(1,222,036)
Purchases of treasury stock	(994,102)	(149,996)
Exercise of stock options	98,057	143,945
Excess tax benefits from stock-based compensation arrangements	3,566	3,810
Dividends paid	(141,001)	(81,034)
Distributions to noncontrolling interests	(21,381)	(24,112)
Other financing activities, net	(7,356)	9,542
Net cash used in financing activities	(1,029,828)	(604,881)
Net change in cash and cash equivalents	(154,540)	26,884
Add: Decrease in cash and cash equivalents included in assets held for sale	17,234	—
Cash and cash equivalents, beginning of period	295,586	164,886
Cash and cash equivalents, end of period	$158,280	$191,770

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 NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012
(unaudited)
(in thousands)

	Quest Diagnostics Stockholders' Equity							
	Shares of Common Stock Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Compre-hensive (Loss) Income	Treasury Stock, at Cost	Non-controlling Interests	Total Stock-holders' Equity
Balance, December 31, 2012	158,331	$2,151	$2,370,677	$4,690,378	$14,320	$(2,914,479)	$22,682	$4,185,729
Net income				706,390			25,717	732,107
Other comprehensive loss, net of tax					(22,308)			(22,308)
Dividends declared				(137,103)				(137,103)
Distributions to noncontrolling interests							(21,381)	(21,381)
Issuance of common stock under benefit plans	781	5	1,992			13,594		15,591
Stock-based compensation expense			21,355			2,752		24,107
Exercise of stock options	2,006		(6,602)			104,652	7	98,057
Shares to cover employee payroll tax withholdings on stock issued under benefit plans	(176)	(2)	(10,083)					(10,085)
Tax benefits associated with stock-based compensation plans			(906)					(906)
Purchases of treasury stock	(15,550)		(70,000)			(924,102)		(994,102)
Other							1,889	1,889
Balance, September 30, 2013	145,392	$2,154	$2,306,433	$5,259,665	$(7,988)	$(3,717,583)	$28,914	$3,871,595

	Quest Diagnostics Stockholders' Equity							
	Shares of Common Stock Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Compre-hensive (Loss) Income	Treasury Stock, at Cost	Non-controlling Interests	Total Stock-holders' Equity
Balance, December 31, 2011	157,420	$2,146	$2,347,518	$4,263,599	$(8,067)	$(2,912,324)	$22,127	$3,714,999
Net income				499,905			26,621	526,526
Other comprehensive income, net of tax					22,035			22,035
Dividends declared				(81,239)				(81,239)
Distributions to noncontrolling interests							(24,112)	(24,112)
Issuance of common stock under benefit plans	1,112	8	2,457			13,198		15,663
Stock-based compensation expense			40,322			2,765		43,087
Exercise of stock options	3,090		(13,809)			157,754		143,945
Shares to cover employee payroll tax withholdings on stock issued under benefit plans	(344)	(3)	(19,856)					(19,859)
Tax benefits associated with stock-based compensation plans			4,845					4,845
Purchases of treasury stock	(2,561)					(149,996)		(149,996)
Other							1,687	1,687
Balance, September 30, 2012	158,717	$2,151	$2,361,477	$4,682,265	$13,968	$(2,888,603)	$26,323	$4,197,581

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)
(dollars in thousands unless otherwise indicated)

1. DESCRIPTION OF BUSINESS

Background

Quest Diagnostics Incorporated and its subsidiaries ("Quest Diagnostics" or the "Company") is the world's leading provider of diagnostic information services ("DIS") providing insights that empower and enable patients, physicians, hospitals, integrated delivery networks, health plans, employers and others to make better healthcare decisions. The Company offers the broadest access in the United States to DIS through its nationwide network of laboratories and Company-owned patient service centers and the Company is the leading provider of DIS, including routine testing, esoteric or gene-based testing and anatomic pathology testing. The Company provides interpretive consultation through the largest medical and scientific staff in the industry, with hundreds of M.D.s and Ph.D.s, primarily located in the United States, many of whom are recognized leaders in their fields. The Company's Diagnostic Solutions ("DS") businesses offers 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 is a leading provider of testing for clinical trials. The Company's diagnostics products business manufactures and markets diagnostic products. In addition, the Company offers healthcare organizations and clinicians robust information technology solutions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The interim 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. The interim consolidated financial statements have been compiled without audit. Operating results for the interim periods are not necessarily indicative of the results that may be expected for the full year. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company’s 2012 Annual Report on Form 10-K.

The year-end balance sheet data was derived from the audited financial statements as of December 31, 2012, but does not include all the disclosures required by accounting principles generally accepted in the United States (“GAAP”).

The Company completed the sale of its OralDNA salivary-diagnostics business ("OralDNA") during the fourth quarter of 2012. In April 2013, the Company completed the sale of its HemoCue diagnostics products business ("HemoCue"). During the third quarter of 2006, the Company completed its wind-down of NID, a test kit manufacturing subsidiary, and classified the operations of NID as discontinued operations. The accompanying consolidated statements of operations and related disclosures have been recast to report the results of OralDNA and HemoCue as discontinued operations for the three and nine months ended September 30, 2013 and 2012. See Note 14 for a further discussion of discontinued operations.

The Company completed the sale of its Enterix colorectal cancer screening test business (“Enterix”) in September 2013. The Enterix business has not been reclassified to discontinued operations due to the level of continuing involvement in the Enterix business subsequent to its sale.

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 common stock and 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.

Adoption of New Accounting Standards

On January 1, 2013, the Company adopted a new accounting standard issued by the Financial Accounting Standards Board ("FASB") related to the testing of indefinite-lived intangible assets, other than goodwill, for impairment. Similar to the guidance related to the testing of goodwill for impairment, an entity testing an indefinite-lived intangible asset for impairment has the option to perform a qualitative assessment before calculating the fair value of the asset. If, after assessing the totality of events and circumstances an entity determines that it is not more-likely-than-not that the indefinite-lived intangible asset is impaired, the entity would not be required to perform the quantitative impairment test. However, if the qualitative assessment indicates that it is more-likely-than-not that the fair value of the asset is less than its carrying amount, then the quantitative assessment must be performed. An entity is permitted to perform the qualitative assessment on none, some or all of its indefinite-lived intangible assets and may also bypass the qualitative assessment and begin with the quantitative assessment of indefinite-lived intangible assets for impairment. The adoption of this new standard did not have a material impact on the Company’s consolidated financial statements.

On January 1, 2013, the Company adopted a new accounting standard issued by the FASB that adds new disclosure requirements for amounts reclassified out of accumulated other comprehensive income ("AOCI"). The total changes in AOCI must be disaggregated between reclassification adjustments and current period other comprehensive income. This new standard also requires an entity to present reclassification adjustments out of AOCI either on the face of the income statement or in the notes to the financial statements based on their source and the income statement line items affected by the reclassification. This standard is effective prospectively for the Company for interim and annual periods beginning on January 1, 2013. The adoption of this new standard did not have a material impact on the Company’s consolidated financial statements.

New Accounting Pronouncements

In March 2013, the FASB issued a new accounting standard on foreign currency matters that clarifies the guidance of a parent company's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. Under this new standard, a parent company that ceases to have a controlling financial interest in a foreign subsidiary or group of assets within a foreign entity shall release any related cumulative translation adjustment into net income only if a sale or transfer results in complete or substantially complete liquidation of the foreign entity. This standard shall be applied prospectively and will become effective for the Company on January 1, 2014. The Company expects that the adoption of this standard will not have a material effect on its consolidated financial statements.

In July 2013, the FASB issued a new accounting standard to permit the use of the Fed Funds Effective Swap Rate to be used as an alternative benchmark interest rate for hedge accounting purposes in interest rate derivatives. The new standard is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The new standard is not expected to have a material effect on the Company's consolidated financial statements.

In July 2013, the FASB issued a new accounting standard on the financial statement presentation of unrecognized tax benefits. The new standard provides that a liability related to an unrecognized tax benefit would be presented as a reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. The new standard becomes effective for the Company on January 1, 2014 and it should be applied prospectively to unrecognized tax benefits that exist at the effective date with retrospective application permitted. The Company's analysis indicates that the adoption of this standard will not have a material effect on its consolidated financial statements.

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED
(unaudited)
(dollars in thousands unless otherwise indicated)

3. EARNINGS PER SHARE

The computation of basic and diluted earnings per common share was as follows (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Amounts attributable to Quest Diagnostics' stockholders:				
Income from continuing operations	$402,737	$158,541	$670,893	$489,889
Income from discontinued operations, net of taxes	2,406	4,541	35,497	10,016
Net income attributable to Quest Diagnostics' common stockholders	$405,143	$163,082	$706,390	$499,905
Income from continuing operations	$402,737	$158,541	$670,893	$489,889
Less: Earnings allocated to participating securities	1,484	645	2,410	1,951
Earnings available to Quest Diagnostics' common stockholders – basic and diluted	$401,253	$157,896	$668,483	$487,938
Weighted average common shares outstanding – basic	149,625	158,783	153,477	158,518
Effect of dilutive securities:				
Stock options and performance share units	1,295	1,919	1,318	1,546
Weighted average common shares outstanding – diluted	150,920	160,702	154,795	160,064
Earnings per share attributable to Quest Diagnostics' common stockholders – basic:				
Income from continuing operations	$2.68	$0.99	$4.36	$3.07
Income from discontinued operations	0.02	0.03	0.23	0.07
Net income	$2.70	$1.02	$4.59	$3.14
Earnings per share attributable to Quest Diagnostics' common stockholders – diluted:				
Income from continuing operations	$2.66	$0.98	$4.32	$3.04
Income from discontinued operations	0.02	0.03	0.23	0.07
Net income	$2.68	$1.01	$4.55	$3.11

Earnings per common share are computed independently for each quarterly period. Therefore, the sum of quarterly earnings per common share will not equal earnings per common share for the nine months ended September 30, 2013.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Stock options and performance share units	1,527	1,317	1,690	1,925

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QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED
(unaudited)
(dollars in thousands unless otherwise indicated)

4. 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. The Invigorate program is intended to address continued reimbursement pressures and labor and benefit cost increases, free up additional resources to invest in science, innovation and other growth initiatives, and enable the Company to improve operating profitability and quality. In connection with this program, the Company also launched a voluntary retirement program to certain eligible employees, which was essentially completed at the end of the first quarter of 2013. The Invigorate program is currently expected to be principally completed by the end of 2014.

As part of the Invigorate program, the Company launched a major management restructuring aimed at driving operational excellence and restoring growth. The key element of this organizational change is to eliminate the complexity associated with the Company's prior structure, including reducing management layers, so that the Company can better focus on customers and speed decision-making. The new organization is designed to align around future growth opportunities, improve execution and leverage company-wide infrastructure to maximize value and efficiency. The majority of the organizational changes became effective on January 1, 2013. The Company has completed the elimination of at least three layers from the organization, and has reduced approximately 450 management positions from the Company through the end of the third quarter of 2013 associated with this initiative. The Company expects to eliminate a total of approximately 500 management positions by the end of 2013.

The following table provides a summary of the Company's pre-tax restructuring and integration charges associated with the Invigorate program and other employee separation costs for the three and nine months ended September 30, 2013:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Employee separation costs	$24,827	$27,866	$66,182	$31,550
Facility-related costs	4,172	414	5,415	414
Asset impairment charges	—	1,147	—	1,147
Accelerated vesting of stock-based compensation	—	3,030	1,284	3,030
Total restructuring charges	28,999	32,457	72,881	36,141
Other integration costs	$7,945	$2,431	$21,202	$5,241
Total restructuring and integration charges	$36,944	$34,888	$94,083	$41,382

Of the total employee separation costs incurred in the three and nine months ended September 30, 2013, $1.0 million and $19.5 million, respectively, represent costs associated with the Company's management layer reduction initiative, and $0.4 million and $4.7 million, respectively, represent costs incurred under the Company's voluntary retirement program. In connection with further restructuring efforts, the Company entered into agreements to outsource certain aspects of support functions. As a result of these agreements, the Company incurred approximately $16.5 million of employee separation costs in the three and nine months ended September 30, 2013 related to this initiative. The remaining employee separation costs incurred during the three and nine months ended September 30, 2013 represent other actions the Company has taken to restructure its business.

Of the total employee separation costs incurred in the three and nine months ended September 30, 2012, $20.6 million and $23.3 million, respectively, represent costs incurred under the Company's voluntary retirement program.

Of the total $36.9 million in restructuring and integration charges incurred during the three months ended September 30, 2013, $10.4 million and $26.5 million was recorded in cost of services and selling, general and administrative expenses, respectively. Of the total $94.1 million in restructuring and integration charges incurred during the nine months ended September 30, 2013, $37.1 million and $57.0 million was recorded in cost of services and selling, general and administrative expenses, respectively.

(dollars in thousands unless otherwise indicated)

Of the total $34.9 million in restructuring and integration charges incurred during the three months ended September 30, 2012, $19.8 million and $15.1 million was recorded in cost of services and selling, general and administrative expenses, respectively. Of the total $41.4 million in restructuring and integration charges incurred during the nine months ended September 30, 2012, $25.7 million and $15.7 million was recorded in cost of services and selling, general and administrative expenses, respectively.

In addition to the restructuring and integration charges noted above, the Company incurred approximately $2.4 million and $8.5 million in the three and nine months ended September 30, 2013, respectively, primarily associated with professional fees incurred in connection with further restructuring our business and integration costs associated with recent acquisitions.

The Company incurred approximately $9.7 million and $28.8 million in the three and nine months ended September 30, 2012, respectively, primarily associated with professional fees incurred in connection with further restructuring our business and integration costs associated with recent acquisitions.

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

The following table summarizes activity in the restructuring liability as of September 30, 2013 and December 31, 2012:

	Employee Separation Costs	Facility-Related Costs	Total
Balance, December 31, 2012	$40,018	$ 257	$40,275
Current period charges	66,182	5,415	71,597
Other / adjustments	2,915	—	2,915
Less:			
Cash payments	(59,229)	(575)	(59,804)
Balance, September 30, 2013	$49,886	$ 5,097	$54,983

5. BUSINESS ACQUISITIONS

Acquisition of Businesses from UMass Memorial Medical Center

On January 2, 2013, the Company completed the acquisition of the clinical outreach and anatomic pathology businesses of UMass Memorial Medical Center ("UMass"). This purchase was the first step in a series of transactions between the parties whereby the two organizations expect to eventually have a financial stake in a new entity that will perform diagnostic information testing services in a defined territory within the state of Massachusetts. The assets acquired at the acquisition date primarily represent goodwill and intangible assets, principally comprised of customer-related intangibles (see Note 9). In addition the Company granted to UMass a call option and UMass granted to the Company a put option for UMass to acquire an 18.90% equity interest in a newly formed entity. The put and call options have a remaining vesting period of approximately 18 months (see Note 8).

Other Acquisitions

On May 15, 2013, the Company completed the acquisition of the toxicology and clinical laboratory business of Advanced Toxicology Network ("ATN") from Concentra, a subsidiary of Humana Inc. The assets acquired at the acquisition date primarily represent goodwill and intangible assets, principally comprised of customer-related intangibles (see Note 9).

On June 22, 2013, the Company completed the acquisition of certain lab-related clinical outreach service operations of Dignity Health ("Dignity"), a hospital system in California. The assets acquired at the acquisition date primarily represent goodwill and intangible assets, principally comprised of customer-related intangibles (see Note 9).

Pro Forma Combined Financial Information

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED
(unaudited)
(dollars in thousands unless otherwise indicated)

Supplemental pro forma combined financial information has not been presented as the combined impact of the above acquisitions are not material to the Company's consolidated financial statements.

6. DISPOSITIONS

Sale of Royalty Rights

As part of its acquisition of Celera in 2011, the Company gained rights to receive royalties on Ibrutinib, an experimental cancer therapy. In July 2013, the Company sold its right to receive royalties related to the commercialization of Ibrutinib for $485 million in cash. The Company has accounted for this transaction as a sale of royalty rights and recognized a pre-tax gain of $474 million, net of transaction costs, associated with this sale.

Sale of Enterix

In September 2013, the Company completed the sale of Enterix and recorded a pre-tax loss of approximately $40 million associated with the sale, which is included in other operating expense, net. The Enterix business has not been reclassified to discontinued operations due to the level of continuing involvement in the Enterix business subsequent to its sale.

7. TAXES ON INCOME

Income tax expense for the three months ended September 30, 2013 and 2012 was $246 million and $104 million, respectively. Income tax expense for the nine months ended September 30, 2013 and 2012 was $414 million and $320 million, respectively. The increase in income tax expense for both the three and nine months ended September 30, 2013, compared to the prior year period, is primarily due to approximately $176 million of income tax expense associated with the gain on sale of royalty rights (see Note 6).

8. FAIR VALUE MEASUREMENTS

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
September 30, 2013		Level 1	Level 2	Level 3
Assets:				
Trading securities	$49,226	$49,226	$—	$—
Cash surrender value of life insurance policies	27,842	—	27,842	—

Put option	5,300	—	—	5,300
Available-for-sale equity securities	1,062	—	—	1,062