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LABORATORY INDUSTRY REPORT®

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Vol. 12, Iss. 10, October 1, 2012

HIGHLIGHTS

Hospital Employment Increasing for Pathologists; Docs Trade Compensation for Stability

In a trend seen across the United States, pathologists increasingly are making the move from private practice to being employees of hospitals and health systems. While pathologists employed by hospitals earn less than those in group practices—$221,000 versus $302,000, according to a recent survey—many of them appreciate the financial stability and greater predictability offered by hospital employment.

According to a report in the *New England Journal of Medicine*, more than half of practicing U.S. physicians are now employed by hospitals or integrated delivery systems, a trend fueled in part by the creation of accountable care organizations and the prospect of more risk-based payment approaches. A 2011 survey by the Medical Group Management Association showed a nearly 75 percent increase in the number of active doctors employed by hospitals since 2000, and pathologists are no exception.

For more on this trend, see *Inside the Laboratory Industry* on page 4.

Analysts Mixed on Impact of Gap-Filling for MDx Codes

Research analysts are mixed on what the Centers for Medicare and Medicaid Services' (CMS) recent recommendation on the payment methodology for molecular diagnostic (MDx) codes means for companies that develop MDx tests.

CMS on Aug. 31 said it recommends using gap-fill methodology for pricing of molecular pathology procedures that are paid under the clinical laboratory fee schedule (CLFS). The agency left open the possibility that it might still price some of the new codes on the physician fee schedule. The agency is expected to announce the final physician fee schedule and the final clinical laboratory fee schedule in November.

The codes at issue include 92 Tier 1 analyte-specific high-volume procedures and nine Tier 2 resource-level codes, which are intended to replace the old "stacking" methodology currently used for billing purposes.

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Analysts Mixed on Impact of Gap-Filling for MDx Codes, *from page 1*

CMS's recommendation has left analysts mostly unfazed regarding the bottom lines of companies that will be affected by the changes, such as Myriad Genetics. The Salt Lake City-based laboratory's BRACAnalysis test has been a blockbuster for breast and ovarian cancer detection and is expected to be impacted by the changes.

"For gap-fill, taking the average reimbursement levels at which other payers currently reimburse the test would result in a level of reimbursement in the range [Myriad] is currently receiving," said Isaac Ro, a vice president with Goldman Sachs, in a recent report. He also noted that Myriad's Medicare billings comprise only about 10 percent of revenues.

"I see little risk that there is going to be a meaningful impact on reimbursement," said Laura McGuigan, a senior research analyst with B. Riley & Co. in Los Angeles, who covers Myriad and Redwood City, Calif.-based Genomic Health Inc.

McGuigan added that Myriad's pricing to CMS for its procedures is at a large enough discount compared to full price—$3,500 versus $5,100—to not make it a likely target for a steep reimbursement cut. Meanwhile, gross margins are high enough for it to remain extremely profitable. "They make a lot of money on that test," she observed.

McGuigan also noted that Vermillion, the Austin, Texas-based laboratory that sells an ovarian cancer detection test in collaboration with Quest Diagnostics, did not use the stacking methodology. It has applied for a unique CPT code, sidestepping much of the gap-filling issue altogether.

However, Darren Lehrich, an analyst with Deutsch Bank, said he viewed the preliminary decision to use the gap-fill methodology as a modestly negative outcome, "but it's not clear by how much until the final values are published in the final rule(s) expected in November." Lehrich said he expects both Quest and LabCorp to have about a 5 percent revenue exposure to tets billed on a code stack across all payer categories.

In a recent conference call with analysts, Bio-Reference Laboratory Chief Executive Officer Marc D. Grodman, M.D., said he did not expect the CMS changes would affect his company's bottom line.

Since the Aug. 31 announcement, Myriad's stock has trended up about 8 percent, while Genomic Health is up about 3 percent after an initial drop. Bio-Reference's stock dropped about 10 percent in the wake of the news but has since made up virtually all of that loss.

AEL Consolidates East Tennessee Operations; Beefs up Same-Day Services

Memphis-based American Esoteric Laboratories (AEL) has consolidated its operations in eastern Tennessee with a facility merger that will cut costs while beefing up its menu of same-day services.

AEL brought its Knoxville and Morristown labs into a single 10,000-square-foot facility in Knoxville. The new space was created by retrofitting existing commercial office space. AEL left its old Knoxville lab, a 2,200-square-foot space acquired from Ascendant Medical Laboratories in 2010.

"There's a pretty big demand for same-day tests from area doctors, and the main driver was having a centralized location for clients and patients in that market," said AEL President Rosanne P. Russell. The new Knoxville facility will be able to meet the region's demand and is located next to Interstate 40, the region's primary east-west highway. The merger of the two facilities, about 50 miles apart, will save AEL about $250,000 a year, according to Russell.

Altogether, about 75 different tests can be performed at the Knoxville facility, including bread-and-butter procedures such as urinalysis, vitamin B-12, cholesterol, and metabolic panels.

> ***"There's a pretty big demand for same—day tests from area doctors, and the main driver was having a centralized location for clients and patients in that market."***
> ***—Rosanne Russell, President, AEL***

No layoffs are planned as part of the consolidation, although Russell believes a couple of staff members may leave due to attrition. Altogether, the new Knoxville facility employs 80.

The Morristown facility, acquired from Physicians Medical Laboratories in 2006, will continue to operate as a basic pathology laboratory and a patient collection site.

Altogether, AEL operates seven laboratory sites statewide, although the bulk of its operations are in Memphis. Russell said growth in the eastern portion of the state will likely be organic moving forward, and that no acquisitions are on the radar.

However, Russell did note that AEL was looking for potential growth through acquisitions in eastern Kentucky. It also operates in Mississippi, Arkansas, Missouri, and Alabama. It acquired three small labs in Alabama earlier this year.

Although Russell declined to mention who AEL's major competitors are in Tennessee, they include firms such as Molecular Laboratory Pathology Network in Marysville and Pathology Laboratories West in Knoxville.

Russell declined to provide annual sales figures for AEL, which is a division of Sonic Healthcare USA.

Inside The Lab Industry

Pathologists Shifting Toward Hospital Employment

Gene Herbek, M.D., is approaching his first decade as a hospital-employed pathologist after switching midcareer from an independent group practice.

It wasn't a desire for better hours or a more balanced lifestyle that prompted Herbek to make the change. Instead, it was a professional conundrum.

Herbek had been practicing with Pathology Medical Services of Siouxland in Sioux City, Iowa, when a group of area physicians decided to open a surgical hospital just outside of town. The new center was across the border in South Dakota, a mere 10-minute drive away from Sioux City, but in a state that lacks a certificate of need law or personal income tax. Sioux City doctors flocked into Dakota Dunes, a planned community with rambling homes and an Arnold Palmer-designed golf course.

"They drained all the medical care out of Sioux City," Herbek said.

Herbek's practice provided much of Sioux City's surgical pathology work before the center opened. However, his income dropped by 25 percent after its opening—a galling event considering he had been practicing in Sioux City for a quarter of a century.

"It is more lucrative for hospitals. They capture more revenue, and they have more control over more employees."
—Bruce Friedman, M.D., Pathology Education Consortium

Not surprisingly, there were bad feelings between those doctors who brought their practices over the border and those who chose to remain. "It really factionalized the physicians," Herbek said.

After performing *locum tenens* work to make up for lost income, Herbek was approached by Methodist Hospital in Omaha, Neb., and began a hospital-employed position in early 2004. Herbek had attended medical school and performed his residency in Omaha, 100 miles south of Sioux City, so it was not a move to an unfamiliar place. However, it required his living away from his wife during the workweek for a period of time until she was able to obtain a new teaching position nearby.

"I had been one to resist it," said Herbek, who is now the president-elect for the College of American Pathologists. "But it was the best thing I've ever done."

Trend Is Apparent

Herbek is not alone. Industry observers and a prominent physician recruiter say there definitely is a trend of pathologists moving toward hospital-employed rather than independent practice, with a variety of factors motivating them.

"The big era is moving forward for hospital employers," said Bruce Friedman, M.D., president of the Pathology Education Consortium and professor emeritus of pathology at the University of Michigan Medical School. According to Friedman, both hospitals and individual providers benefit.

"It is more lucrative for hospitals. They capture more revenue, and they have more control over more employees," Friedman said. "A lot of problems for clinicians disappear as well, such as an irregular schedule."

Such was the case for Kevin Godfrey, M.D., a pathologist who had practiced in an independent group in Southern California for 20 years before joining a medical practice affiliated with Kaiser Permanente. Although California law prohibits most instances of direct employment of doctors by hospitals, Godfrey is a de facto employee, as he practices pathology exclusively for Kaiser enrollees and its hospitals.

"When I practiced on my own, I often had to work with private physicians who worked odd hours," said Godfrey, who estimates he works about 90 fewer minutes a day with Kaiser.

Working with Kaiser has also eliminated financial uncertainties, Godfrey added. Among the reasons he was attracted to a more employerlike relationship was the fact he practiced in the string of small cities south between Los Angeles and Long Beach served primarily by community hospitals of between 100 and 200 beds. These facilities either closed or regularly changed ownership—in one instance, a hospital served by Godfrey's practice changed title four times in a year.

Pathologists seeking financial stability are among the factors driving them toward hospital employment, according to Jay Torio, a senior consultant with the physician recruitment firm Merritt Hawkins in Irving, Texas.

"Independent practices have more overhead, more regulations, and have to engage in cost-intensive projects such as implementing electronic medical records," said Torio, who also noted that younger physicians do not want to work themselves ragged after finishing their residencies or fellowships.

Placement Trends Changing

The shift in focus by Torio's firm has been dramatic. In 2004, 11 percent of Merritt Hawkins's placements were for hospital-employed positions, according to Torio. This year, it is 63 percent. Torio does not have the exact numbers for pathologist placements, but he said it followed along with the other specialties.

"It makes perfect sense that pathologists would be following the same career pathways as other specialist physicians," said Alwyn Cassil, spokesperson for the Washington, D.C.-based Center for Studying Health System Change (HSC). According to a survey of more than 500 clinicians performed by HSC last year, hospital-based employment is rising rapidly, driven in part by consolidation of hospitals.

However, there are no hard statistics specifically documenting the move of pathologists away from independent practice. And one prominent consultant in the area said a survey he had undertaken indicated no major shifts in practice patterns.

Barry Portugal, president of Health Care Development Services in Nokomis, Fla., said a recent survey undertaken by his firm noted that 65

percent of all pathologists currently working in hospitals are independent contractors. Portugal's firm primarily represents hospitals and health care systems rather than pathology practices.

"Hospitals do not understand how pathologists work, and thus they have no productivity standards. So a hospital administrator or a CFO would not know if they needed three pathologists or five," Portugal said.

By contrast, Herbek claimed hospitals are taking a very close look at how pathologists practice.

"These systems want to keep costs down, and they are going to follow the algorithms and the practice patterns very closely," he said. "Pathlogists are the most scrutinized and reviewed group of physicians. We are in the fishbowl, and we're ahead of the game. Everything we do is on slides."

Pay Discrepancies

Portugal noted that hospitals also often do not offer pathologists competitive compensation. That's the result of current benchmarking data being off the mark, he says.

Indeed, there are some discrepancies between the pay of independent and hospital-employed pathologists. According to Medscape, the average pay of a hospital-based pathologist is $221,000, significantly lower than those in solo or group practice.

However, some hospitals pay quite competitively. At Greenwich Hospital in Greenwich, Conn., five of the hospital's 10 highest-paid employees in 2009 were pathologists. Their compensation ranged from $431,000 to $571,000, according to published reports.

Although Herbek's paychecks had been depressed by the arrival of the surgical center, he said he is now earning more than when he was in independent practice, with his compensation generally keeping pace with the rate of inflation. Godfrey said he is in the same situation. What both of them particularly enjoy are the enhanced benefits typically offered by large employers, as well as not having to go through the ordeal of administrative work.

"I can focus on the practice and not the management of the practice," Herbek said. "I don't have to worry about malpractice, life, or health insurance."

That is not to say there are no drawbacks to employing pathologists in hospitals. The HSC noted in its 2011 report that the trend could drive up costs, which may be passed on to payers and consumers. "Hospitals and their employed physicians continue to practice in a predominantly fee-for-service environment that has incentives to increase the volume of services delivered," it said. "And, productivity-based compensation used by many hospitals for employed

Compensation for Pathologists by Setting

Academic: $146,000

Hospital: $221,000

Solo: $256,000

Multispecialty group practice: $292,000

Single specialty group practice: $302,000

Source: Medscape

physicians reinforces these incentives. Numerous physician respondents noted that employed physicians face pressure from hospitals to order more expensive testing alternatives."

Friedman says that smaller hospitals may be challenged to find quality pathologists, perhaps driving them to seek alliances with larger players.

Herbek argues that younger pathologists, in seeking a better life-work balance, are missing out on opportunities to further the profession. But he believes a phone call he recently received from one of his former partners in Sioux City is portending the future.

"They think the [group] is going to be employed soon," he said.

Bio-Reference Reports Strong Earnings Growth

Bio-Reference Laboratories reported strong earnings growth for the third quarter of fiscal 2012—the strongest numbers posted by the New Jersey-based lab in its history.

Net income for the quarter ending July 31 was $12.6 million, up 25 percent from the third quarter of fiscal 2011, $10.1 million. Revenues were up 16 percent, reaching $172.3 million, compared to $148 million reported for the year-ago quarter.

"We have transitioned by moving innovative new services out of development mode and into implementation mode. We have been able to maintain our focus on additional new services and programs," said Bio-Reference Chief Executive Officer Marc Grodman, M.D. The lab provided services to nearly 2 million patients during the quarter, up 14 percent compared to the prior quarter.

For the first nine months of fiscal 2012, Bio-Reference reported net income of $29.3 million on revenues of $485.6 million. For the same period during fiscal 2011, net income was $25.9 million on revenues of $407.3 million.

Grodman noted that the company had introduced three new tests in the oncology and women's health sectors during the year that had helped spur growth. Moreover, the company has also expanded individual services it offers to niche markets outside of the Northeast.

"We have a great deal of business in the New York region, but we derive an even greater portion of our revenues from the specialty markets that we serve across the country," Grodman said. "We are able to grow because of our national footprint and our ability to introduce our service, support, and technology innovation throughout the country."

However, in a conference call with investors, Grodman said he believes the company's growth in esoteric testing has "plateaued." It currently comprises 61 percent of Bio-Reference's business, and he expects it to remain at around 60 percent.

Although the company's performance beat analysts' estimates on earnings and met expectations for revenue, its stock dipped about 10 percent when earnings were announced on Aug. 30, dropping to $25.78 per share in trading on Nasdaq. It has since rebounded and is trading at over $28 per share.

INDUSTRY BUZZ

Could Competitive Bidding Make a Comeback?

Several years after competitive bidding for laboratory services crashed and burned within the Medicare program, the concept is once again rearing its ugly head.

A consortium of economists and finance experts—including former director of the Office of Management and Budget Peter Orszag and former director of the Centers for Medicare and Medicaid Services (CMS) Donald M. Berwick, M.D.—proposed reviving competitive bidding in a recent edition of the *New England Journal of Medicine*.

The consortium wants to try to address rising health care costs in a holistic manner. Laboratory services were among many areas it felt ripe for curbing growth. And while lab services were at the periphery of their proposals, it did not escape industry attention. The American Clinical Laboratory Association (ACLA) lodged a strong objection to the idea, noting in a briefing paper that it "would have a devastating impact on the industry and on beneficiaries' access to safe, high-quality and innovative lab testing."

ACLA President Alan Mertz notes that the intention of competitive bidding was to cut rates between 10 percent and 20 percent. CMS has since cut reimbursements to labs by that much in the intervening years. With sequestration and other budget-related issues, Medicare payment could be cut 5 percent further in early 2013, he added.

Although CMS has introduced—and expanded—competitive bidding demonstrations for durable medical equipment, Mertz observed that the two industry segments are very different.

"This is far more on the spectrum of a complex medical service rather than a product," he said. "A crutch or a wheelchair can be mass-produced, whereas a Pap smear has to be collected and then tested. There are also thousands of labs in many shapes and sizes, and [the industry is] extremely decentralized."

Laboratory competitive bidding had required labs providing more than $100,000 in fee-for-service testing to Medicare to submit bids on 303 different procedures. Just before a demonstration was launched in San Diego in 2008, providers in the region blocked its implementation by suing the U.S. Department of Health and Human Services in federal court. Congress repealed competitive bidding for labs later that year.

The just-floated proposal is nowhere near implementation, and Mertz believes lawmakers have little appetite to revive competitive bidding. But should that happen, he noted that the industry would fight against it.

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Merritt Hawkins 800-876-0500

Pathology Medical Services of Siouxland 712-279-3226

Myriad Genetics 801-584-3600

Quest Diagnostics 800-222-0446

Vermillion 512-519-0400

 Laboratory Industry Report (ISSN 1060-5118) is published by G2 Intelligence, 1 Phoenix Mill Lane, Fl. 3, Peterborough, NH 03458-1467 USA. Tel: 800-401-5937. Fax: 603-924-4034. Web site: www.G2Intelligence.com.

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