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LABORATORY INDUSTRY REPORT®

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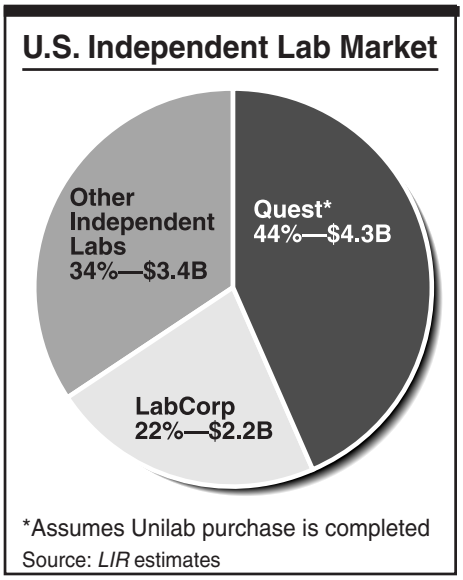
WASHINGTON G-2 REPORTS

Quest To Buy Unilab For $1.14 Billion

Quest Diagnostics (Teterboro, NJ) has signed a definitive agreement to acquire Unilab (Tarzana, CA) for $1.14 billion, including approximately $200 million of Unilab debt. The price tag is equal to 2.9 times Unilab's reported revenue of $390 million in 2001.

The purchase—combined with Quest's closure on April 1 of its acquisition of American Medical Laboratories (Chantilly, VA)—will boost Quest's annual revenue run rate to approximately $4.32 billion and give it a 44% share of the national independent lab market of $9.9 billion and 12% of the total U.S. lab market of $35.4 billion. In California, the Quest-Unilab combination will generate an estimated $500 million of annual revenue (excluding Quest's Nichols Institute), giving it an estimated 40-50% share of the state's $1.2 billion independent lab market.



Despite Quest's growing share of the lab market, chairman Ken Freeman says he does not anticipate any deal-breaking issues with the Federal Trade Commission and the deal may close by June 30. *Continued on p. 2*

Lab Capitation Down, But Far From Out

Though many capitation contracts for laboratory services have been converted to fee-for-service over the past few years, capitation is still a significant source of revenue for many laboratories. For example, Quest Diagnostics says it derived approximately 9%, or roughly $300 million, of its total revenue last year from capitated payments. Unilab reports that capitation represents 10-15% of its annual revenue, or roughly $50 million. And several laboratory networks around the country have recently signed major new capitated agreements, including a trio of hospitals in Rochester, NY and Joint Venture Hospital Laboratories in Michigan. For more on capitation, see *Inside The Laboratory Industry*, pp. 5-7.

■ **QUEST TO BUY UNILAB**, *from page 1*

The deal will bring Unilab back into familiar arms. The company was created in 1988 as a spin-off of the western U.S. clinical laboratory business of Corning Inc.'s MetPath division, which eventually became Quest Diagnostics.

By purchasing Unilab, Quest will gain a major presence in the California physician office market. Unilab serves about 45,000 clients and has 150 managed care contracts covering approximately five million lives. It currently operates three major testing facilities in the state—in Tarzana (just outside Los Angeles), Sacramento and San Jose—as well as 39 rapid response labs and 381 patient service centers.

Quest operates three major testing facilities in California—in Dublin (just east of San Francisco), Van Nuys (just north of Los Angeles) and San Diego—as well as 11 rapid response labs and about 119 patient service centers. In addition, its primary national esoteric testing facility (Nichols Institute) is located in San Juan Capistrano (between Los Angeles and San Diego). Quest has roughly 2,400 employees in the state: about 1,200 at its routine lab operations and another 1,200 at Nichols Institute.

California Operations: Quest & Unilab

	Quest	*Unilab*
Major labs	3	3
Esoteric labs	1	0
Rapid response labs	11	39
Patient service centers	119	381
Employees	2,400	3,700
Revenue*	$100M+	$390M

*California revenue for Quest is estimated by *LIR* and excludes Nichols Institute.

Source: *LIR* from Quest Diagnostics

Ultimately, Freeman expects Quest will achieve $30 million in annual cost savings from the acquisition. He expects consolidation of overlapping facilities and a reduction of employees, but says it's too early to say exactly which labs will be shut down. Freeman also expects Quest to benefit by redirecting Unilab's esoteric testing work to Nichols Institute. Unilab currently sends out approximately $23 million worth of esoteric tests per year, primarily to Specialty Laboratories (Santa Monica, CA). Robert Whalen, president of Unilab, is expected to lead integration activities in California after the deal closes.

By acquiring Unilab, Quest also eliminates a potential major competitor in the Arizona market. Unilab recently bought Integrated Medical Laboratories (IML-Scottsdale). IML, an independent lab that generates roughly $3 million in annual revenue, is now expected to be folded into Sonora Quest Laboratories LLC (Tempe), a joint venture between Quest and Banner Health System (Phoenix).

Terms of the Quest-Unilab deal call for Unilab shareholders to receive $26.50 in cash or 0.3256 shares of Quest, or a combination of both, for each share of Unilab. If Unilab stockholders elect to receive 30% of the consideration in cash and if all options are exercised, Quest will issue approximately 8.5 million shares (worth $685 million) and pay approximately $295 million in cash. Quest will also assume some $200 million of Unilab debt, giving the transaction a total value of approximately $1.14 billion. To finance the acquisition (as well as the AML deal which recently closed), Quest says it will need to borrow approximately $1 billion. This will raise Quest's total debt to approximately $1.8 billion.

The sale of Unilab will mark a big payday for investment firm Kelso & Co. (New York City), which took Unilab private in November 1999 in a transaction valued at ap-

Quest Diagnostics + AML + Unilab Financials For 2001 *($MM)*

	Quest	AML[1]	Unilab	Combined
Total revenue	$3,627.7	$300.0	$390.2	$4,317.9
—Clinical lab	3,482.0	300.0	390	4,172.0
—Trial, kit, other	145.7	0	0	145.7
EBITDA[2]	556.7	37.3	80.8	674.8
Net income	162.3	1.2	-2.9	160.6
Est'd accessions	107.0	8.8	14.6	130.4
Avg. rev. per accession	32.54	34.09	26.73	31.99
Employees	29,000	2,850	3,700	35,550
Revenue/employee	$125,093	$105,263	$105,459	$121,460

[1]Data for AML are estimated based on annualizing reported results for nine months ended Sept. 30, 2001. [2]EBITDA=earnings before interest, taxes, depreciation, amortization and non-recurring charges.
Source: *LIR* from company reports

proximately $450 million. Kelso made an equity investment of $139.5 million and borrowed the rest to complete the deal. In June 2001 (less than 19 months later), Unilab returned as a publicly traded company through an IPO. Now, less than a year later, Quest is paying $1.14 billion for it.

Four Tough Questions For Quest Diagnostics' Chief

Following the announcement of the Quest-Unilab deal, *LIR* got the opportunity to interview Ken Freeman, chairman of Quest Diagnostics. Excerpts follow:

LIR: *Will Quest-Unilab have a lock on the California marketplace?*
Freeman: That is a sorely mistaken perception. California is the most competitive and fastest-growing market in the country. There are [some] 500 independent labs and 700 hospital labs in the state. Furthermore, there are no barriers to entry and new labs are being created every day. Across the country, Quest has encountered huge competition from hospital lab networks such as Joint Venture Hospital Labs in Michigan and Alliance Laboratory Services in Cincinnati. The bottom line is that if you don't provide value, you won't keep customers.

LIR: *What are the opportunities to raise capitation rates in California?*
Freeman: California is an intensely competitive marketplace. I don't anticipate dramatic reimbursement changes in California. Nationally, we are expecting to improve our average price per accession by 2-3% annually for the next few years.

LIR: *Isn't three times revenue too much to pay for a routine testing lab?*
Freeman: We are paying 12.5 times Unilab's expected EBITDA for 2002 [estimated at $90 million]. That compares favorably to Quest's current market multiple. Acquisition prices have increased since we bought SmithKline Beecham Clinical Labs, but the industry is a far different place than it was a few years ago. [Quest paid less than one times revenue to acquire SBCL in August 1999.]

LIR: *In the 1990s, a number of other labs ran into integration problems after making several large acquisitions. Why won't Quest encounter similar difficulties?*
Freeman: One key is maintaining high customer service levels. This requires motivated employees. Too often the employees at the acquired company are made to feel like the losers. We strive to treat all employees with fairness and respect. This has not always happened in the past, but is vitally important. We look to learn things from the companies we acquire … and to create management teams with representation from both companies.

Cedars-Sinai's Geller Voices Concern Over Quest-Unilab Deal

"Unfortunately, there is almost no public awareness of the fact that the quality of laboratory medicine may be less in large national laboratories than in the local/regional and, certainly, hospital-based laboratories"

For a hospital lab's perspective on the Quest-Unilab combination, *LIR* contacted Stephen Geller, MD, chairman of pathology at Cedars-Sinai Medical Center in Los Angeles. A summary of his comments is presented below:

"The new entity will clearly have great strength in competing in local markets … Mega-laboratories can [deploy] considerable resources to achieve their sales and marketing goals, seriously threatening the viability of independent laboratories and hospital-based outreach laboratories, even without consideration of their performance in actual testing."

Geller believes consolidation is leading to "a homogenization, at a medium or lesser level, of quality of laboratory services as the excellent, somewhat less cost-efficient entities are unable to maintain profitability. In this respect, the laboratory business is similar to other businesses when monopolistic entities dominate the field. If you recognize that more than 50% of healthcare decisions depend on lab testing data, you must be concerned."

Top 10 California Independent Lab Facilities Have 70% Share

Two companies now dominate the Golden State lab market—Quest and LabCorp

The 10 highest volume independent laboratory testing facilities in California perform 140 million tests annually, accounting for 70% of all testing done by independent labs in the state, according to data from the CLIA Provider Application File/April 2001.

Topping the list: Unilab's facility in Tarzana, which performs 45.8 million tests per year. The company also runs major facilities in Sacramento (13.6 million tests) and San Jose (13.2 million). Smaller labs that it has recently acquired include Pathology Associates Laboratories (Los Angeles) and Medical Arts Clinical Laboratories (Santa Barbara).

California's Top 10 Independent Lab Facilities

Facility/City	*Test Volume**
Unilab/Tarzana	45,827,985
LabCorp/San Diego	17,611,856
Quest/Dublin	17,146,330
Quest/Van Nuys	16,561,681
Unilab/Sacramento	13,571,450
Unilab/San Jose	13,161,688
Quest/San Juan Capistrano	4,847,404
LabCorp's Bio-Diagnostics/Torrance	4,226,064
Quest/San Diego	3,663,375
LabCorp/Torrance	3,364,000
Total, 10 facilities	139,981,833
Total, all CA independent labs	198,621,050

*Totals are for annual reportable test results; panel tests are exploded into individual test components.

Source: *LIR* from the CLIA Provider Application File/April 2001

Quest Diagnostics' three major routine testing facilities have a combined test volume of 37.4 million. In addition, the company's Nichols Institute, which performs esoteric tests for clients throughout the country, performs 4.8 million tests per year.

Laboratory Corp. of America's highest volume California facility is located in San Diego and performs 17.6 million tests. Smaller labs that LabCorp has recently acquired include Bio-Diagnostics Laboratories (Torrance), Pathology Medical Laboratories (San Diego) and National Genetics Institute (Los Angeles).

There are 525 CLIA-certified independent lab facilities in California. Of this total, Unilab owns 40, Quest 15 and LabCorp 11. That leaves 459 others owned by approximately 300 smaller lab companies.

Some Advice On Capitated Laboratory Contracts

Lab capitation rates remain below $1 PMPM on the West Coast, but are as high as $2-$2.75 in New York City

Since capitated contracts are usually awarded on an exclusive basis, the key benefit for laboratories is access to large physician networks that are required to use their services. The drawbacks include low reimbursement and the complexity of administering the contract.

Between 1994 and 1997, when managed care was at the height of its power, capitated contracts for clinical lab services in California dropped as low as $0.25 per member per month (PMPM), notes Nate Headley, chief executive of Spectrum Laboratory Networks (Greensboro, NC) and former CEO of Sacramento-based Physicians' Clinical Laboratories. "These insane prices guaranteed that labs would lose money."

Since then, pricing has improved dramatically. But lab executives in California and Washington tell *LIR* that some big commercial labs are still competing at rates below $1 PMPM. Meanwhile in upstate New York and Michigan, capitated lab contracts have recently been awarded at rates of $1.50-$2 PMPM, and in the New York City area, contracts are going for $2-$2.75 PMPM. The national median in 2000 was $1.25 PMPM, rising to more than $2 PMPM in 2001, according to surveys published by National Health Information (Atlanta, GA), a healthcare research firm.

Despite improvement in lab capitation rates, a simple analysis by *LIR* indicates that managed care companies may still be getting the better end of the bargain.

According to a *LIR* survey of six labs that have capitated contracts in California, New York, Michigan, Washington, North Carolina and New Mexico, the average commercial HMO member utilizes approximately 2.5 billable tests per year (excluding hospital inpatient and outpatient testing). Thus, a capitated contract that pays $2 PMPM (or $24 per-member per-year) is effectively paying a lab $9.60 per billable test ($24 divided by 2.5 billable tests).

In contrast, according to an analysis of the top 33 laboratory test codes (ranked by total allowed charges) from the Medicare Part B fee schedule, the average allowed charge is $10.52 per CPT code (*LIR, Nov.'01, p. 7*). In addition, *LIR* has estimated that the big three commercial labs (Quest, Laboratory Corp. of America and Unilab) collect an average $12 for every billable test they perform across all their contracts (Medicare, patient bill, client bill, capitated, etc.)—*see LIR, Dec.'01, p. 3*.

Clinical Lab Capitation Scenarios For Commercial HMO Members

PMPM Cap Rate	*Total Annual Reimbursement*	*Billable Test Utilization*	*Avg. Reimbursement Per Billable Test*
$0.50	$ 6.00	2.5	$ 2.40
1.00	12.00	2.5	4.80
1.50	18.00	2.5	7.20
2.00	24.00	2.5	9.60
2.50	30.00	2.5	12.00

Source: *LIR*

For advice on negotiating capitated contracts and an update on current reimbursement rates across the country, we spoke with executives at five labs that have experience with capitation. Highlights follow:

Joint Venture Hospital Laboratories (JVHL-Detroit, MI) recently won a contract to provide capitated lab services to approximately 125,000 commercial HMO members of Detroit-based Health Alliance Plan in southeastern Michigan. The contract, which becomes effective May 1, 2002, combines about 55,000 HAP members formerly covered by Quest Diagnostics and 70,000 SelectCare HMO members that JVHL had already covered. HAP acquired SelectCare HMO earlier this year, then moved to consolidate its lab contract.

The new combined contract will pay JVHL nearly $2 PMPM and covers all tests ordered at outpatient clinics and physician offices, but excludes inpatient, ambulatory surgery center, skilled nursing, home health and emergency room testing, Jack Shaw, executive director of JVHL, tells *LIR*.

JVHL now has capitated lab contracts covering a total of more than one million managed care members, according to Shaw. Other big HMO contracts include Blue Care Network (550,000 members), The Wellness Plan (72,000 members) and OmniCare Health Plan (100,000 members). JVHL, which manages lab contracts for a network of 123 hospital-affiliated labs throughout Michigan, collects 6% of network revenue for administrative costs.

Shaw estimates that commercial HMO members in Michigan utilize about 3.5 to 4 billable tests per year. (This figure is higher than the national average of about 2.5 billable tests because JVHL's figures include hospital outpatient testing.) Thus, hospital labs participating in the network will receive approximately $6.40 for each billable test they perform ($2 PMPM x 12, divided by utilization of 3.75 tests). Shaw says this is enough for JVHL hospitals to cover incremental costs and make a small profit.

JVHL has won contracts, Shaw says, despite competitive bids from the national commercial labs because JVHL is locally based and can provide HMOs with more complete laboratory test data for HEDIS reporting.

SED Medical Laboratories (Albuquerque, NM) has been renegotiating better terms for its managed care contracts, according to Jim Fantus, president. In January 2000, for example, SED converted a capitated contract covering 40,000 lives to fee-for-service. The capitated contract had been priced at less than $1 PMPM and required cytology and surgical pathology services as well as clinical lab services. "This contract was very unprofitable for us," notes Fantus. He estimates that all-inclusive capitated contracts for commercial HMO members need to be priced at about $2 PMPM in order to be profitable. He says the switch to fee-for-service almost tripled the amount of revenue SED collects vs. the old capitated contract.

In addition, Fantus says SED renegotiated higher reimbursement for a capitated contract to cover 7,000 Medicare HMO members in January 2001. The current rate is approximately three times higher than what the former contract paid. He estimates that all-inclusive capitated contracts for Medicare HMO members need to be priced at better than $4 PMPM in order to be profitable.

Fantus advises labs to have regular utilization reviews and corresponding capitation rate adjustments built into their contracts with HMOs. "Very often, the utilization data from the managed care plan that you based your capitation rate on will not be what you actually experience. Subsequent reviews and payment adjustments can reduce this risk."

Pathology Associates Medical Laboratories (PAML-Spokane, WA) and its PacLab Network cover nearly 100,000 capitated lives throughout the state. PAML's largest single contract is with Group Health Cooperative, covering 35,000 lives in eastern Washington. Capitation rates are edging up to around $1 PMPM in the state, but some large commercial labs are still bidding well under $0.75 PMPM, according to Noel Maring, director of strategic initiatives at PAML.

Maring warns hospital labs against underestimating the added costs that might be required to serve a capitated contract, such as expanding courier services and setting up new patient service centers. He also stresses the need to have systems in place to differentiate tests covered under a capitated agreement from those that are excluded and billed as fee-for-service. PAML typically excludes anatomic pathology (including Pap testing), post-mortem exams, drugs-of-abuse testing, molecular diagnostics and cytogenetics, Maring adds.

PAML is seeking to structure its capitated contracts, Maring notes, to include annual automatic payment hikes based on medical inflation indicators such as the Bureau of Labor Statistics' index for medical care services inflation.

Key "Do's & Don'ts" When Negotiating Capitated Lab Contracts

- ❑ Get a minimum of $1.50 to $2.00 PMPM
- ❑ Don't underestimate cost of administering the contract
- ❑ Don't underestimate cost for expanded client service, courier network, patient service centers
- ❑ Look to exclude surgical pathology, cytology, home health and high-priced esoteric tests
- ❑ Demand periodic utilization reviews and corresponding adjustments to capitation rates
- ❑ Demand annual upward cap rate adjustments based on medical inflation rates
- ❑ Don't expect to recoup losses from "pull-through" business
- ❑ Be prepared to say "no" to unprofitable contracts

Sunrise Medical Laboratories (Hauppauge, NY) won a capitated agreement to cover 80,000 commercial members of MDNY Healthcare (Melville, NY), effective last Jan. 1. The contract covers all clinical lab and outpatient pathology and cytology services, but excludes certain higher-priced specialized tests and home health-related testing, according to chief financial officer Martin Colucci. He says capitated lab contracts in the New York City area are now paying $2-$2.75 PMPM vs. $1 PMPM a few years ago. "If you're not going to make money with a capitated contract, there's no reason to sign it," Colucci advises.

Spectrum Laboratory Network (Greensboro, NC) converted its only capitated lab contract—covering approximately 350,000 members of Partners Health Plan—to fee-for-service last year. CEO Nate Headley says the decision was based more on contract administration issues than on pricing. "Identifying which patients are covered under a capitated contract is complex and expensive … fee-for-service eliminates the confusion." Capitated lab contracts have all but vanished in North Carolina, he adds. "None of the labs are willing to perform services that guarantee an operating loss … the entire industry has learned you can't do business that way."

Unilab (Tarzana, CA) received 35-40% of its test volume and 10-15% of its revenue from capitated contracts in 2001, according to the company's latest annual report. In total, Unilab provides capitated lab services to about five million managed care members in California. These figures suggest that Unilab gets an average $0.65 PMPM to $1 PMPM. This translates into average reimbursement (using estimated utilization of 2.5 tests per patient per year) between $3.12 and $4.80 per billable test. For all lines of business, the company received an average $11 of revenue per billable test in 2001 (based on reported revenue of $390.2 million divided by 36 million billable tests).

Will "Per Unit" Contracting Further "Commoditize" Lab Services?

UnitedHealth Group (Minneapolis, MN), the nation's second largest managed care company after Aetna Inc. (Hartford, CT), has initiated in various parts of the country a new contracting method for all clinical laboratory tests, treating them as a single commodity that can be reimbursed at a single "per unit" rate, *LIR* has learned. To find out more about this trend, we spoke with Joseph Miles, general manager of Frontline Laboratory Network (Northeast Colorado), a not-for-profit cooperative formed for contracting purposes by nine Colorado hospitals, including Boulder Community Hospital, Poudre Valley Hospital and North Colorado Medical Center.

Frontline signed a "per unit" lab services contract with UnitedHealth Group in September 2001. Under this non-exclusive contract, Frontline provides clinical lab services to UnitedHealth's 85,000 HMO and indemnity members in northeast Colorado for a fixed reimbursement "per unit"—defined as a billable lab test as described by its CPT code.

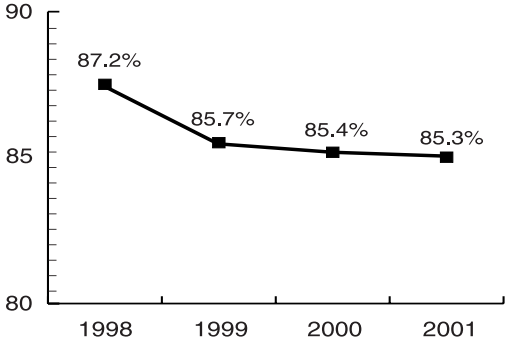
Miles tells *LIR* that reimbursement under the contract falls in the range of $7-$10 per unit. Each billable lab test, or unit, is reimbursed at the same amount, regardless of test complexity. Anatomic pathology, cytology and a handful of the most expensive lab tests (those priced above $150 per test) are reimbursed separately under a fee schedule.

This "per unit" reimbursement method makes it much easier for UnitedHealth to administer the contract because it basically reduces the normal fee schedule with 1,150 items to a single unit payable at one price. However, Miles believes this type of contract encourages managed care companies to view laboratory services as a commodity that can be distilled in scope and dimension to a single element and judged on the basis of price alone. Frontline accepted this type of contract, Miles says, because UnitedHealth, one of the largest health insurers in Colorado, offered no alternative.

UnitedHealth Reports Record Profit Of $913 Million

Even as UnitedHealth continues to tighten the screws on laboratory service providers, the managed care giant reported a record net profit of $913 million in 2001, up 30% from $705 million in 2000, according to financial reports recently released by the company. Revenue was up 11% to $23.454 billion in 2001. The company provided health insurance coverage to a total of 8.54 million members as of Dec. 31, 2001, including 6.2 million members in risk-based HMO plans and 2.3 million in fee-for-service plans.

Medical Cost Ratio* At UnitedHealth



*Medical cost ratio=medical costs as a percentage of premiums
Source: *LIR* from UnitedHealth

UnitedHealth spent 85.3% of every premium dollar it collected on medical services last year, while 14.7% went toward marketing, administration and other expenses. This compares with its medical cost ratio of 87.2% in 1998. Over the last few years, the company has ratcheted down this ratio by raising premiums 1-2% more than medical

costs. For example, in 2001 UnitedHealth raised premiums by an average 13% (net of benefit changes) and anticipates hiking rates by more than 13% this year. Medical costs for UnitedHealth rose 11-12% in 2001, and the company expects the same rate of change this year.

Meanwhile, company chairman William McGuire, MD, received compensation last year totaling $62 million, according to UnitedHealth's latest annual shareholder proxy. This included a salary of $1.8 million and a bonus of $3.7 million. In addition, he got 650,000 10-year stock options valued at $54.6 million if the company's stock price rises 10% annually over the lifetime of the options. McGuire further received $403,845 in other compensation, including company-provided transportation, life insurance and savings plan payments. Finally, he got $1.7 million as part of the company's special long-term executive compensation plan.

Miami Man Gets 18 Months For Lab Test Scheme

Roberto Llanes, 41, of Miami, FL, has been sentenced to 18 months in prison for a lab test scheme that cheated Medicare out of $1.5 million. He was also ordered to pay it back. Llanes was sentenced by Judge David F. Levi after pleading guilty on Nov. 2, 2001 to two counts of healthcare fraud.

The U.S. Justice Department had alleged that Llanes paid kickbacks to doctors and clinics in exchange for ordering trace mineral tests for measuring heavy metals in blood and urine from Monterey Medical Labs (Monterey, CA). Llanes paid approximately $150 per patient directly to certain doctors. According to federal prosecutors, Medicare was billed between $800 and $1,000 for each panel of tests. Monterey Medical Labs billed the program for more than $1.5 million in tests from September 1997 to June 1999.

Llanes is the fourth defendant to plead guilty in the scheme and the first to be sentenced. The owner of Monterey Medical Labs, Michael Conte, pled guilty to healthcare fraud on Oct. 12, 2000.

Hospital Union Membership On The Rise, Says Union Boss

Hospital workers throughout New York State are joining unions at an accelerating rate, according to Mike Rifkin, executive vice president of Local 1199 of the New York Health and Human Services Union (New York City). Rifkin tells *LIR* that over the past three years, Local 1199 has helped organize new unions at eight hospitals—primarily in the suburbs of New York City. Most recently, 34 lab workers at Nyack Hospital (Nyack, NY) joined Local 1199, giving the union its first presence in that hospital (*see First Monday, March '02*).

Rifkin says hospital technical workers—including respiratory, x-ray and laboratory technicians—are in the shortest supply and have the greatest leverage. Earlier this year, he notes, 1,200 workers at Good Samaritan (Suffern, NY)—including nurses, technicians and service employees—negotiated a 23% average pay hike over four years. Rifkin says technicians got the highest percentage pay hikes.

Expansion Underway At ACM Medical Laboratory

Now that ACM Medical Laboratory (Rochester, NY) and three Rochester hospital systems have won an exclusive contract to provide lab services to BlueCross BlueShield of Rochester (*LIR, Feb.'02, p. 9*), Arthur Glenz, president of ACM, says his facility is seeking to expand its test menu and geographic reach.

ACM is a for-profit regional reference lab owned by Unity Health System in Rochester. ACM manages a rapid response lab at Park Ridge Hospital, which is part of Unity Health, as well as a freestanding 58,000 square-foot core lab facility in Rochester. It employs 330 FTEs and performed approximately two million billable tests last year. Commercial activities include reference testing for hospitals, physician offices and nursing homes. ACM also has an extensive clinical trials business and was recently certified by the federal Substance Abuse & Mental Health Services Administration to perform drug testing for federal employees.

Effective July 1, 2002, Unity Health (and ACM) along with two other Rochester hospital systems—Strong Health and ViaHealth—will become exclusive providers of lab services to 723,000 members of BlueCross BlueShield of Rochester. Glenz anticipates that the contract will significantly expand the volume of esoteric tests coming to ACM. As a result, ACM will add PCR testing, expanded microbiology tests and additional esoteric tests to its menu, he says. Additions within the past 12 months include Androstenedione (serum); Parvovirus B19 Antibody, IgM & IgG (serum); Testosterone, total and free (serum); and C-Peptide (serum).

In addition, Glenz says that ACM, ViaHealth and Strong Health are seeking to consolidate their reference lab contracts with a single vendor. ACM currently use American Medical Laboratories (Chantilly, VA), ViaHealth uses Specialty Labs (Santa Monica, CA) and Strong Health uses Laboratory Corp. of America (Burlington, NC).

Finally, Glenz notes, ACM is planning to expand its geographic reach. It currently operates 25 patient service centers and a courier network that covers most of western New York, including Rochester, Buffalo and Syracuse.

ACM Laboratory At A Glance

Principal	Arthur Glenz, president
Main labs	Park Ridge Hospital, plus freestanding commercial lab (both in Rochester, NY)
Patient service centers	25
Employees	330 FTEs
Billable test volume (2001)	2 million
Estimated annual budget	$25 million
Reference lab	American Medical Laboratories

LabCorp Acquires Cytology Screening Of Albany, NY

Laboratory Corp. of America (Burlington, NC) closed on its acquisition of Cytology Screening Inc. (Albany, NY) on March 1. Cytology Screening specializes in Pap testing and pathology services, employs 55 people, and generates estimated annual revenue of roughly $5 million. The company had been owned by its president, Gerry Mauro.

Lab Stocks Jump 6% In Latest Four Weeks

Stock prices for the 15 companies in the G-2 Laboratory Index jumped an unweighted average of 6% in the four weeks ended April 5, 2002, with nine stocks rising in price, two unchanged and four declining. So far this year, lab stocks have risen 2%, while the S&P 500 is down 2% and the Nasdaq is down 9%.

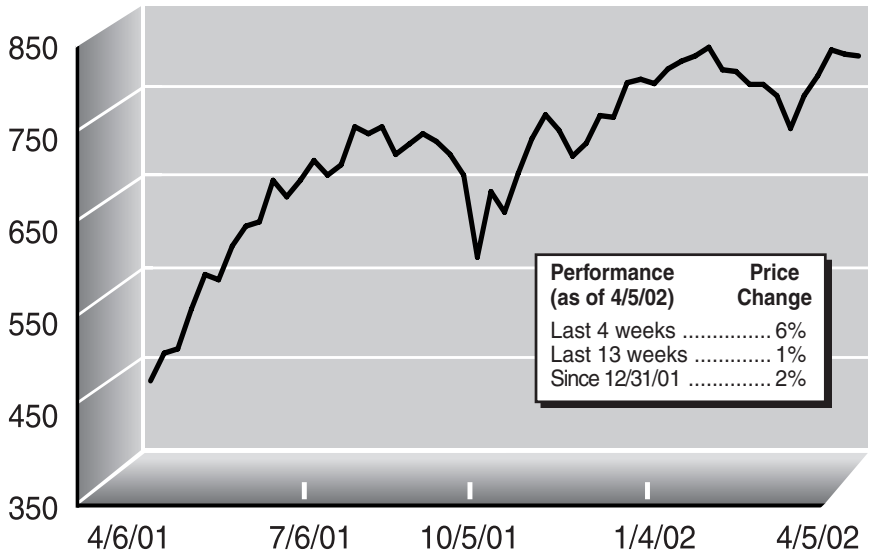
Bio-Reference Labs (Elmwood Park, NJ) surged 53% to $9.35 per share for a market capitalization of $107 million (or about 1.3 times annual revenue). Evidently, investors view Bio-Reference as a potential takeover candidate, and they were encouraged by news that **Quest Diagnostics** is willing to pay nearly three times revenue to acquire **Unilab**.

"Now is the peak time to sell if you're an independent lab, given the multiples that the national labs are willing to pay," notes David Nichols, president of Nichols Management Group (York Harbor, ME).

Other labs that appear to have benefited from news of the Quest-Unilab transaction include **Medtox** (St. Paul, MN), which rose 13% to $11.30 per share; **Lab*One*** (Lenexa, KS), up 11% to $18.70; and **Dianon** (Stratford, CT), which rose 10% to $67.15. **Unilab** was up 28% to $26.84; **Quest** was up 14% to $82.50.

Specialty Laboratories (Santa Monica, CA) fell 24% to $18.40 per share for a market capitalization of $394 million (or about 2.3 times revenue). Unilab has historically used Specialty as its primary esoteric testing lab. Send-outs from Unilab represented approximately 8% (or about $14 million) of Specialty's overall revenue last year. Unilab is now expected to shift its esoteric testing to Quest's Nichols Institute in San Juan Capistrano.

G-2 Laboratory Stock Index



Source: The G-2 Laboratory Stock Index is tabulated weekly by *Laboratory Industry Report* from the average percentage change in the price of 15 laboratory testing service stocks.

% price change, 4 weeks ended 4/5/02

UP	*$ Price*	*% Chg*
Bio-Reference	9.35	+53
Dianon	67.15	+10
Impath	38.11	+1
LabCorp	95.25	+11
Lab*One*	18.70	+11
MDS	14.25	+5
Medtox	11.30	+13
Quest	82.50	+14
Unilab	26.84	+28
UNCHANGED		
AmeriPath	26.84	0
Dynacare	15.77	0
DOWN		
Enzo Biochem	19.85	-1
Myriad	30.01	-18
PharmChem	0.65	-14
Specialty	18.40	-24

INDUSTRY buzz

Despite the dominance that a **Quest-Unilab** combination will have in California, smaller independent labs in the state tell *LIR* they're confident their high service levels will allow them to maintain and expand their customer base.

Gary Burkhartsmeier, lab operations director at Health Line Clinical Laboratories in Burbank, says combining Quest, Unilab and American Medical Labs is likely to present substantial problems in business integration and account retention at Quest. "I think the future is still very bright for service-oriented regional laboratories." Health Line is one of California's largest privately held labs, with 420 employees and annual revenue of $40 million.

Alan Kaye, president of PathNet Esoteric Laboratory Institute in Van Nuys, says major lab mergers typically result in 10% customer attrition during consolidation. "This could mean that $50 million worth of business may be coming up for grabs in California." PathNet generates annual revenue of about $10 million from Pap testing, biopsies and testing for sexually transmitted disease.

Bruce Smith, vice president of operations at Physician's Automated Laboratory in Bakersfield, believes there will always be a place for smaller community-based labs. "Fast turnaround time and personal service can create a tremendous amount of loyalty from physicians." Physician's Automated, which has 130 employees, is a full-service independent lab with annual revenue of $10-$15 million.

Alfred Lui, MD, president of Pathology Inc., an anatomic pathology lab in Torrance, believes Quest may enforce a stricter pricing discipline on the managed care contracts it inherits from Unilab. "This could provide a more level playing field for smaller labs competing for contracts." Lui also anticipates a spurt in new lab startups from displaced Quest-AML-Unilab executives.

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Bio-Reference Labs 201-791-2600
Frontline Lab Network 720-876-0340
Health Line Clinical Labs 818-954-0202
Joint Venture Hospital Labs 313-271-3692
LabCorp 336-584-5171
Nichols Mgmt Group 207-363-8230
PAML 509-755-8900
PathNet 818-780-6300
Pathology Inc. 310-225-3145
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