

LABORATORY INDUSTRY REPORT®

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California IPAs Up In Arms Over Quest-Unilab Deal

Complaints from independent practice associations (IPAs) in California may have triggered the Federal Trade Commission's decision to ask Quest Diagnostics for more information about its pending acquisition of Unilab (Tarzana, CA), *Laboratory Industry Report* has learned. Presidents of several large California IPAs tell *LIR* they are concerned that the Quest-Unilab combination will result in higher prices for lab services and reduced choice.

In contrast, most hospital lab directors in California say they welcome Quest's acquisition of Unilab because it will eliminate the state's most aggressive pricing competitor. Hospitals tell *LIR* that Unilab has regularly bid for capitated contracts for commercial members at less than \$1 per-member per-month. Unilab has capitated lab service agreements covering about five million managed care members in California.

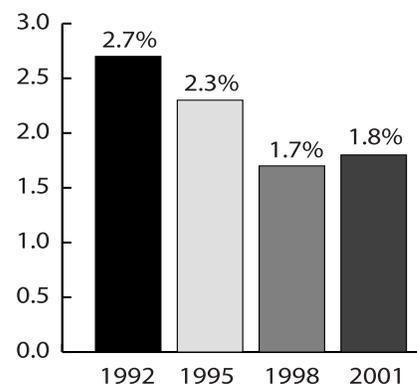
For details from our exclusive interviews with California IPA and hospital lab directors as well as an analysis of another major pending acquisition—LabCorp's bid for Dynacare—see *Inside The Laboratory Industry*, pp. 5-7.

Medicare Part B Lab Spending Up 8.8% To \$4.4B

Medicare Part B spending for clinical laboratory services rose 8.8% to \$4.448 billion in calendar 2001, according to preliminary data from the Centers for Medicare & Medicaid Services. Despite this dramatic upturn, Part B lab outlays failed to keep pace with total Medicare expenditures (including Parts A and B), which rose 9.5% to \$245.6 billion. As a result, Part B lab spending represented only 1.8% of total Medicare spending, whereas a decade ago, it comprised approximately 3% of the total.

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Part B Lab Spending As %
Of Overall Medicare Outlays



Source: *LIR* from CMS data

Medicare Part B Lab Spending, from p. 1

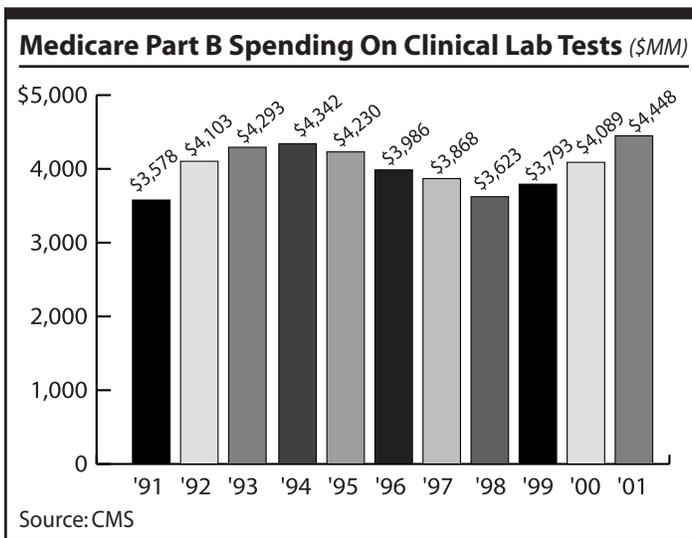
The 8.8% jump marks the third year in a row that Medicare Part B lab spending has increased. In 2000, it rose 7.8%; in 1999, it was up 4.7%. Between 1994 and 1998, it fell by an average 4.4% per year.

Recent increases in Medicare Part B lab spending are probably the result of several factors, including the continuing shift from inpatient to outpatient care. For example, inpatient days at hospitals edged up 0.3% in 2000 to 192.4 million, while outpatient visits increased 5.3% to 521.4 million, according to the latest available data from the American Hospital Association.

Another obvious factor is an overall increase in the rolls of Medicare beneficia-

ries. The Medicare program provides health insurance for people 65 years of age and older, certain disabled people and people with kidney failure. Between 1996 and 1999, the total number of beneficiaries grew 0.9% per year to 39.14 million. The 65+ category grew 0.5% per year to 33.929 million, while the number of disabled/kidney failure beneficiaries grew 3.9% to 5.21 million.

Expanded coverage of preventive screening also is contributing to growth. For example, coverage of colorectal cancer screening became effective Jan. 1, 1998, and coverage of prostate cancer screening, including an annual prostate-specific antigen test, became effective Jan. 1, 2000. 🏠



Medicare Draft Plan Would Maintain Lab Fee Freeze

In an effort to free up funds to help pay for a prescription drug benefit, House Republican leaders have drafted a Medicare reform package that would eliminate the annual inflation update to the lab fee schedule until an unspecified “competitive bidding system” for lab services is in place. Medicare lab fees, which have not been updated since 1997, are scheduled to get an annual update on Jan. 1, 2003, unless Congress decrees otherwise. Based on the 1.4% that the Consumer Price Index has risen so far this year, the scheduled hike would mean additional Medicare lab service payments of roughly \$62 million next year (\$4.448 billion X 1.4% = \$62 million). 🏠

Dynacare’s U.S. Hospital Joint Ventures Collapsing

Dynacare (Dallas, TX and Toronto, Canada), which has agreed to be acquired by Laboratory Corp. of America, has announced that its hospital joint ventures with Allegheny Hospital (Pittsburgh, PA) and Ellis Hospital (Schenectady, NY) have each been terminated. Dynacare says this will result in an after-tax charge of approximately \$4.7 million that will be booked in the



Dynacare's U.S. Hospital Joint Ventures

<i>Hospital</i>	<i>Location</i>	<i>Initial Agreement</i>	<i>Current Status</i>
Memorial Hermann	Houston, TX	Sept. 1995	Terminated
Ellis	Schenectady, NY	Aug. 1996	Terminated
Froedtert Memorial Lutheran	Milwaukee, WI	Aug. 1997	Ongoing
University Health Systems	Knoxville, TN	Aug. 1999	Ongoing
Allegheny Hospital	Pittsburgh, PA	Dec. 2000	Terminated

Source: LIR from Dynacare

Hospital (Houston, TX) in September 1995. Owned 50-50 by Dynacare and Hermann Hospital, the venture managed all inpatient lab services to the hospital and was building outreach volume. Hermann Hospital later merged with the Memorial System in Houston, and the contract, which expired on Sept. 30, 2000, was not renewed. Dynacare subsequently purchased the 50% partnership interest from Memorial Hermann for \$7.2 million and is now operating the venture as an independent lab.

Of five hospital joint ventures that Dynacare has secured in the U.S. since 1995, only two remain ongoing. One is with Froedtert Memorial Lutheran Hospital (Milwaukee, WI), established in August 1997. The other is with University Health Systems (Knoxville, TN) and manages inpatient and outreach lab services for the University of Tennessee Memorial Hospital. 🏠

second quarter. The company did not provide a reason for the terminations, and Osama Sherif, executive vice president in charge of acquisitions and joint ventures at Dynacare, did not return phone calls from LIR seeking comment.

The company also had launched a joint venture with Hermann

CAP Opposed To Direct-Access Laboratory Testing

The College of American Pathologists (Northfield, IL) has issued a statement opposing direct-access laboratory testing whereby patients self-order tests without a physician's authorization.

"Patients are best served when laboratory tests are ordered by a qualified physician where such a physician directs the course of the diagnostic and therapeutic care of the patient, and a physician should determine which clinical and anatomic laboratory services are appropriate," CAP president Paul Raslavicus, MD, said in a press release. "The College is especially concerned for the patient who may receive a 'false-negative' result and hence not seek appropriate follow-up care to address the suspected condition."

CAP says that if a pathologist or pathology group decides to permit direct-access testing, the following issues should be considered:

- 1) Is a physician, or other appropriate healthcare provider, available to assist the patient in the proper interpretation of test results, particularly when the results fall outside an expected range?
- 2) Is the director of the laboratory able to order appropriate tests and assist the patient with interpretation of results? Has the laboratory developed a policy that ensures appropriate access to necessary additional diagnostic testing or therapeutic intervention?
- 3) Does the laboratory have a policy specifying the levels of testing or particular tests that will be available by direct access? 🏠

U.S. Railroad To Pay \$2.2 Million In DNA Discrimination Case

The case is the first-ever EEOC litigation challenging genetic testing under the Americans with Disabilities Act of 1990

In a mediated settlement with the U.S. Equal Employment Opportunity Commission, one of the nation's biggest railroad companies—Burlington Northern Santa Fe Railway Co., with 39,000 employees and based in Fort Worth, TX—has agreed to pay \$2.2 million to settle charges of illegally testing workers for genetic defects.

EEOC's lawsuit had charged Burlington Northern with genetically testing or seeking to test 36 employees—mostly track workers who said they had job-related carpal tunnel syndrome—without their knowledge as part of a comprehensive medical exam. Specifically, employee blood specimens were tested for chromosome 17 deletion, a predictor of some forms of carpal tunnel syndrome. A former employee had filed charges with the EEOC, alleging he was threatened with termination when he refused to be tested. Burlington Northern had started the genetic testing in March 2000 and voluntarily suspended it in February 2001, shortly after EEOC sought a court order against the company.

Under the settlement, Burlington Northern will pay \$2.2 million within 90 days to the 36 employees. The company also has agreed not to use genetic tests in required medical exams of its employees in the future.

The Americans with Disabilities Act bars employers from requiring medical exams unless needed to determine whether a worker can perform a particular job or poses a threat to anyone. "While the EEOC did not find that Burlington Northern had used genetic tests to screen out employees, employers should be aware of the EEOC's position that the mere gathering of an employee's DNA may constitute a violation of the Act," EEOC commissioner Paul Steven Miller said in a statement.

Athena Diagnostics (Worcester, MA) had performed the tests for Burlington Northern, but was not charged with any violation by EEOC. The Brotherhood of Maintenance of Way Employees, a railroad workers union, filed a lawsuit against Athena in February 2001 for allegedly performing genetic tests without patients' consent, but this suit was dismissed without prejudice in May 2001. ▲

NeoGenomics Opens Molecular Diagnostics Lab

NeoGenomics (Naples, FL) says its new 2,200 square-foot molecular genetics and cytogenetics laboratory has passed compliance inspections by state and national authorities and is now open for business.

The company has won its first three contracts to be the preferred provider of genetic testing services to the Naples Women's Center (an ob/gyn practice), North Naples Family Care (a general practice) and the Naples branch of Florida Cancer Specialists (a large oncology/hematology practice).

Michael Dent, MD, president and founder of NeoGenomics, says the lab will market its services to hospitals and physician groups throughout southwest Florida. ▲

Feds Taking A Closer Look At Quest-Unilab Transaction

The Federal Trade Commission has asked the nation's largest publicly traded laboratory company, Quest Diagnostics (Teterboro, NJ), for additional information about its planned acquisition of Tarzana-based Unilab, California's largest independent lab provider. After Quest replies, the FTC will have 30 days to review the material before deciding whether to let the takeover proceed or to file a complaint to try to block the deal. In general, such requests occur infrequently. For example, the FTC made such requests to only 24 of the total 288 mergers valued at \$1 billion or more that were announced in 2000.

The Commission most likely is concerned that the Quest-Unilab union may create a monopoly with the power to raise prices indiscriminately in the market for lab services to physician offices in California. For the most part, hospital labs in the state welcome the potential for lab prices to be raised and are not opposed to the transaction. Assuming completion of the deal, hospital lab directors believe Quest would likely raise prices on Unilab's capitated contracts or switch them to fee-for-service agreements.

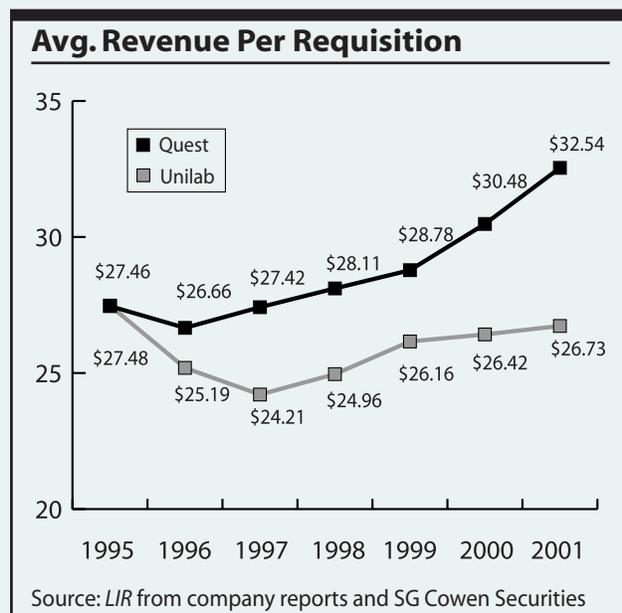
Quest has employed this strategy throughout the country for the last couple years, helping boost its average revenue per requisition to approximately \$32.54 in 2001 from \$26.66 in 1996. Unilab's average revenue per requisition has also risen over the past few years, but at \$26.73, remains significantly below Quest's.

Ken Freeman, chairman of Quest, has stated that he does not anticipate dramatic reimbursement changes in California (assuming the Unilab deal is completed). Nonetheless, independent practice associations (IPAs) that LIR has interviewed have cast a wary eye on the deal. In California, HMOs

currently pay IPAs approximately \$45-\$55 per-member per-month (PMPM) to cover all non-inpatient medical care of members, including all physician office and laboratory services. IPAs are fearful that the Quest-Unilab deal will result in higher prices for lab services, thereby cutting into physicians' share of the reimbursement dollars.

Presented below are highlights of our interviews with four IPA executives and five hospital lab directors:

Scott Liff, executive director of lab services at John Muir/Mount Diablo Health System (JMMDHS—Walnut Creek, CA), says Quest and Unilab are the largest competitors in its market (the East San Francisco Bay area). He believes the merger could bring opportunities



for hospital outreach programs and smaller independent labs because (1) Quest would likely raise prices or drop marginal capitated contracts and physician office clients served by Unilab, and (2) the integration of Unilab into Quest would likely cause some disruption and loss of accounts. JMMDHS, which includes John Muir Medical Center and Mount Diablo Medical Center, performs about five million reportable test results annually, including 60%-70% from outreach testing.

Albert Holloway, chief executive of The IPA Association of America (Oakland, CA), says, "Anytime you get less competition it's natural that higher prices will follow." When we mentioned that many capitated contracts for lab services were priced below cost in California, he replied, "I'd rather have prices go up as a result of the separate decisions of two or three competitors than from the decision of a monopoly." Without the "checks and balances" that competition provides, lab service levels are likely to decline, he adds. The IPA Association of America represents approximately 700 IPAs across the country.

Elizabeth Wagar, MD, laboratory director at UCLA Medical Center Clinical Laboratories in Los Angeles, says UCLA performed approximately 4.1 million billable tests in the year ended April 30, 2002, including about one million from outreach to about 30 physician clinics affiliated with the hospital. Wagar believes the Quest-Unilab merger will have little impact on the market because the two labs already dominate the physician office market in Los Angeles.

Wagar says UCLA plans to expand its outreach services in the areas of anatomic pathology and cytogenetics. Because of low reimbursement levels, however, UCLA has limited its outreach efforts primarily to local physicians affiliated with the hospital,

she says. Despite some improvement, "capitation rates are still not enough to cover costs."

Sam Romeo, MD, president of University Affiliates in Los Angeles, says that in the past there has been only one motivation for consolidation in the healthcare industry—to gain leverage to raise prices.

Generally, hospital outreach programs are not very competitive, Romeo says. He believes the Quest-Unilab combination will make it even more difficult for hospital labs to compete. Quest-Unilab "will have a lab draw station on every other block ... and the ability to underbid smaller competitors."

University Affiliates includes 2,500 physicians in southern California, and Unilab is its largest provider of lab services. Romeo says his IPA contracts with labs using a fee-for-service schedule only, so that testing in physician office labs is not discouraged.

Teresa Bryant, director of laboratory services at St. Joseph's Medical Center (Stockton, CA), says St. Joseph's performed approximately two million billable tests last year, including 70% from outreach. The hospital's outreach program, named HealthCare Clinical Laboratories, has been active since 1982, has capitated contracts with three major IPAs and shares in the MediCal/Medicaid local initiative. Bryant says capitated lab contracts covering commercial HMO members in the Stockton area (about 50 miles south of Sacramento) currently average about \$1.00-\$1.10 PMPM, though she has seen some competitors bid as low as \$0.70 PMPM. Bryant believes Quest's acquisition of Unilab could lead to opportunities for hospital outreach programs to pick up market share. Quest has increasingly been willing, she points out, to direct routine tests from physician offices to local hospitals in exchange for getting their esoteric tests.

Marvin Labrie, chief executive of Physicians Medical Group of Santa Cruz (PMGSC—Santa Cruz, CA), says Unilab is the dominant lab in his market (located about 60 miles south of San Francisco). “The hospitals in this area offer no serious competition.” PMGSC has a capitated lab contract with Unilab that covers approximately 35,000 commercial lives at less than \$1 PMPM. His biggest concern with Quest’s planned acquisition of Unilab is that service levels could decline. “Service from Unilab has always been flexible and responsive.”

Don Sharar, director of laboratory services at Northridge Hospital Medical Center (Northridge, CA), is looking forward to the merger of Quest and Unilab because it will probably result in higher reimbursement. Northridge performs about 800,000 billable tests per year, including 35% from its outreach business which is managed by United West Lab (Santa Ana, CA).

Marc Moser, chief executive of The Torrance Hospital IPA (Torrance, CA), is not

concerned about the merger since his IPA contracts with Long Beach Memorial Hospital (LBMH) for lab services—at a capitated rate of less than \$1 PMPM for commercial members. Moser notes that the South Bay area of Los Angeles is one of the few areas in southern California where Unilab does not have a major presence—LabCorp and LBMH are the dominant providers.

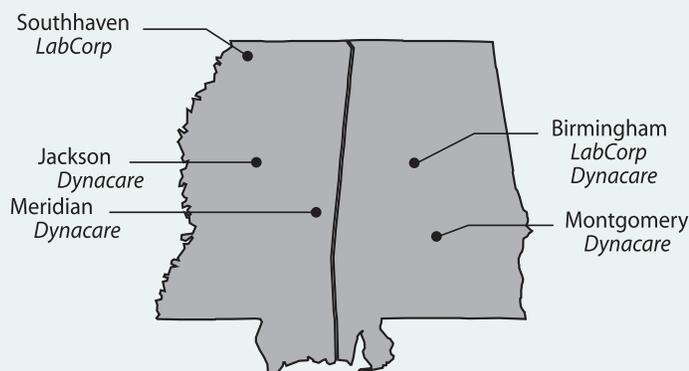
Jeff Turner, managing director of laboratory at San Gabriel Valley Medical Center, says the potential merger of Quest and Unilab would not have a significant effect on his lab, given its limited outreach business. San Gabriel performs a total of 24,000-25,000 billable tests per month, with less than 10% coming from outreach. Turner says Unilab and Quest already have most of the HMO contracts in the Los Angeles area. He does point out, however, that the Quest-Unilab combination would be in a particularly strong position if a competitive bidding system for Medicare lab services were ever put in place. 🏠

LabCorp-Dynacare Would Be Strongest In Alabama/Mississippi

Now that the FTC has asked for more information from Quest Diagnostics regarding its planned acquisition of Unilab, speculation is growing that Laboratory Corp. of America’s recently announced \$685 agreement to purchase Dynacare may get a second look too (*see LIR Alert, May 9*).

In general, the potential LabCorp-Dynacare operations are far less concentrated than those of Quest and Unilab. There are a few areas of the country where the overlap of LabCorp and Dynacare operations may cause concern at the FTC, however. These regions include Texas and Seattle, WA, but the area most likely to come under the most scrutiny is Alabama/Mississippi. LabCorp’s largest lab facility in the nation is located in Birmingham (100,000 square feet), while Dynacare’s largest lab facility is in Montgomery (54,150 square feet) and another is in Birmingham (29,140 square feet). Both companies have significant operations in Mississippi as well. 🏠

LabCorp, Dynacare In Alabama, Mississippi





Pathologists' Malpractice Insurance Costs May Jump

For the most part, malpractice liability insurance has been a minor expense for pathologists, who typically pay less than \$15,000 per year for coverage. That's a far cry, for example, from the \$108,000-\$208,000 per year that ob/gyns in the Miami/south Florida area pay each year, or the \$70,000-\$161,000 paid by general surgeons in Dallas, TX, according to data from Medical Liability Monitor (Chicago, IL).

Pathologists may not be immune, however, from higher malpractice coverage costs, says Joe Plandowski, president of Lakewood Consulting Group (Lake Forest, IL). He believes that as new diagnostic tests are developed that help physicians guide patient drug therapy decisions, liability for pathologists will increase. Plandowski also notes that the recent decision by St. Paul Companies (St. Paul, MN) to exit the malpractice insurance market is also likely to drive up rates for all physicians. St. Paul had been the nation's largest provider of malpractice insurance.

In general, physicians and medical facilities renewing their medical malpractice insurance should expect a rate increase of anywhere from 30%-80% this year, according to Keith Becker, senior vice president at Atlanta-based Marsh USA, which provides insurance to some 8,000 physicians and 2,500 medical groups across the country. He says the catastrophic losses from the Sept. 11 terrorist attacks have pressured insurance companies to review the profitability of all their lines of business. Becker also points to the unrelenting increase in medical malpractice awards and settlements. Median medical liability awards for all plaintiff verdicts, for example, have rocketed from \$362,500 in 1994 to \$1 million in 2000, according to Jury Verdict Research (Horsham, PA). 🏠

Malpractice Fears Driving Up The Cost Of Care, Physicians Say

An overwhelming majority of practicing physicians say that fears of malpractice liability have caused them to order needless tests and make unnecessary referrals, thereby contributing to the rising cost of healthcare, according to a recent survey by Harris Interactive, a market research and consulting firm in Rochester, NY. A total of 300 physicians responded to the poll conducted on behalf of Common Good, a newly formed bipartisan coalition. Key findings:

Do concerns about malpractice liability ever cause you to...?

(n=300 practicing physicians)

	Yes	No
...Order more tests than you would based only on professional judgment of what is medically needed	79%	21%
...Prescribe more medications (such as antibiotics) than you would based only on professional judgment of what is medically needed	41%	59%
...Refer patients to specialists more often than you would based only on professional judgment	74%	26%
...Suggest invasive procedures (such as biopsies) to confirm diagnoses more often than you would based solely on professional judgment	51%	49%

Source: Harris Interactive 🏠



Florida Family Gets First Medical-Data Chip Implants

On May 10, a Florida family—Jeffrey Jacobs, 48, his wife Leslie and their 14-year old son Derek—became the first people to be implanted in the arm with the VeriChip, a microchip that contains a way to access medical record information from remote databases.

When scanned by an external scanner, the implanted chip—slightly larger than a grain of rice—emits a radio frequency signal that transmits an identification number. Medical personnel, using a computer or hand-held device, then feed the ID number into a Web-based database maintained by VeriChip maker Applied Digital Solutions (Palm Beach, FL). The database contains medical information furnished by the patient. The company hopes the tiny chips will eventually be used to replace medical-alert bracelets and cards that alert emergency personnel to conditions such as allergies.

In Leslie Jacobs' case, the scanned chip leads to a warning in her medical information of a heart valve abnormality, while data for Derek warn of allergies to common antibiotics. No hospitals, however, have yet purchased the equipment needed to read the chips.

Applied Digital says it has received guidance from the Food & Drug Administration that the agency does not consider the VeriChip to be a regulated medical device, enabling the company to begin sales and distribution in the U.S. The company expects the sales price to patients to be about \$450 for the complete procedure, with access to the medical database at \$9.95 per month. 🏠

California Medicare To Reimburse For Capsule Endoscopy

For the conditions of coverage, go to www.medicarenhic.com

www.medicarenhic.com

National Heritage Insurance Company, the Medicare Part B carrier for California, has issued a coverage statement for reimbursement of capsule endoscopy for the small intestine. There are approximately 3.4 million Medicare beneficiaries in California, and the coverage decision should be a boon to Given Imaging (Yoqneam, Israel), which makes the only FDA-cleared capsule endoscope.

Capsule diagnostic imaging endoscopy is a new technology which incorporates a digital camera, battery, radio transmitter and light source into a 3cm X 1cm disposable capsule. The capsule is swallowed, then propelled by peristalsis through the upper gastrointestinal (GI) tract. Images sent by the camera are broadcast to a wireless recorder worn on the waist. The recorded data are later downloaded to a computer workstation for video analysis.

The California carrier suggests that physicians use aggregate code 44799 (un-listed procedure, intestine) when submitting claims, indicating total professional and capsule reimbursement of approximately \$1,000. Given Imaging reports that it sold more than 4,200 capsules in this year's first quarter (list price for each disposable capsule: \$450). As of last March 31, the Given System installed base reached more than 380, including 172 systems in the U.S. and 161 systems in Europe. 🏠



First-Quarter Revenue Up 11% To \$2.1B At 15 Lab/Path Companies

Combined revenue at 15 publicly traded laboratory and pathology companies totaled \$2.134 billion in the three months ended last March 31, up 11% from \$1.919 billion in the same period last year. Excluding growth from acquisitions, *LIR* estimates that the underlying growth rate for the combined 15 companies was approximately 6%-7%.

The largest revenue gain was posted by **Dianon** (Stratford, CT), which was helped by its recent acquisition of UroCor. Dianon reported a 66% increase in revenue to \$44.623 million; net income rose to \$5.285 million from \$2.05 million.

LabOne (Lenexa, KS) increased revenue by 41% to \$70.641 million; net income rose to \$2.39 million from \$397,000. Growth was helped by its recent acquisition of Osborn Group.

Laboratory testing revenue at **Myriad Genetics** (Salt Lake City, UT) grew by 48% to \$7.255 million. Overall, including drug research revenue, Myriad reported a net loss of \$3.371 million in the three months ended March 31 vs. a net loss of \$1.228 million in the same period last year; revenue was up 13% to \$13.058 million.

The largest decline in revenue was reported by **Enzo Clinical Laboratories** (ECL), a part of Enzo Biochem (Farmingdale, NY). In the three months ended last Jan. 31, revenue at ECL fell 26% to \$6.355 million. Enzo attributed the decline to the loss of a large capitated contract. This contract with MDNY Healthcare is now being serviced by Sunrise Medical Laboratories (Hauppauge, NY)—see *LIR*, Feb. '02, p. 4. 🏠

Laboratory Company Financials 1Q02 vs. 1Q01 (\$000)

Laboratory Cos.	Revenue			Net Income		
	1Q02	1Q01	% Chg	1Q02	1Q01	% Chg
Bio-Reference Labs ¹	\$23,864	\$19,831	20	\$1,260	\$503	151
Dynacare ²	107,748	95,808	12	4,314	2,089	107
Enzo Clinical Labs ³	6,355	8,635	-26	NA	NA	NA
LabCorp	590,000	525,400	12	65,800	43,500	51
LabOne	70,641	50,045	41	2,390	397	502
Medtox	12,351	11,606	6	485	438	11
Myriad Genetics ⁴	7,255	4,915	48	NA	NA	NA
PharmChem	7,476	9,634	-22	4,326	-700	NA
Psychemedics	3,568	4,064	-12	52	9	467
Quest Diagnostics	946,762	882,553	7	66,689	35,748	87
Specialty Labs	43,614	43,822	0	1,254	3,402	-63
Unilab	103,869	95,308	9	8,660	3,171	173
Total, 12 cos.	1,923,503	1,751,621	10	155,231	88,557	75
Pathology Cos.						
AmeriPath	112,892	98,745	14	12,648	3,241	290
Dianon	44,623	26,803	66	5,285	2,050	158
Impath	52,581	42,136	25	1,449	4,032	-64
Total, 3 cos.	210,096	167,684	25	19,382	9,323	108
Grand total, 15 cos.	2,133,599	1,919,305	11	174,612	97,880	78

¹Results for Bio-Reference Labs are for the three months ended April 30, 2002.

²Dynacare results are reported under Canadian accounting standards (not U.S. GAAP).

³Enzo Clinical Labs is part of Enzo Biochem; results are for the three months ended Jan. 31, 2002.

⁴Results for Myriad Genetics are for the laboratory testing division only.

Source: *LIR* from companies



Lab Stocks Rise 10% In Latest Four Weeks

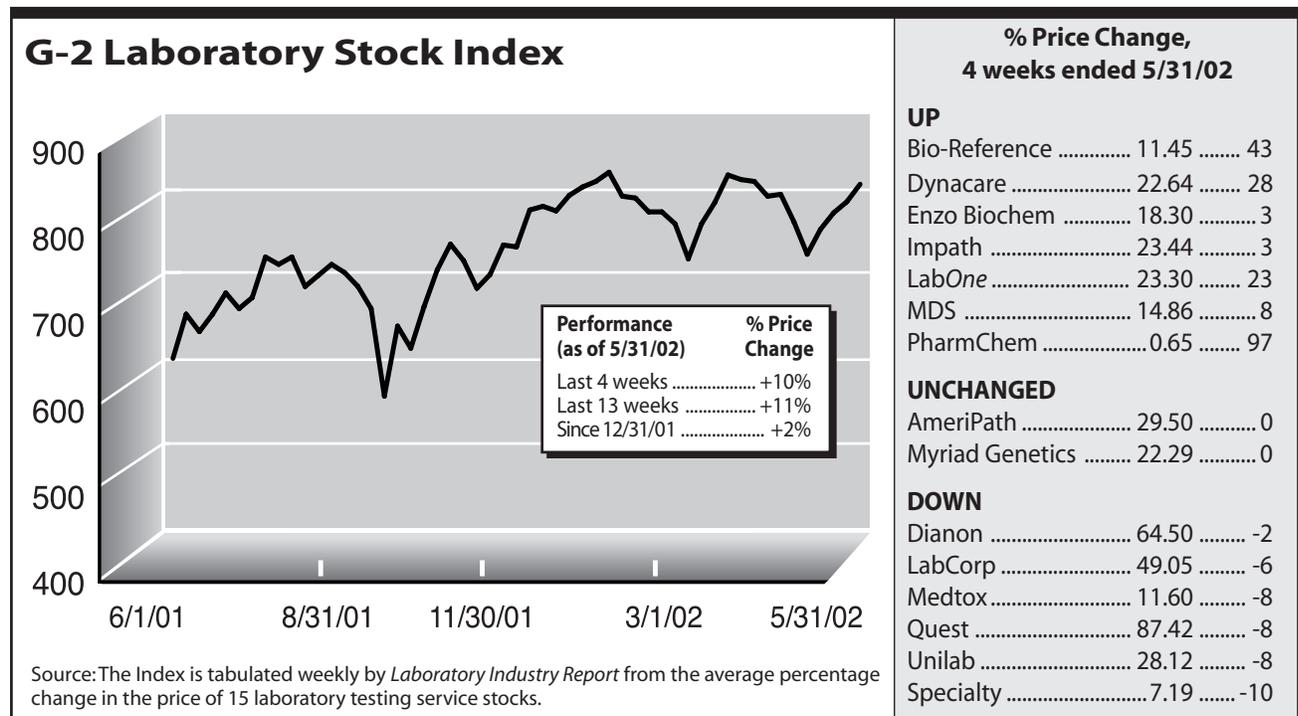
Stock prices for the 15 companies in the G-2 Laboratory Stock Index were up an unweighted average of 10% in the four weeks ended May 31, 2002, with seven stocks moving up in price, two unchanged and six falling. So far this year, lab stocks have climbed 2%, while the S&P 500 is down 7% and the Nasdaq is down 17%.

Bio-Reference Laboratories (Elmwood Park, NJ) jumped 43% to \$11.45 per share for a market capitalization of \$148 million. The company recently reported net income of \$1.26 million for the three months ended April 30, 2002, up from \$502,501 in the same period last year; revenue rose 20% to \$23.864 million.

Dynacare (Dallas, TX and Toronto, Canada) rose 28% to \$22.64 per share for a market cap of \$464 million on news that it is being acquired by Laboratory Corp. of America (*see p. 7*).

Specialty Laboratories (Santa Monica, CA) fell 10% to \$7.19 per share for a market cap of \$160 million. The company recently announced that Milberg Weiss (New York City), a 170-lawyer firm, has filed a lawsuit against Specialty. The lawsuit alleges violations of federal securities laws with regard to Specialty's financial reports and statements, and seeks damages on behalf of Specialty shareholders. In a press release, Specialty said the lawsuit is without merit and it will defend itself vigorously.

Shares of **Quest Diagnostics** and **Unilab** each fell 8% on growing concern by investors that the Federal Trade Commission could seek to block the merger of the two companies based on antitrust issues. 🏠



INDUSTRY buzz

In August 1999, Quest Diagnostics paid \$1.2 billion to acquire SmithKline Beecham Clinical Laboratories (SBCL). The price worked out to approximately 0.75 times the \$1.58 billion of revenue and 46 times the \$26 million of profit that SBCL generated in 1998. At the time, many industry observers, including this publication, questioned the seemingly high price Quest paid. In hindsight, the deal turned out to be a masterstroke for Quest and its chairman Ken Freeman. The integration of SBCL has been completed nearly without a hitch, and Quest's profits have jumped from \$27 million in 1998 to \$162 million in 2001.

It looks like Quest and LabCorp are overpaying for Unilab and Dynacare, but only time will tell

Quest now has made plans (pending FTC clearance) to acquire Unilab at a price tag of \$1.14 billion, or nearly the same amount it paid for SBCL. The price is equal to 2.9 times Unilab's reported revenue of \$390 million in 2001 and 52 times its profit of \$22 million (excluding write-offs).

References in this issue

Applied Digital Solutions
561-805-8000

Dynacare Inc. 416-487-1100

Given Imaging 770-662-0870

Harris Interactive 585-214-7949

LabCorp 336-584-5171

Lakewood Consulting Group
847-295-8805

Marsh USA 404-995-2552

NeoGenomics 941-923-1949

Physicians Medical Group of
Santa Cruz 831-479-6810

Quest Diagnostics 201-393-5000

The IPA Association of America
510-569-6561

Unilab 818-996-7300

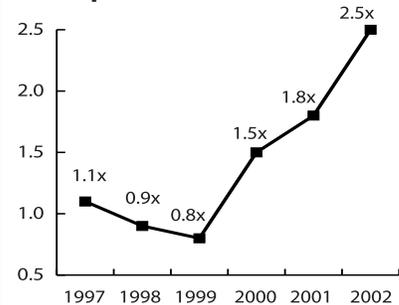
University Affiliates 626-943-1040

Torrance Hospital IPA
310-540-1070

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Quest is not the only one paying steep prices to acquire big labs. LabCorp has agreed to pay \$685 million to purchase Dynacare. That price tag is equal to 2.9 times Dynacare's 2001 revenue of \$238 million and 36 times its net income of \$19 million under U.S. accounting standards. 🏠

Average Multiple* Paid To Acquire Labs



*Purchase price, including assumed debt/annual revenue of acquired lab
Source: LIR based on analysis of 48 transactions between 1997-May 2002

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