Your Independent Source for Business & Financial News

LABORATORY INDUSTRY REPORT®

Dennis W. Weissman, Publisher

Vol. XI, No. 8/August 2002

HIGHLIGHTS

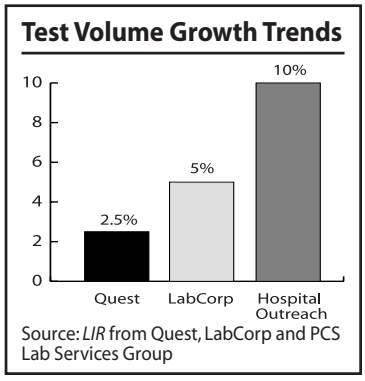
WASHINGTON G-2 REPORTS

Quest, LabCorp To Re-Energize Sales Efforts

Recent reports from Quest Diagnostics (Teterboro, NJ) and Laboratory Corp. of America (Burlington, NC) signal that the nation's lab heavyweights are having trouble keeping up with more nimble regional competitors. According to mid-year financial reports, Quest is currently growing its lab test volume by approximately 2.5% per year (excluding gains from all acquisitions), while LabCorp is growing its test volume by 5%. This compares to 10% annual growth at the average hospital outreach program shown in recent survey data from Park City Solutions (*Laboratory Industry Report, July '02, p. 1*).

"Over the past five years, many hospital outreach programs have been able to create the service-oriented cultures needed to compete against the national labs," says Stan Schofield, president of NorDx Laboratories (Portland, ME), a consolidated lab venture with five member hospitals.

Meanwhile, chief executives at Quest and LabCorp each say they plan to re-energize their physician office sales efforts. For more on how the competition is playing out, see *Inside The Laboratory Industry*, pp. 5-7.



Source: *LIR* from Quest, LabCorp and PCS Lab Services Group

Florida Decision May Have National Implications For Pathologists' Professional Component Charges

Health plan members are not required to pay professional component charges for clinical laboratory tests that pathologists did not personally review, according to a July 12 ruling by the Florida District Court of Appeal, Fifth District (Daytona Beach). The decision relates to a dispute between Central States Southeast & Southwest Inc. (Chicago, IL) vs. the Florida Society of Pathologists, AmeriPath Florida and Ruffolo, Hooper & Associates. If it stands, the ruling could make it more difficult for pathologists to collect on professional component billing that is intended to cover their services for supervising clinical laboratories, says Jeff Howard, consultant at Ray Howard & Associates (Jacksonville, FL). It also could serve as a precedent with implications for pathologists across the country, he points out.

Continued on p. 2

FLORIDA DECISION, *from page 1*

Central States is a nationwide preferred provider organization (PPO) that has about 20,000 members in Florida. Like other PPO plans, its members get two separate bills after they receive hospital-based laboratory services—the first covers tests performed by a hospital lab, the second covers professional component services from pathologists.

The Florida Society of Pathologists says it will ask the state's Supreme Court to review the case

Case Background

In 1995, the U.S. Court of Appeals for the Seventh Circuit, in *Central States vs. Pathology Laboratories of Arkansas P.A.*, found that Central States had no obligation to pay pathologists' bills because its health plan only covered "treatment," not the pathologists' "hands-off" services. Following this decision, Central States sent letters to its Florida plan members informing them that pathologists' charges for professional services were not appropriate and that members had no obligation to pay. The Florida Society of Pathologists sued, alleging that these letters contained false statements, constituted an unfair trade practice and interfered with the pathologists' business relationships with patients. Central States appealed after the pathologists won a favorable ruling from a trial court.

In reversing the trial court, the appeals court agreed with Central States that its plan members had no obligation to pay. "The pathologists have not shown prospective business relations with the members of Central States; the pathologists' claim is that the members owe them for work the pathologists have already performed." Central States' general counsel, Thomas Nyhan, observes: "It appears that the opinion has provided significant protection to the participants in the Central States plan—and to hospital patients in general—with regard to a controversial billing practice."

Strong Reaction

But David Greiner, MD, a board member and past president of the Florida Society of Pathologists says, "We were shocked by the appeals court decision." The Society is now working to get the case heard by the Florida Supreme Court, he adds. "The outcome will have a huge impact of the future of pathology."

Attorney Jack Bierig, with Sidley, Austin, Brown & Wood (Chicago, IL), which is representing the pathologists, tells *LIR* the appeals court was wrong to define pathology professional charges as a form of overhead that does not need to be reimbursed by the patient. Clinical pathology is not limited to direct, hands-on review of particular test results, he says, but involves deciding whether to offer or modify a test, designing protocols for new procedures, teaching physicians how to evaluate test results and being on-call to handle questions from physicians. "We believe that pathologist direction is a medical service that benefits patients….The benefit is accurate, reliable test results."

Daniel Hanson, MD, president of Pathology Laboratories Inc. (Toledo, OH) and a board member of the American Pathology Foundation (Mundelein, IL), tells *LIR* that third-party payers require hospitals to be accredited by the Joint Commission on Accreditation of Healthcare Organizations, and JCAHO requires hospital labs to have a physician director. "Third-party payers demand that physicians serve as lab directors, but some payers don't want to pay for these services. Central States is making an irrational argument."

Howard says hospital-based pathologists typically devote approximately 40% of their time (and as high as 60%) directing the operations of a laboratory. Pathologist supervision is absolutely necessary and deserves to be compensated, he insists. "Pathologists are responsible for the quality of every lab test performed in a hospital lab." Bierig agrees: "You can be sure that if a lab test is done wrong or is reported inaccurately, the patient is going to say the pathologist is responsible and sue for malpractice."

Bierig believes the appeals court decision, if it stands, could have a negative influence on healthcare quality. "If pathologists don't have a good way of getting paid, they may no longer want to take on the responsibilities of directing labs."

HMO Rates To Skyrocket Next Year, Says Hewitt

HMO premium rates are set to jump more than 20% in 2003, continuing a trend of double-digit healthcare cost increases and forcing employers to share more of the costs with employees, according to employer survey data from Hewitt Associates (Lincolnshire, IL). *LIR* notes that despite the huge jump in premiums, the nation's largest lab companies—Quest Diagnostics and LabCorp—each say their average revenue per requisition is rising at less than 5% annually.

The Hewitt survey, based on data from 140 employers with more than one million employees, shows that, for 2003, HMO rates are set to go up an average 22% vs. 15.3% in 2002. "We are seeing unprecedented HMO increases for 2003. With no clear solutions on the horizon, we expect it'll get worse before it gets better," says Mindy Kairey, e-business leader for Hewitt's Health Management Practice.

"The days of health plans buying market share are over. These data show that HMOs are standing strong in negotiations, regardless of the size of the contract," Kairey notes. "If this continues, it will accelerate the movement to self-funded national HMOs [and] increase the interest in consumer-driven health plans."

IRS Action Could Boost Direct-To-Consumer Lab Testing

The Internal Revenue Service on June 26 established a new employer-funded health reimbursement arrangement (HRA) that eliminates some of the drawbacks of health flexible spending accounts (FSAs) and is likely to encourage the fledgling trend toward consumer-driven healthcare. Under an HRA program, an employer gives an employee and dependents a fixed amount—say $2,000-$3,000 per year—to spend on health expenses. Employees may carry over unspent amounts in their health account from year-to-year and to keep the money if they change jobs or retire, as opposed to the "use it or lose it" rules that apply to FSAs. The HRA money also is non-taxable to the employee.

These new tax rules, combined with skyrocketing health insurance premiums (*see above story*), could encourage more employers to take the leap into employee-directed health plans, resulting in greater demand for direct-to-consumer lab testing.

Specialty Labs Resolves CLIA Compliance Issues

Specialty Laboratories (Santa Monica, CA) announced July 17 that the Centers for Medicare & Medicaid Services has found it to be in compliance, as of June 19, with all condition-level requirements established under CLIA (Clinical Laboratory Improvement Amendments). As a result, Specialty's CLIA certificate has been restored, along with its right to bill Medicare and Medicaid directly. The CMS finding follows clearance by the California Department of Health Services (CDHS) which, in follow-up surveys of the national reference lab on July 1-2, determined that Specialty had corrected long-standing deficiencies in complying with state laws governing lab personnel licensure and supervision.

Specialty In Brief *($000)*

	2Q02	2Q01	% Chg
Revenue	$34,146	$45,157	-24%
Pretax income	-12,402	5,502	NA
Net income	-7,400	3,246	NA
Cash & securities	71,759	75,687	-5%
Long-term debt	3,490	2,739	27%
Accession volume	740,000	791,000	-6%
Revenue per accession	50.11	57.07	-14%

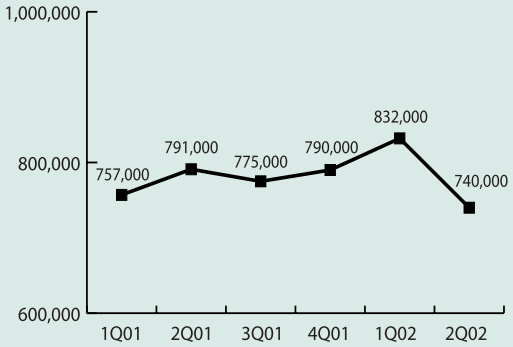
Source: Specialty Laboratories

To wrap up matters quickly with CMS, Specialty agreed to rescind its appeal filed April 17 against revocation of its CLIA certificate, to forego seeking $2.3 million in Medicare/Medicaid reimbursement suspended since Feb. 22, and to pay a fine of $351,000 for the days it was out of compliance. Specialty also must pay an undisclosed fine to California and undergo three years of on-site monitoring by the state.

The monetary penalties levied against Specialty are insignificant relative to the damage it has sustained from lost business from skittish customers. For example, in the three months ended June 30, 2002, Specialty reports that its revenue plummeted to $34.1 million, down 24% from $45.2 million in the same period a year earlier; net loss for the second quarter was $7.4 million vs. a net gain of $3.2 million. Contributing to the revenue decline: a 6% drop in accession volume, a 14% decline in pricing and the loss of $2.3 million in Medicare/Medicaid testing for which it could not bill while under CLIA sanctions.

Specialty stated in a press release that it expects accession volume to stop declining and resume growing at some point in the third quarter. Based on the declining accession rate through June, the company estimates total accessions will fall to below 690,000 in the third quarter—a drop of about 11% from the same period last year.

Specialty's Accession Volume



Source: Specialty Laboratories

Douglas Harrington, MD, chief executive of Specialty, told *LIR*, "We have been through the wringer and a lot of companies would have come out with a sense of defeat, but the mood here is very positive. We were just waiting to get through the regulatory issues to go into full-tilt mode for sales. This is not a defeated company."

Asked if Specialty is up for sale, he replied: "Our board of directors has a responsibility to consider any reasonable offer. Despite considerable industry consolidation, our focus as a company is execution, not the auction block."

Largest National Labs Shift Strategy Toward Higher-Volume Growth

Hospital consolidation is creating economies of scale that make lab outreach programs increasingly competitive, says industry consultant Barry Portugal

"I'm not happy with the progress we are making in driving volume growth," said Ken Freeman, chairman and CEO of Quest Diagnostics, during a July 23 conference call to discuss the company's second-quarter earnings. In the three months ended June 30, 2002, Quest reported that its test volume grew by 12% compared to the prior year. But after subtracting the volume added from its recent acquisitions—American Medical Laboratories (AML-Chantilly, VA), Clinical Diagnostic Services Inc. (Englewood, NJ) and a lab in Puerto Rico—the company's underlying growth rate was approximately 2.5%, well short of Quest's stated goal of long-term test volume growth of 4%-5% annually.

Laboratory Corp. of America too has come up short on its goal for test volume growth. In the second quarter, the company reported overall volume growth of 7%. But after accounting for volume added from recent acquisitions, LabCorp's underlying volume growth rate was 5%, or approximately 1%-2% below the company's goal. "Some smaller labs have really hurt us in certain regions of the country," noted Tom Mac Mahon, chairman and CEO, during a July 25 conference call.

Indeed, hospital outreach programs and small independent lab competitors seem to be taking a bite out of the growth rates at both Quest and LabCorp.

Sandra Sullivan, president of the consulting firm, Laboratory Strategy and Sales (Winnetka, IL), tells *LIR* she has seen an increase over the past 2-3 years in the number of hospitals seeking to revitalize their laboratory outreach programs. "More frequently than in prior years, hospitals are approaching outreach as a specific business opportunity, rather than an appendage to their inpatient lab operations."

One of the biggest advantages hospital laboratories have, according to Sullivan, is the ability to provide physician clients with a complete patient lab record that includes inpatient, outpatient and outreach lab test results.

Stan Schofield, president of the consolidated hospital lab venture, NorDx Laboratories (Portland, ME), says his lab is experiencing outreach volume growth of 8%-12% per year. "The national labs are facing tougher competition. The number of competitors is not increasing, but those of us with existing outreach programs have gotten smarter and more experienced." NorDx now employs three salespeople vs. only one five years ago. Overall, NorDx employs 340 FTEs and performs 2.2 million billable tests per year.

Barry Portugal, president of Health Care Development Services (Northbrook, IL), believes multi-hospital systems that have developed integrated outreach programs are generally more successful than those run by single hospitals. The advantage the larger hospital systems have, he says, is a built-in customer base of affiliated or owned physician practices. As hospital consolidation continues, more and more services will be brought in-house, he predicts.

Ken Geromini, executive director of Life Laboratories (Springfield, MA), says his lab is growing by some 4% per year and most of that is coming at the expense of Quest Diagnostics. "We are finally matching the service levels [it] provides." He cites improvements in marketing, customer service and customized client reports. Life Laboratories markets its clinical lab services, he notes, in conjunction with anatomic pathology services offered by the hospital pathology group. Life Labs is an independent for-profit lab owned by the Sisters of Providence Healthcare System (Springfield, MA), has 200 FTEs and performs 2.5 million billable tests per year.

"Healthcare is like politics. It works best when done locally," says Roy Trucks

"The national labs have lost some of their focus on the physician office market. They have been preoccupied with acquisitions and genetic testing," observes Joe Plandowski, president of Lakewood Consulting Group (Lake Forest, IL).

Roy Trucks, chief executive of Doctors Laboratory (Valdosta, GA), expects his lab to grow by approximately 10% this year from revenue of $26 million in 2001. Doctors Laboratory, a privately held independent lab, is seeing strong growth, he says, from its expansion into Florida. He also notes that managed care companies have moved away from exclusive contracts with the national labs, opening new opportunities for regional labs.

Though many hospital outreach programs and smaller independent labs have outpaced the national labs in recent years, there's no time for celebration. Executives at both Quest and LabCorp have indicated they want to accelerate their internal growth rate. Competitors will undoubtedly feel this shift in focus in the marketplace.

Remember, Quest has annual revenue of some $4.3 billion and employs 1,000 salespeople; LabCorp has annual revenue of more than 2.5 billion (including Dynacare) and employs some 600 salespeople.

The apparent increased emphasis on volume growth, *LIR* speculates, could mean that Quest and LabCorp may become a little more aggressive in their pricing for managed care contracts—though both companies stress that they remain committed to pricing discipline.

For the latest news on the lab industry's two giants, read on:

QUEST DIAGNOSTICS is "retooling and reorienting" its salesforce to accelerate volume growth in the second half of this year and in 2003, according to Freeman. Among the changes will be a greater effort to bring more cytology work in-house. Quest currently collects approximately 12 million Pap samples per year. Most are tested at its own facilities, but capacity constraints have led to outsourcing some to local labs. Quest says the acquisition of AML has added cytology capacity that it will utilize.

During Quest's recent conference call, Freeman also noted:

- ❑ The company has converted about 74% of its Pap test volume to thin-layer methods. He anticipates this conversion rate could go much higher, given that in some regions of the country Quest has already converted up to 90%.
- ❑ Oncology represents a "very significant growth opportunity." Quest now employs about 200 pathologists and is seeking to hire additional pathologists in various subspecialties. In total, Quest generates about $400 million in annual

revenue from anatomic pathology.

- A new sales group has been created to market esoteric testing to hospital clients. Vicki DiFrancesco, a former sales manager at AML, has been named vice president for sales and marketing for the new group. In addition, Freeman said AML's esoteric testing lab in Chantilly, VA will be renamed "Nichols Institute East."
- Quest has an initiative to introduce hair testing for drugs of abuse to its workplace drug testing clients. Quest gained access to this expertise through the acquisition of AML.
- Quest's hospital joint ventures are performing well, with growth rates that exceed the company's overall business. Key joint ventures include Sonora Quest (Tempe, AZ), CompuNet Clinical Labs (Dayton, OH) and Mid America Clinical Laboratories (Indianapolis, IN).

Despite slow test volume growth, Quest continues to report strong profits. For the six months ended June 30, 2002, it posted net income of $153.8 million, up dramatically from $61.2 million in the same period a year earlier; revenue was up 11% to $2.016 billion. In addition to acquisitions, Quest's revenue was bolstered by increases of 2%-3% in revenue per requisition.

Despite sluggish growth in test volume, Quest and LabCorp continue to report high profits

In regard to Quest's planned acquisition of Unilab (Tarzana, CA), Freeman says he anticipates the transaction will close in the third quarter (*see p. 12 for details*).

LABCORP has been disappointed with growth in certain regions of the country where it is encountering strong competition from local labs, according to Mac Mahon. "We plan to more effectively compete with smaller labs….We will strengthen ourselves in those regions of the country, but we will not get into competitive pricing wars."

During LabCorp's recent conference call, Mac Mahon pointed out that the recent acquisition of Dynacare would expand LabCorp's reach in several high-growth regions, including the South, Southwest and Pacific Northwest. Ultimately, he expects LabCorp to achieve as much as $45 million in annual cost savings from the acquisition.

Mac Mahon also highlighted the following:

- LabCorp recently signed an expanded agreement with Aetna (Hartford, CT) that covers Aetna members in Connecticut, New York and New Jersey.
- LabCorp's gene-based testing business is growing by 24% annually. Human papillomavirus (HPV) testing has doubled over the past year, while Cystic Fibrosis (CF) testing has increased sixfold. LabCorp now performs approximately 7,500 CF tests per month
- Other sources of future growth include a new national contract with Premier Inc. (San Diego, CA), a group purchasing organization representing 1,600 hospitals. Under the contract, which became effective immediately, LabCorp joins Quest and ARUP Laboratories (Salt Lake City, UT) as a preferred provider of esoteric testing to Premier hospitals.

Meanwhile, LabCorp continues to report strong profits. For the six months ended June 30, 2002, it recorded net income of $144.3 million, up 51% from $95.6 million in the same period a year earlier; revenue was up 12% to $1.202 billion. In addition to acquisitions, LabCorp's revenue was bolstered by a 4%-5% increase in revenue per requisition.

How Much Is Your Lab Paying For ThinPrep?

Since gaining approval from the Food & Drug Administration in 1996 to market its ThinPrep liquid-based Pap test, Cytyc Corp. (Boxborough, MA) has aggressively promoted the new technology and played a key role in helping the lab industry secure favorable reimbursement for it. Today, more than 50% of the 55 million Pap tests done annually in the U.S. use Cytyc's ThinPrep method at an average reimbursement of better than $20 per test.

The company has implemented regular pricing increases, however, sparking criticism from many lab customers. Cytyc charges a list price of $11.25 per ThinPrep kit, with an estimated average selling price of somewhere between $7-$9 per kit. A recent survey by investment firm UBS Warburg LLC (New York City) shows that some lab customers pay more than $10 per kit, while others pay below $5.

Conversion Assessment

Labs are currently using:

Conventional Pap	41%
Cytyc ThinPrep	49%
TriPath SurePath/Prep	10%

n=278

Source: UBS Warburg

The survey findings, based on some 278 responses from small and regional labs nationwide, indicate that on average, 49% had switched to ThinPrep, 41% still used the conventional Pap test and 10% used TriPath's SurePath/Prep kits.

Sixteen percent of the labs paid more than $10 for each ThinPrep kit, while 6% said they paid less than $5. The highest percentage of labs (46%) said they paid $9-$10. The overall weighted average price for small and regional labs is $7.41 per kit, according to the survey.

ThinPrep Price Assessment

Labs receiving a ThinPrep price of:

More than $10	16%
$9-$10	46%
$7-$8	26%
$5-$6	6%
less than $5	6%

n=197

Source: UBS Warburg

Jeffrey Keene, spokesman for Cytyc, says the company does not reveal the average selling price for its ThinPrep test, but higher-volume labs can get discounts. In addition, he notes, the company is reducing some of its regular end-of-quarter promotional activities—a move intended to trim inventory buildup and firm up pricing.

ThinPrep Conversion Rate

Labs indicating that ThinPrep conversion was…

Accelerating	52%
Decelerating	4%
Constant	33%
Not applicable	11%

n=278

Source: UBS Warburg

In response to grumblings from labs that say Cytyc charges too much, Patrick Sullivan, chairman and CEO, tells *LIR* the company's lobbying efforts were instrumental in raising Medicare reimbursement for Pap testing from $7.15 (prior to Jan. 1, 2000) for traditional tests to $28 per test for thin-layer methods (effective April 1, 2001). "Historically, labs had lost $2-$3 for every traditional Pap test they did. Today, they can earn $5-$10 per ThinPrep test," he says.

FDA Clears Matritech's BladderChek Point-Of-Care Test

Matritech Inc. (Newton, MA) has received clearance from the Food & Drug Administration to market its NMP22 BladderChek urine test for monitoring patients with a history of bladder cancer.

Stephen Chubb, chairman and CEO of Matritech, tells *LIR* the test has achieved CLIA-waived status and will be marketed to urologists for office-based testing in conjunction with cystoscopy. The price per test kit will be approximately $20. The test is reimbursed by Medicare under CPT code 86294 (national limit=$27.11 per test), according to Chubb.

BladderChek looks and works much like a home pregnancy test. Using technology licensed from the Massachusetts Institute of Technology (Cambridge), the test detects levels of the nuclear matrix protein, NMP22, in urine. NMP22 is elevated in bladder cancer cells 20- to 80-fold and is released in the urine of bladder cancer patients.

Clinical trial results involving 668 patients showed that NMP22 BladderChek detected four times more early-stage bladder tumors and 2.5 times as many life-threatening, high-grade tumors as cytology, according to Chubb. He says the company will submit additional clinical data to get the test cleared for use in screening patients at risk for bladder cancer.

Estimated New U.S. Cancer Cases, Deaths: 2002

	New Cases	*Deaths*
1. Lung	169,400	154,900
2. Colon	107,300	48,100
3. Breast	205,000	40,000
4. Prostate	189,000	30,200
5. Pancreas	30,300	29,700
6. Lymphoma	60,900	25,800
7. Leukemia	30,800	21,700
8. Liver	16,600	14,100
9. Ovary	23,300	13,900
10. Brain & nervous system	17,000	13,100
11. Bladder	56,500	12,600
12. Esophagus	13,100	12,600

Source: American Cancer Society

Bladder cancer is one of the most common cancers, with 56,500 new cases and 12,600 deaths in the U.S. expected this year, according to data from the American Cancer Society (ACS). If diagnosed at its early/localized stage, the five-year survival rate is 94%, according to ACS.

Chubb says Matritech's BladderChek point-of-care format can be applied to other cancers such as breast and prostate. The company is conducting clinical trials for laboratory-based tests for these cancer types.

Abbott To Distribute Cholestech's A1c Test

Cholestech Corp. (Hayward, CA) has signed an agreement with Abbott Laboratories (Abbott Park, IL) for global distribution of its Cholestech GDX System, a CLIA-waived test system for determining levels of glycated hemoglobin (A1c). A1c testing provides an average glucose level over the previous 90 days and can be used to indicate the long-term progress of a patient's diabetes and therapy management. The American Diabetes Association recommends A1c testing four times a year for all diabetes patients.

Bush Proposes Caps On Medical Malpractice Awards

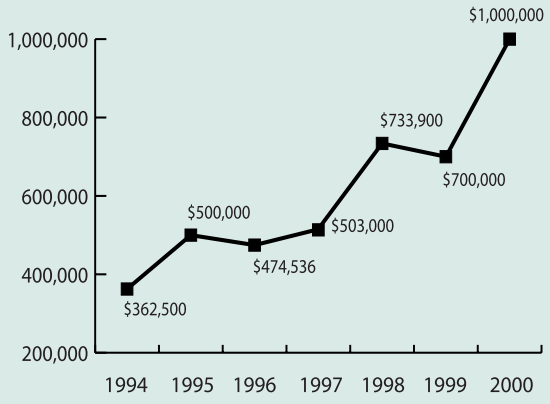
President George W. Bush has proposed a limit of $250,000 in damage awards for medical malpractice lawsuits, contending frivolous suits are driving up healthcare costs. "It is estimated that frivolous lawsuits drive up the cost of government health programs by over $25 billion every year. It's a national problem that requires a national solution," Bush said in a speech at High Point Regional Hospital (Greensboro, NC) on July 25.

In the past, malpractice insurance has been a fairly insignificant expense item for most pathologists and laboratory facilities. But the exit of several large insurance companies from the malpractice market, including St. Paul Companies (St. Paul, MN), has driven up rates and even made getting any coverage at all difficult for some labs (*LIR, July '02, p. 12; June '02, p. 8*).

Bush's proposed cap would apply to "non-economic damages"—most of which are for "pain and suffering." He would still allow injured patients to receive unlimited economic damages to compensate for loss of past and future earnings and to pay for medical and domestic services.

In a study released to coincide with Bush's speech, the U.S. Department of Health & Human Services said malpractice awards dramatically raise health costs by prompting doctors to practice "defensive medicine"—ordering unnecessary tests and treatments to ward off lawsuits—and by forcing insurance companies to boost malpractice premiums. Median medical liability awards for all plaintiff verdicts have risen from $362,500 in 1994 to $1 million in 2000, according to Jury Verdict Research (Horsham, PA).

Median Medical Liability Awards



Source: Jury Verdict Research

The American Medical Association (AMA-Washington, DC), which represents nearly 300,000 doctors, has come out in support of the President's proposal. "The United States has created a litigation lottery, where select patients receive astronomical awards and others pay higher costs for healthcare and suffer access problems because of it," stated Donald J. Palmisano, MD, president-elect of AMA, in a press release.

In an unlikely alliance, the American Association of Health Plans (AAHP-Washington, DC), which represents more than 1,000 HMOs, PPOs and other health plans, has also come out in favor of malpractice caps. "In many states, the crisis is so acute that many specialists—including obstetricians—are moving elsewhere, because they simply can't afford to pay six-figure malpractice insurance premiums. Many of these doctors face a painful choice: relocation or retirement," according to Karen Ignani, president of AAHP.

Political analysts say malpractice reform is unlikely to pass before the Nov. 5 elections because lawmakers are caught up in other major legislation, notably reform of corporate governance and creation of a homeland security department.

Lab Stocks Tumble 23% In Latest Four Weeks

Share prices for the 15 companies in the G-2 Laboratory Stock Index dropped an unweighted average of 23% in the four weeks ended July 29, 2002, with fourteen stocks falling in price and only one rising. So far this year, lab stocks have fallen 25%, while the S&P 500 is down 21% and the Nasdaq is down 31%.

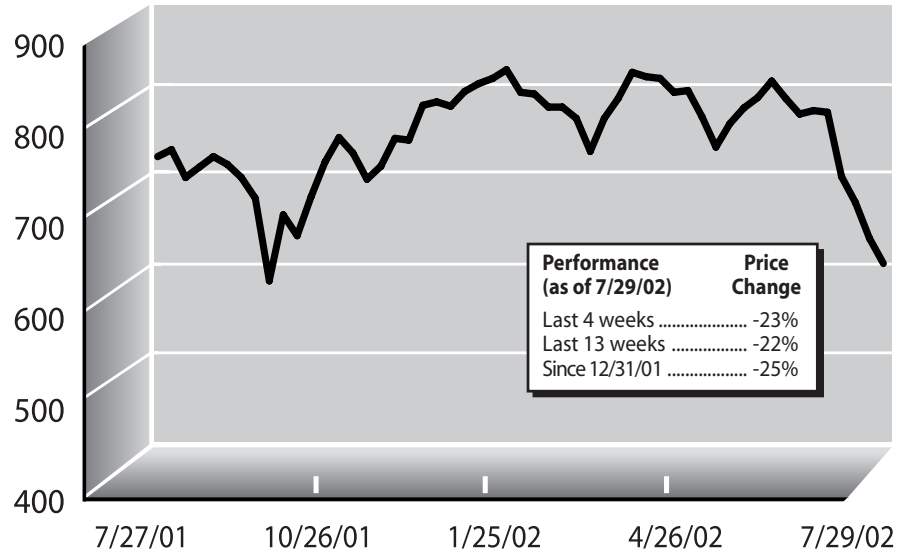
Quest Diagnostics (Teterboro, NJ) fell 34% to $56.75 per share, reducing Quest's market capitalization from $8.6 billion to $5.7 billion. The decline appears to have been triggered by investors' concern over the company's slow test volume growth (*see p. 5*). Worries that Quest's planned acquisition of Unilab (Tarzana, CA) could be blocked by the Federal Trade Commission may also have contributed to the decline (*see p. 12*).

Shares of **Laboratory Corp. of America** (Burlington, NC) were also hit hard by worries over test volume growth. LabCorp fell 32% to $30.98 per share; its market cap was reduced from $6.5 billion to $4.4 billion.

Pathology stocks continued to get hammered on news of payment revisions, proposed by the Centers for Medicare & Medicaid Services, that would lower Medicare reimbursement for many high-volume pathology codes. **AmeriPath** (Riviera Beach, FL) fell 37% to $15.10 per share; **Dianon** (Stratford, CT) fell 34% to $35.45 per share; and **Impath** (New York City) dropped 27% to $13.13 per share.

Myriad Genetics (Salt Lake City, UT) was the sole stock in the G-2 Index that rose in the past four weeks. It was up 7% to $21.68 per share for a market cap of approximately $520 million.

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 7/29/02

	Price ($)	% Chg
UP		
Myriad	21.68	+7
DOWN		
AmeriPath	15.10	-37
Bio-Reference	6.26	-34
Dianon	35.45	-34
Dynacare	18.00	-18
Enzo Biochem	13.33	-7
Impath	13.13	-27
Lab*One*	20.84	-20
LabCorp	30.98	-32
MDS	13.53	-16
Medtox	8.00	-22
PharmChem	0.66	-23
Quest	56.75	-34
Specialty	7.40	-12
Unilab	17.71	-35

INDUSTRY buzz

What's up with the planned Quest Diagnostics/Unilab merger? Quest spokesman Gary Samuels would only tell *LIR* that Quest (1) continues to work with the Federal Trade Commission to address its questions, (2) does not believe the merger would violate antitrust law, and (3) believes the deal will close in the third quarter of this year. When Quest first announced the deal in March, the company had thought the transaction would close by June 30.

Samuels offered no comment on speculation that the FTC may be concerned about how the merger would affect competition in the northern California lab market.

During a recent conference call, Unilab's chief executive Robert Whalen, also refused to answer analysts' questions about potential FTC concerns. He did, however, go out of his way to stress his opinion that there is plenty of competition in the northern California lab market. Whalen cited Sutter Health System (Sacramento), Catholic Healthcare West (San Francisco) and John Muir/Mount Diablo Health System (Walnut Creek) as having significant lab outreach programs. In addition, he said there are very few barriers to market entry and any number of other hospitals in northern California could decide to launch similar outreach programs.

Investors appear to have some doubt that the transaction will be completed. Unilab stock closed at $18.75 per share on Aug. 1. If investors had full confidence that the deal would close, Unilab stock would be trading at $19.67 to $21.72 per share, based on terms of the transaction and Quest's current share price.

References in this issue

Cytyc Corp. 978-263-8000

Doctors Laboratory 912-244-4468

Health Care Development Services 847-498-1122

Hewitt Associates 847-295-5000

LabCorp 336-584-5171

Laboratory Strategy and Sales 847-441-7870

Lakewood Consulting Group 847-295-8805

Life Laboratories 413-748-9515

Matritech 617-928-0820

NorDx 207-885-7800

Ray Howard & Associates 904-268-0787

Quest Diagnostics 201-393-5000

Specialty Laboratories 310-828-6543

Unilab 818-996-7300

Laboratory Industry Report (ISSN 1060-5118) is published by Washington G-2 Reports, 1111 14th St NW, Ste 500, Washington, DC 20005-5663. Tel: 202-789-1034. Fax: 202-289-4062. Order line: 212-629-3679. Website: www.g2reports.com

Publisher: Dennis W. Weissman. Editor: D.J. Curren. Managing Editor: Jondavid Klipp, *labreporter@aol.com*