

LABORATORY INDUSTRY REPORT®

Dennis W. Weissman, Publisher

Vol. XIII, No. 4/April 2004

HIGHLIGHTS

TOP OF THE NEWS

- Florida Medicaid to award lab contract 1
- Genzyme to buy Impath 1-2

LAB NETWORKS/PARTNERSHIPS

- LabCorp buys two MDS labs 3
- LabOne acquires drug testing firm 3

NEW LAB COMPANIES

- New labs formed in Texas and Georgia 4

INSIDE THE LAB INDUSTRY

- The inside story on the Florida Medicaid lab contract 5-8
- Medicare competitive bidding update 8

REGULATORY/LEGAL

- Quest pays \$11M to settle fraud charges 9

FINANCIAL

- Some expert opinion on billing 10
- Quest vs. LabCorp: Long-term stock performance 11

INDUSTRY BUZZ

- An update of the Ford RFP 12



Florida Medicaid To Award Statewide Lab Contract

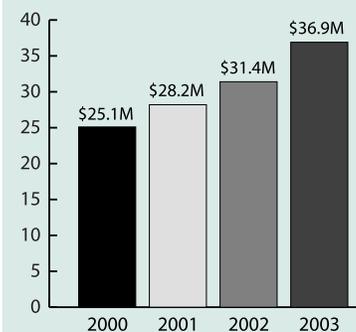
The Centers for Medicare & Medicaid Services (CMS) have considered competitive bidding for laboratory testing services as a method to cut health spending for at least the past 10 years. But it looks like the Florida Medicaid program could become the first government entity to actually get a competitive bidding program off the ground.

On March 2, Florida issued a request for proposal (RFP) inviting independent labs to bid on a contract to provide all lab testing services—including clinical, anatomic pathology, and Pap testing—to Medicaid recipients across the entire state. And Florida’s Bureau of Medicaid Services could award a three-year contract to a single lab as soon as mid-April.

The move comes as Florida, like many other states, struggles to balance its budget in the face of ballooning Medicaid costs. In the fiscal year ended June 30, 2003, Florida’s Medicaid program spent \$36.9 million on lab services provided by independent labs, up 18% from \$31.4 million the previous year.

A lot of lab money is at stake in Florida. But perhaps even more important is the ripple effect that initiation of this contract could have on other states struggling to balance their budgets. Florida Medicaid could potentially serve as a template for other state programs, or even the federal Medicare program, observes *LIR*. See *Inside the Laboratory Industry* for more details, pp. 5-8. 🏠

Florida Medicaid Spending on Independent Lab Services



Source: Florida Bureau of Medicaid Services

Genzyme To Buy Impath For \$215 Million

Genzyme Corp. (Cambridge, MA) has been named the lead bidder to purchase the cancer testing business of Impath Inc. (New York City) for \$215 million in cash. Impath filed for Chapter 11 bankruptcy protection last September. Although there is still time for a competing bidder to step into the mix, *LIR* believes this is unlikely. The deal is expected to close by June 30, and will make Genzyme third-largest esoteric testing lab in the nation.



A top priority at Genzyme will be to stem the outflow of key salespeople and pathologists at Impath, notes LIR.

■ **GENZYME TO BUY IMPATH**, *from page 1*

The purchase of Impath plus another recent deal to buy Alfigen Inc. (Pasadena, CA) will make Genzyme Genetics the third-largest esoteric testing lab company in the country after Quest Diagnostics and LabCorp. Impath sold its Tamtron software business to Impact Medical Systems (Mountain View, CA) for \$22 million in December. In addition, the deal with Genzyme does not include Impath's Gene Bank tissue repository or clinical trials businesses, which Impath is still trying to sell.

Genzyme's acquisitions of Impath's cancer testing business and Alfigen will more than double its annual revenue to an estimated \$246 million; its number of employees will increase from 700 to about 1,500; and it will add major testing facilities in New York City, Phoenix, Los Angeles, and Pasadena (see table below). These acquisitions could also give Genzyme the size and geographic coverage needed to begin competing for some of the nation's largest group purchasing organizations, such as Novation or Premier, observes LIR.

Of course, these acquisitions don't come without risks, particularly in the case of Impath. Based on monthly financial operating statements filed with the U.S. Bankruptcy Court for the Southern District of New York, LIR estimates that Impath's cancer testing business generated an estimated \$125 million in revenue last year, so at \$215 million, Genzyme is paying a little less than two times annual revenue. But Impath's testing business appears to be deteriorating fast, largely because of a mass exodus of key employees that have taken client relationships with them to competing labs. In fact, LIR estimates that at least 100 employees have resigned since the company filed for bankruptcy protection last fall.

But Dan Quinn, a spokesman for Genzyme, says, "We've been very careful and diligent in our evaluation of Impath. We think it's a very valuable business." He says that Genzyme plans to continue operating Impath's three large lab facilities in New York City (80,000 sq. ft.), Los Angeles (68,800 sq. ft.), and Phoenix (11,171 sq. ft.). In addition, Quinn says Genzyme plans to hire substantially all of the 700 employees currently working at Impath's cancer testing business.

In a separate deal, Genzyme recently completed the acquisition of Alfigen, a privately held lab with an estimated \$20 million in annual revenue. Genzyme plans to keep Alfigen's main laboratory in Pasadena open and will hire most of Alfigen's 100 employees, but chief executive Ahmed Alfi will leave after a transition period.

Alfigen specializes in fetal health tests and preimplantation genetic diagnosis of embryos to improve the success rate of in vitro fertilization. Genzyme did not disclose the purchase price of the acquisition. 🏠

The New Genzyme Genetics

	Genzyme Genetics	Impath*	Alfigen*	Combined
Annual revenue	\$101M	\$125M	\$20M	\$246M
Employees	700	700	100	1,500
Major lab facilities	5	3	1	9
Lab locations	Westborough, MA Santa Fe, NM Yonkers, NY Orange, CA Tampa, FL	Los Angeles Phoenix	NYC	Pasadena, CA

*revenue is estimated for Impath and Alfigen

Source: LIR

MDS Sells New York, Georgia Labs To LabCorp

MDS generated a total of about \$100 million in revenue from its U.S. lab operations last year, including an estimated \$40-\$50 million from its New York and Georgia labs.

MDS Inc. (Toronto) has sold its MDS Hudson Valley Labs (Poughkeepsie, NY) and MDS Laboratories Georgia (Snellville, GA) to LabCorp (Burlington, NC) for an undisclosed sum. LabCorp has not disclosed whether it will keep the acquired labs open or consolidate them into existing facilities.

MDS Hudson Valley Labs operates a 30,000 sq. ft. lab that is located about 60 miles north of New York City and has 380 employees. It was originally formed in 1988 as a joint venture between three local hospitals and MDS for the purpose of providing lab management services to the hospitals and building an outreach business. In 2001, the hospitals sold their equity stake in the joint venture to MDS, which then operated the venture as an independent lab. The acquisition puts LabCorp in the heart of a new geographic market that is currently dominated by Quest.

MDS Laboratories Georgia operates a 16,000 sq. ft. lab in suburban Atlanta and has 155 employees. It was originally formed in 1997 as a joint venture between MDS and the hospital management company, HCA (Nashville, TN). But the joint venture was subsequently dissolved and MDS had been operating it as an independent lab.

Cam Crawford, president of MDS Diagnostic Services, says the sale to LabCorp will not affect MDS's joint venture operations at Memphis Pathology Labs and Integrated Regional Laboratories (Fort Lauderdale, FL) or its lab management relationship with Duke University Health System Clinical Laboratories (Durham, NC). But he says that MDS is not seeking to establish any new joint venture labs in the United States. 🏠

LabOne Completes Acquisition Of Northwest Toxicology

LabOne (Lenexa, KS) has completed the purchase of the assets of the drug testing division, Northwest Toxicology, from NWT Inc. (Salt Lake City) for \$10 million plus potential performance bonuses. Northwest Toxicology is a SAMHSA-certified lab with about \$11 million to \$12 million in annual revenue primarily from testing for drugs of abuse. LabOne says that it plans to maintain the Northwest Toxicology lab in Salt Lake City, but 35 of the total 95 employees are being laid off.

FDA Cracking Down on Hair Testers

LabOne says that Northwest Toxicology will suspend hair testing for drugs of abuse on March 31, 2004, due to recent FDA guidance. In December, the FDA issued letters to four companies performing hair tests for drugs of abuse stating "regulations require that, among other things, the screening tests used on the collected samples be approved, cleared, or otherwise recognized by the FDA as accurate and reliable." The three other companies that received the letter were Medimpex United, Avitar Inc., and Omega Laboratories. Psychemedics Corp. (Cambridge, MA) is the only laboratory that has received FDA clearance on all of the assays for its five-drug hair-test panel. 🏠

Two New Lab Companies: Research Think Tank And BestCare Lab

In our continuing effort to find newly formed laboratories and describe the entrepreneurs behind them, *LIR* offers the following profiles on two very different companies:



Robert Lloyd Jr.

Research Think Tank (Alpharetta, GA) was formed early last year by its chief executive, Robert Lloyd Jr., age 41, and its laboratory director, Paul Feorino, 75. Research Think Tank is a reference laboratory that specializes in molecular diagnostics for HIV, hepatitis, and cytomegalovirus. The company also provides clinical trials lab testing to pharmaceutical firms and platform evaluation services to diagnostic manufacturers.

In the mid 1990s, Lloyd and Feorino had started a lab research company called Applied Science that was developing new testing techniques for infectious disease. In 1997, they sold that company to Visible Genetics, which used the acquired technology to help create the TruGene HIV-1 genotyping system. Visible Genetics was then sold to Bayer Diagnostics, which now markets the FDA-cleared TruGene test.

Lloyd tells *LIR* that after a five-year non-compete contract with Visible Genetics/Bayer ended, he and Feorino invested about \$400,000 of their own money to startup Research Think Tank. The company's lab was certified by CLIA in March 2003 and began clinical testing a few months later. Lloyd says the biggest challenge that Research Think Tank faces is the low prices offered by Quest and LabCorp. Its biggest advantage is the ability to respond quickly to client needs.

Research Think Tank currently has 15 employees and is expanding fast, according to Lloyd. He says the company generated about \$300,000 in revenue last year and expects \$4 million to \$5 million this year.



Karim Maghareh

BestCare Laboratory Services (Houston) was funded with about \$100,000 of savings from its president, Karim Maghareh, age 47, and his friends and family. Maghareh is a medical technologist (ASCP) who formerly managed a satellite lab for Dynacare in Houston and also served as the director of laboratory services at Roy Schneider Hospital (Saint Thomas, Virgin Islands).

Maghareh opened BestCare in early 2002, and for awhile, he was the only employee at a lab with no clients and was having second thoughts about starting his lab. Then in April 2002, he got his first nursing home client and he has been adding one or two more clients each month for the past two years from word-of-mouth advertising.

BestCare now has 18 employees, 30 nursing home clients, handles 250 to 300 requisitions per day, and generated net revenue of nearly \$2 million last year, according to Maghareh. He's thinking about expanding into other cities in Texas and also wants to get into the physician office market, although exclusive managed care contracts make this difficult. His goal is to reach \$4 million in net revenue this year.

Maghareh attributes his success in the nursing home market to dependability, good communication with clients, a willingness to be flexible to client requests for phlebotomy services, and next-day test result turnaround. 🏠

Looks Like Competitive Bidding In Florida Will Become A Reality

LabCorp generated \$13 million from Florida Medicaid last year, while Quest got \$9 million. Several dozen smaller independent labs were reimbursed a total of \$15 million.

The requirements of the 88-page RFP issued by the Florida Bureau of Medicaid Services for a statewide lab contract all but guarantee that the award will go to either Quest Diagnostics or LabCorp, observes *LIR*. In fact, a March 9 meeting in Tallahassee held by Florida Medicaid to answer questions about the RFP was only attended by five lab companies, including Quest, LabCorp, and Florida Reference Laboratory (Miami), a small, privately held lab.

Two end-stage renal dialysis laboratories also attended the meeting: Davita Laboratory Services (Deland) and Royco Inc. (Fort Lauderdale), which does business as ESRD Laboratory. Although its chances are slim, it looks like ESRD Laboratory is planning to make a bid. The company filed a formal protest with Florida's Agency for Health Care Administration on March 15 arguing that as a CLIA-certified lab that has been accredited by COLA, it should be allowed to make a bid. As currently written, the RFP only allows CLIA-certified labs that have been accredited by the College of American Pathologists (CAP) or the Joint Commission on Accreditation of Healthcare Organizations (JCAHO) to make bids.

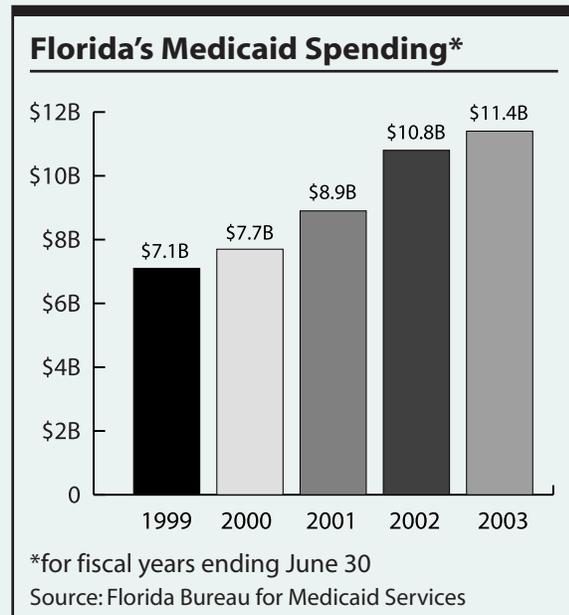
ESRD Laboratory's protest will put the RFP process on hold. The original RFP had listed a deadline for bids of March 30 with plans to announce the winner on April 20. When the protest is resolved, a new timetable will be issued.

However, this is a technical issue that *LIR* believes is not likely to cause a major delay in the contracting process. Furthermore, *LIR* observes that ESRD Laboratory does not have the statewide infrastructure necessary to compete for the contract. Data from Florida Medicaid show that ESRD Laboratory only generated \$15,975 in revenue from the Florida Medicaid program last year.

So the only question really is: How low will Quest and LabCorp bid to win a deal that will give them as much as \$37 million per year in revenue, while at the same time knocking a blow to their archrival in a key state? The winner will also gain valuable experience that they can put to use, if other state Medicaid programs follow Florida's lead. Neither Quest nor LabCorp would comment directly on their plans to bid on the contract. But informed sources tell *LIR* that each company can make an aggressive bid and still make money given their existing infrastructures and the ability to subcontract work to smaller labs in rural regions of the state.

More than 1.1 million Medicaid recipients in Florida will be required to use the winning lab. A roughly equal number of Medicaid recipients covered by HMOs or eligible for Medicare will have an option to use the winning lab. The contract does not cover lab services provided by hospitals to inpatients or outpatients, nor does it cover physician office lab testing. And hospitals and physician office labs cannot submit bids.

Quest and LabCorp are the only two lab companies in the state with enough laboratories, couriers, and patient service centers needed to even try to service a contract covering so many people over such a wide geography, notes *LIR*. Another big challenge in the RFP is a requirement for the winning lab to electronically transmit test results to the state's real-time prescription tracking and dispensing system.



The RFP requires labs to bid a percentage reduction from the Florida Medicaid lab fee schedule, which currently reimburses labs at only about 70% of Medicare rates. But *LIR* thinks that Quest or LabCorp could bid as low as 50% of Medicare rates. That would equal the same rates that Quest and LabCorp each get from some of the nation's biggest managed care companies.

Clearly, Florida needs to do something to curb the growing expense of its Medicaid program. Over the past five years, the state's Medicaid budget has grown by an average of 12% per year. In the fiscal year that ended June 30, 2003, Medicaid comprised 21%, or \$11.4 billion, of the state's

total budget of \$53.9 billion. And by 2015, Medicaid spending is projected to grow to \$40 billion (equal to almost 80% of the entire Florida budget today).

As mentioned earlier, the Florida Medicaid program spent about \$37 million on lab services from independent labs in fiscal year 2003. So hypothetically, a winning bid that lowered Florida Medicaid lab fees by about 20% would save the state about \$7.4 million per year. But that's hardly a drop in the bucket to the overall Medicaid budget in Florida.

Nonetheless, when *LIR* interviewed Bob Maryanski, bureau chief for Florida Medicaid Services, he seemed determined to implement the Medicaid lab contract. "What about all the small labs that will lose their Medicaid business?" *LIR* asked. "Anybody can bid as long as they meet the RFP requirements The contract will go to the lab that offers the greatest fee reduction and quality That's what competition is all about," answered Maryanski.

For more perspective, *LIR* analyzed the Medicaid reimbursements to independent labs in Florida and contacted half a dozen smaller labs that get significant business from the program. Comments from these labs plus a brief snapshot of Quest and LabCorp's operations in Florida follow:

LabCorp operates the biggest Medicaid lab business in Florida and collected \$13.3 million of reimbursement from the program last year. The company has roughly 100 PSCs in the state with a major lab facility in Tampa.

Quest Diagnostics collected \$9.2 million of Florida Medicaid revenue last year. Quest has 139 PSCs in Florida and major laboratories in Tampa, Deerfield Beach, and Miramar.

Finlay Clinical Lab (Miami) received \$1.3 million in Medicaid reimbursement last year, or about one-third of its total business, according to Begonia Ayo, lab manager. She says that if the contract is carried out, Finlay, which has 50 employees, will be forced to downsize.

Madelyn Hoyos, president of **Mogar Laboratory Corp.** (Miami), tells *LIR* that she has already warned her 25 employees that some of them may lose their jobs if Mogar loses its Medicaid business. Mogar generated \$775,382 from Medicaid last year, and it comprises about one-third of the company's overall business, according to Hoyos. Like all other small independent labs that *LIR* spoke with, Hoyos says that she first got news of the RFP through a letter from Florida Medicaid that she received on March 8. This gave her no time to make plans to attend the proposal conference in Tallahassee the following day. "I'm shocked at the way this contract is being carried out," says Hoyos.

National Medical Laboratory (Miami) collected \$619,881 in revenue from Florida Medicaid, which represents more than 10% of its business. Noel Carrion, lab manager, tells *LIR* that providing phlebotomy services to Medicaid patients in nursing homes will be the biggest challenge for Quest or LabCorp.

Paul Gotcher, chief executive at **DSI Laboratories**

(Fort Myers), believes the sudden shift of 1.1 million Medicaid recipients to a single lab company will lead to severe service problems. "This is a very difficult population to serve. Many don't speak English, and many are illegal aliens without green cards. Patient service centers will be overwhelmed. I don't care how big a lab company you are, your service levels are going to get fouled up," says Gotcher. He says the disruption may give hospital outreach programs and independent labs the opportunity to win other business away from the winning lab. DSI Laboratories, which is owned by Naples Community Hospital, received \$611,575 in revenue from the Florida Medicaid program last year, or approximately 4% of its total revenue.

Florida Medicaid Program Expenditures Top 20 Independent Lab Companies, Fiscal 2003

<i>Company</i>	<i>Reimbursement</i>
LabCorp	\$13,264,243
Quest Diagnostics	9,218,483
Florida Dept. of Health, Bureau of Laboratories	2,344,569
Finlay Clinical Lab	1,333,054
Genzyme Genetics	1,013,272
CD Enterprises/Bryce Clinical Lab	865,334
Mogar Laboratory	755,382
AmeriPath	715,213
National Medical Laboratory	619,881
DSI Laboratories	611,575
Doctors Laboratory	594,356
Bio-Tech Clinical Laboratories	441,787
Millennium Medical Laboratory	429,389
Florida Family Laboratory	408,667
Meridian Clinical Laboratory	354,684
University of Miami Surgery	286,360
ViroLogic	252,247
Integrated Regional Laboratories	252,108
American Health Associates	247,368
Specialty Laboratory	234,804

Source: Florida Bureau of Medicaid Services

“The big labs already have the HMO contracts. Now they want Medicaid. What’s next, Medicare?” asks Carlos Rodriguez, president of **Bio-Tech Clinical Laboratories** (Miami). He believes that neither Quest nor LabCorp have enough patient service centers to service the entire Medicaid population in Florida. “Patients are already complaining about the waiting times at Quest and LabCorp,” says Rodriguez. He says he’s already called his state representatives to complain about the Medicaid contract. “There’s going to be a lot of protests from smaller labs over this contract,” he adds. Bio-Tech has about 15 employees and received \$441,787 in revenue from the Florida Medicaid program last year.

Integrated Regional Laboratories (IRL—Fort Lauderdale), a joint-venture company owned by MDS Inc. and HCA, received \$252,108 from Florida Medicaid last year. Valerie Fuldauer, ethics, compliance, and privacy officer at IRL, says her lab simply doesn’t have the statewide coverage needed to make a bid for the contract. “If it had been done on a regional basis, which had been discussed, then smaller independent labs could compete,” she notes. “This contract will have major ramifications on the health care of Medicaid patients in rural areas, but it hasn’t gotten any attention. The state needs to wake up and see what’s happening,” she adds.

The Florida Dept. of Health, Bureau of Laboratories, which provides lab testing services through a network of county health departments, received \$2.3 million in reimbursement from the Florida Medicaid program last year. These laboratories will not be affected by the contract and will continue to provide and be reimbursed by Medicaid for lab services. 🏠

A Quick Update on Medicare Competitive Bidding

While Florida Medicaid could be only weeks away from implementing a competitive bidding program for lab services, the federal Medicare program is also moving, albeit slowly, in this direction.

As part of the Medicare reform legislation passed in December, the Secretary of Health & Human Services has been directed to conduct several pilot projects to examine payment alternatives to the traditional Medicare Part B fee schedule. Among the projects is a competitive bidding demonstration for independent lab services, which represent more than \$2 billion in annual spending by Medicare Part B. Pap testing and colorectal cancer screening will be excluded from the demonstration.

Congress has instructed the HHS Secretary to submit a progress report on the project by Dec. 31, 2005, but no date has been set for implementation. On March 3, CMS held an open-door meeting to get public input on how the project should be structured. For the most part, the forum served as a platform for the various laboratory trade groups to voice their opposition to competitive bidding.

Among the points made: 1) competitive bidding focuses on reducing price and could result in lesser quality and access to care; 2) the project should include every lab test because high-volume tests like Pap testing subsidize low-volume tests that are often performed at a loss; 3) there should be multiple winners for each region that goes up for bid; and 4) an advisory committee composed of labs, test makers, physicians, and patients should be formed to provide input to CMS on the process. 🏠



Quest To Pay \$11 Million To Settle Allegations Of Medicare Fraud

Quest Diagnostics (Teterboro, NJ) has agreed to pay the government \$11.35 million to settle allegations that two of its predecessor companies, MetPath and Damon Laboratories, as well as the recently acquired Unilab, had improperly billed Medicare and Medicaid for unnecessary lab tests.

The lawsuit was originally filed in 1997 under the whistle-blower provisions of the False Claims Act by Kevin Spear, a former sales representative for Unilab. These whistle-blower provisions permit private citizens to bring suit on behalf of the U.S. government. Under the False Claims Act, Spear will receive a 21% share of the settlement, or nearly \$2.4 million.

The complaint stated that between 1990 and 1997, Quest (MetPath and Damon) and Unilab had automatically included a test called apolipoprotein when doctors ordered a panel for heart risk evaluation. But doctors were unaware that the lab companies had billed Medicare and Medicaid separately for the apolipoprotein tests, according to the complaint. Quest fully cooperated with the investigation, but maintains that it did nothing wrong.

Meanwhile, *LIR* observes that over the past 12 years, commercial laboratories have paid out more than \$1.3 billion to resolve federal and state fraud claims alleging overcharges to Medicare and Medicaid. The largest to date has been a

\$486 million payment by Fresenius Medical Care of North America (Lexington, MA) to resolve a sweeping investigation of health care fraud at National Medical Care (NMC), a kidney dialysis subsidiary owned by Fresenius. Of this amount, \$385 million was recovered under the False Claims Act. Three NMC subsidiaries also pled guilty to three separate conspiracies and were levied fines of \$101 million. The Fresenius/NMC scam involved fraudulent and fictitious blood testing claims by LifeChem Inc., NMC's clinical blood testing laboratory; kickbacks to dialysis facilities to obtain blood testing contracts for LifeChem; and fraudulent claims submitted to Medicare for intradialytic parenteral nutrition (IDPN), a nutritional therapy provided to patients during their dialysis treatments. 🏠

Fraud & Abuse Settlements (\$MM)

Company (on behalf of)	Year	Amount
LabCorp (National Health Labs)	1992	\$111
Quest Diagnostics (MetPath)	1993	36
LabCorp (Allied)	1994	5
Quest Diagnostics (Damon)	1996	119
Quest Diagnostics (MetPath)	1996	7
Unilab	1996	4
LabCorp (Roche Biomedical/Allied)	1996	187
Spectra Laboratories	1996	10
Franklin Laboratories	1997	5
Unilab (Meris)	1997	5
SmithKline Beecham Clinical Laboratories	1997	325
Unilab (Physicians Clinical Laboratory)	1997	2
Quest Diagnostics	1998	7
Quest Diagnostics (Damon)	1998	15
Fresenius Medical Care (LifeChem)	2000	486
Quest Diagnostics (Nichols)	2001	13
Dianon	2002	5
Quest Diagnostics (MetPath, Damon, Unilab)	2003	11
Total		\$1,353

Source: *LIR*



Some Expert Advice On Lab Billing And Collection

Some tips for getting physician offices to send clean and complete lab orders:

1) set aside a specific time each day or week to call the physician office to work out billing questions;

2) consider customized requisitions with diagnosis code info included for your largest clients;

3) don't be afraid to include a financial penalty for clients that consistently send lab orders with missing or incomplete info.

On March 16, Washington G-2 Reports hosted a teleconference titled Success Strategies for Lab Outreach Billing & Collections. The call featured expert opinion from three speakers: John Leskiw, chief executive of the accounts receivable management firm Quadax Inc. (Cleveland); Lale White, president of the lab billing system consulting company Xifin Inc. (San Diego); and Doug Jaciow, director, pathology services at Baystate Health System (Springfield, MA). Some highlights from the teleconference are summarized below:

What is the current state of billing and collection at most hospital outreach programs?

Jaciow noted that while hospital labs tend to do a great job at providing quality testing results, most are not doing well when it comes to the financial management of their outreach programs. He believes that many lab managers and directors have a stubbornness that prevents them from admitting they lack the skill base needed to manage an effective billing and collection system. The most frequent complaint physician clients have with hospital outreach programs is incorrect billing, not test turnaround time, according to Jaciow.

What are some financial benchmarks that outreach programs should aim for?

White said that most hospitals have a difficult time determining what their net collected revenue and days in accounts receivable (DAR) are because their outreach billing gets lost in the hospital's inpatient enterprise billing system. She said that when billing and collection are well managed by the laboratory, realistic goals for DAR include 45 days for client billing; 65 days for third-party billing; and 70 days for patient billing. In an average billing mix (70% third party), DAR should be approximately 60-65 days, according to White.

In term of bad debt (*i.e.*, accounts receivable writeoffs), White said that client bad debt should not exceed 1% to 2% and patient bad debt can be 25% to 35% after good collection efforts. Third-party bad debt should not exceed 5%, as there is an alternative responsible party for most claims missing information, or 10% if the lab chooses not to hold ordering physicians responsible for providing adequate billing information.

What are the advantages and disadvantages of outsourcing billing to an accounts receivable management firm?

Leskiw said that advantages to outsourced billing include access to experienced staff (for billing) without the fixed overhead costs associated with adding FTE's in the laboratory, and access to detailed financial reports that, for example, detail collected revenue by client, payer, sales rep., etc. Disadvantages include less direct control of people and the billing process. In terms of the cost of outsourcing, Leskiw said that the A/R management firms typically charge 9% to 11% of net collected revenue for clinical lab claims and 5% to 6% for anatomic pathology claims.

Is there a critical mass outreach programs need to reach to become profitable?

No. All three speakers noted that they had seen outreach programs with as little as \$1 million to \$2 million in annual revenue that had well-run billing systems in place and were profitable by any measure. 🏠



Lab Stock Performance Over The Long Run

Which of the two biggest commercial labs has rewarded its shareholders the most over the long haul? We'll, in the five years ended March 12, 2004, LabCorp stock has increased at an average compound annual rate of 56%. Over the same period, Quest Diagnostics stock has risen by 51% per year.

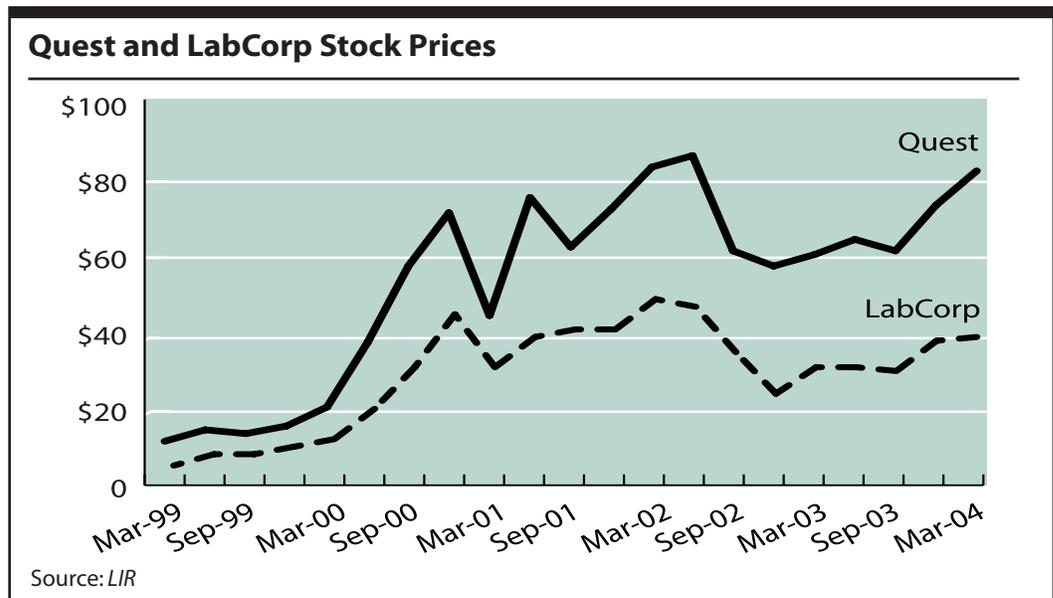
So LabCorp has a slight edge in long-term stock performance. But both stocks have far outpaced the major stock indices. For example, over the past five years, the S&P 500 Index has declined by an average of 3% per year.

The greatest portion of the stock gains by LabCorp and Quest came after Quest completed its acquisition of SmithKline Beecham Clinical Laboratories (SBCL) on Aug. 16, 1999. In the 12 months that followed, Quest shares soared from \$13.19 up to \$61.75, an increase of 368%; LabCorp shares jumped from \$7.19 up to \$29.58, an increase of 311%.

Quest's acquisition of SBCL knocked the most aggressive price competitor out of the market. In the years that followed, Quest and LabCorp both worked to either raise prices on low-priced capitated contracts or convert them to fee-for-service arrangements.

The next major milestone for the lab industry occurred on Jan. 1, 2000 when Medicare reimbursement for traditional Pap smear testing was increased from \$7.15 to a national minimum floor of \$14.60. And effective April 1, 2001, Medicare began reimbursing mono-layer Pap testing at a national cap of \$28. There are some 50 million to 55 million Pap tests performed in the United States each year and the increased reimbursement has added roughly \$1 billion in annual revenue to the lab industry.

The third major positive event in recent years was the removal of the dreaded 20% lab co-pay proposal from the Medicare reform and prescription drug legislation approved by President Bush in December 2003.





Last month *LIR* reported that Ford Motor Company had sent out an RFP to contract all non-hospital lab testing services directly with a single national lab (see *LIR*, March 2004, p. 4). We'll, now we've learned that Daimler Chrysler is also part of this contracting effort.

Word that Daimler Chrysler has teamed with Ford on the RFP nearly doubles the size of this potential contract. Together, the two auto companies spent approximately \$5.7 billion on health care for U.S. employees, retirees, and dependents last year. *LIR* estimates that the value of a national lab contract for Daimler Chrysler and Ford could easily be worth \$57 million per year (assuming 1% of their health care spending went to lab testing).

Bids for this huge contract were supposed to be submitted by mid-February. But sources tell *LIR* that the potential bidders had a problem with at least one of the RFP's stipulations. Namely that the winning lab would need to be licensed as a health insurance company in the state of Michigan, something the national labs apparently don't want to do. Ford and Daimler Chrysler are now revising the RFP to address this concern.

References in this issue

BestCare Laboratory Services
281-335-0997

Genzyme Genetics
508-389-6611

Impath 212-698-0300

LabCorp 336-584-5171

LabOne 913-888-1770

MDS Inc. 416-675-7661

Quadax Inc. 440-777-6300

Quest Diagnostics 201-393-5000

Research Think Tank
770-475-1185

Xifin 858-793-5700

Subscribers are invited to make periodic copies of sections of this newsletter for professional use. Systemic reproduction or routine distribution to others, electronically or in print, is an enforceable breach of intellectual property rights. G2 Reports offers easy and economic alternatives for subscribers who require multiple copies. For further information, contact Randy Cochran at 212-244-0360, ext. 640 (rcochran@ioma.com).

Who are the potential bidders? Obviously Quest Diagnostics and LabCorp. And *LIR* hears that Mayo Medical Laboratories (Rochester, MN) is working with Joint Venture Hospital Laboratories (JVHL—Detroit) on a possible bid. JVHL is a lab network with more than 100 hospital lab members throughout Michigan. Spokeswomen from Ford and Daimler Chrysler would not comment on any of the above scuttlebutt. 🏰

LIR Subscription Order or Renewal Form

YES, enter my one-year subscription to the **Laboratory Industry Report (LIR)** at the rate of \$379/yr. Subscription includes the *LIR* newsletter, e-mail alerts, and yearly subject index. Subscribers outside the U.S. add \$50 postal surcharge.

Check enclosed (payable to Washington G-2 Reports)

American Express VISA Mastercard

Card # _____ Exp. Date _____

Cardholder's Signature _____

Name As Appears On Card _____

Name/Title _____

Company/Institution _____

Address _____

City _____ State _____ Zip _____

Phone _____ Fax _____

e-mail address _____

MAIL TO: Washington G-2 Reports, 3 Park Avenue, 30th Floor, New York, NY 10016-5902. Or call 212-629-3679 and order via above credit cards or fax order to 212-564-0465. 4/04

© 2004 Washington G-2 Reports. All rights reserved. Reproduction in any form prohibited without express permission.

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

Receiving duplicate issues? Have a billing question? Need to have your renewal dates coordinated? We'd be glad to help you. Call customer service at 212-244-0360, ext. 200.

Publisher: Dennis W. Weissman. Managing Editor: Jondavid Klipp, labreporter@aol.com