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LABORATORY INDUSTRY REPORT®

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Vol. 13, Iss. 13, July 3, 2013

HIGHLIGHTS

Tough Times for Lab Companies Translate to Uneven Benchmarks

Publicly traded laboratories tracked by G2 Intelligence during the first quarter of 2013 showed uneven performance in a variety of benchmarks.

Industry analysts have noted the laboratories have been beset by reimbursement reductions and other issues that have made the business environment more difficult than in years past. As a result, the strong benchmarking gains reported in prior years have mostly vanished.

The two largest national laboratories, Quest Diagnostics (Madison, N.J.) and LabCorp (Burlington, N.C.), have been confronting flat earnings in recent years, and their current benchmark numbers tend to bear that out.

For the first quarter of 2013, Quest's revenue per employee was $43,576, compared to $56,148 per employee during the first quarter of 2012. Its pretax income per employee for the quarter was $4,795, versus $6,539 during the first quarter of 2013.

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Laboratory M&A: A Shrinking Window Of Opportunity

Mergers and acquisitions of laboratories during the first half of 2013 appear to be flat, with the number of transactions remaining about the same as compared to the first half of 2012.

Altogether, seven deals were reported by two firms that monitor such transactions, England & Co. in Washington, D.C., and Haverford Healthcare Advisors in Paoli, Pa. According to Haverford, seven deals also occurred during the first half of 2012, suggesting a market that is stable if not dynamic. By comparison, 16 deals were consummated during the first half of 2011.

Industry observers say that the environment for deal-making has been dampened by a variety of issues. Among them are reimbursement pressures, particularly regarding the technical component of CPT code 88305, the 2 percent across-the-board cuts to Medicare reimbursement as part of the budget sequester, reductions to the Part B lab fee schedule, and additional cuts to payments as a result of

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■ **Tough Times for Lab Companies**, *from page 1*

LabCorp was slightly more stable but still down, reporting revenue per employee of $42,379 for the first quarter, compared to $45,912 for the first quarter of 2012. Its pre-tax income per employee was $7,787, versus $8,696 during the first quarter of 2013.

The company with by far the largest employee-to-revenue ratio is Myriad Genetics (Salt Lake City), with $133,851 per employee during its fiscal third quarter, ending March 31. That's up from $111,015 during the same period in 2012. Pretax income per employee was $50,677 for the quarter, compared to $40,616 for the year-ago quarter (for the performance benchmark for all labs, please see the accompanying chart).

Benchmarking Data for Major U.S. Laboratories

Lab	1Q 2013 Revenue per employee	1Q 2012 Revenue per employee	1Q 2013 Pretax income per employee	1Q2012 Pretax income per employee	1Q 2013 Provision for Bad Debt	1Q 2012 Provision for Bad Debt	1Q 2013 Days Sales Outstanding	1Q 2012 Days Sales Outstanding
Quest	$43,576	$56,148	$4,795	$6,539	$71.93 million	$80.7 million	46.0	44.0
LabCorp	$42,379	$45,912	$7,787	$8,696	$198.4 million	$191.5 million	50.0	46.0
Myriad Genetics*	$133,851	$111,015	$50,677	$40,617	$6.3 million	$4.6 million	55.5	45.0
Bio-Reference	$64,729	$55,555	$7,408	$6,152	$5.4 million	$3.4 million	89.0	88.0
NeoGenomics	$59,532	$57,642	$76	$2,293	$3.6 million	$3 million	90.8	64.1
Psychemedics	$48,731	$47,301	$9,800	$10,434	$123,445.00	$121,583.00	73.8	70.7
Enzo Biochem**	$48,808	$56,045	-$12,544	-$7,462	$1.33 million	$1.17 million	53.1	48.7

**Fiscal quarter ending March 30*
***Fiscal quarter ending Jan. 31*
Sources: SEC filings, company press releases, Gurufocus.com

Except for Quest and Enzo Biochem (New York City), provisions for doubtful accounts/bad debt increased among all the companies surveyed were up during the first quarter of 2013, some considerably. Quest cut its total to $71.93 million versus $80.7 million compared to a year ago, a reduction of 10 percent. LabCorp's increased to $198.4 million during the quarter, up from $191.5 million for the first quarter of 2012.

Myriad Genetics' (Salt Lake City) provision also increased significantly, to $6.3 million versus $4.6 million, an increase of 37 percent. Bio-Reference Laboratory (Elmwood Park, N.J.), reported that its bad debt provision increased to $5.4 million for the first six months of its fiscal year, ending April 30, up 59 percent from the $3.4 million reported for the first six months of fiscal 2012. Neogenomics (Irvine, Calif.) reported a 20 percent increase, to $3.6 million from $3 million.

Days sales outstanding were also up for most of the laboratories surveyed. For Quest, it increased to 46 days from 44. LabCorp reported a bigger increase, to 50.1 days versus 46 days in the year-ago quarter. Myriad Genetics reported an increase to 55.5 days, versus 45 days. It noted in a recent filing with the Securities and Exchange Commission that recent delayed Medicare payments from the regional third-party administrator, Noridian, were partly to blame, and it expected its DSO would decrease once issues were resolved in that area.

Lab Stocks Gain 6.2 Percent During First Half of Year

Many of the nation's publicly traded laboratories are confronting flat earnings and a difficult reimbursement environment. And while some stocks have caught the same momentum that has lifted the markets through much of 2013, others are struggling to gain traction.

According to the G2 Intelligence stock index, four of the eight stocks charted have seen increases during 2013. The overall non-weighted average price increase for all the labs is about 6.2 percent. In comparison, the Standard & Poor's index is up about 9 percent for the first of 2013, and the Nasdaq composite is up almost 10 percent.

Gainers

Neogenomics (Fort Myers, Fla.) has risen more than 50 percent, from less than $2.50 a share at the end of 2012 to more than $4 a share as of the end of June. Although its first-quarter revenue was flat, its test volume grew by 19 percent.

LabCorp (Burlington, N.C.) has risen 15.6 percent since the start of 2013, with its stock rising from below $88 a share to more than $100 a share as of late June.

Genomic Health (Redwood City, Calif.) has also posted healthy price gains. The company was trading at around $32 a share, up from $27 a share at the start of the year, a gain of about 18 percent. The company has announced a variety of new genetic tests for cancer in recent months.

Quest Diagnostics (Madison, N.J.) has risen marginally during 2013, starting the year at around $58 a share and ending the first half of the year at around $60 a share. It peaked in early June at just over $63 a share but has since slipped back. Some analysts are taking a wait-and-see view on Quest's recent restructuring.

Minor Gain or Loss in Value

Bio-Reference Laboratories (Elmwood Park, N.J.) has seen its stock remain essentially unchanged from the start of 2013 at $29 a share. It topped $31 a share in January but has since declined. That's despite reporting strong first-quarter earnings.

Psychemedics (Acton, Mass.) is in the same situation as Bio-Reference, with its stock essentially unchanged since the start of the year, trading at around $10.75 a share. It topped $12 a share in February, but even a good quarterly earnings report has not moved the stock up.

Myriad Genetics (Salt Lake City) started 2013 trading at around $27 a share and is currently trading in the $26.50 per share range. The company suffered a significant blow when the U.S. Supreme Court invalidated its patents on non-altered genetic materials, the key to its BRCA tests. Its stock quickly dropped from $34 a share in mid-June almost immediately after the ruling.

Major Loss in Value

Enzo Biochem (New York City) is the only stock in the index to have lost significant value in 2013. It was trading at around $2.75 a share at the start of 2013 and ends the half at around $2 a share, a loss of more than 37 percent. Revenue was mostly flat for 2012, and it posted a large loss for the year as well.

Health Plans Cracking Down On Out-of-Network Lab Referrals

An osteopath practicing in West Palm Beach, Fla., received a letter from insurance giant Aetna last August. Its introduction was ungrammatical but also unambiguous: "Referring Aetna patients to Aetna participating contracted LABS crucial," began the letter.

According to the letter, the osteopath was apparently referring patient specimens to Health Diagnostic Laboratory. It's a rapidly growing regional lab based in Richmond, Va., that specializes in testing for primary care physicians with a focus on issues such as diabetes and cardiac health. Although it has a growing base of referring providers in the Southeast, it is not on Aetna's list of approved network labs.

The concern Aetna raised was that the osteopath's patients would have an undue financial burden placed on them by paying out-of-network fees. "Aetna is getting ready to terminate your participation from the network for being non-compliant after receiving these letters—your office has not stopped referring our members to non PAR labs," the letter stated.

Five days later, Aetna sent the osteopath yet another letter. Like the first piece of correspondence, it contained compositional issues, misspelling his name. And while the salutation was confused, the message certainly was not: Aetna would be terminating the osteopath's practice from its network of primary care providers that fall. It did not provide a specific reason, instead citing a clause in its provider contract allowing terminations without cause if proper notice is given.

> ***"Aetna is getting ready to terminate your participation from the network for being non-compliant."***
> ***—Letter to Provider Over Out-of-Network Lab Referrals***

The letter was one of several from various payers obtained by *Laboratory Industry Report* that told a strikingly similar tale: Primary care providers were being asked not to make any referrals to out-of-network laboratories.

The reasons given to the recipients of the correspondence were consistent—the insurers did not want to impose a financial burden on their enrollees. But the letters hinted that contracts would be dropped if the referral patterns did not change—whether or not the enrollees had coverage for out-of-network services.

Prices Mentioned

Correspondence from UnitedHealthcare to another provider in Florida, a physician who specializes in women's health issues, included a cost-comparison list for lab tests between in-network and out-of-network providers. An in-network lipid panel costs $6, versus $51 for work performed out of network. A level IV pathology workup costs $105 out of network, versus $42 within the network, the letter reminded her.

As with the osteopath, United was trying to discourage the physician from using Health Diagnostic Laboratory.

The issue appears to be a sensitive one in the provider community. The osteopath—whom an Aetna spokesperson confirmed had his network status restored not long after the health plan sent him the termination letter—did not return phone calls to both his office and home seeking comment. Neither did the women's health physician or any of the other doctors mentioned in the letters.

However, laboratory executives, attorneys, and industry observers agree that payers are increasing the pressure on providers to make referrals to in-network laboratories, regardless of whether their patients have coverage for out-of-network benefits.

A Hard Attitude

"Aetna has really taken a hard attitude with all providers, doctors, hospitals and [other providers]," said Daron Tooch, a partner with the Hooper Lundy & Bookman, a Los Angeles law firm that specializes in health care litigation. Tooch has been litigating against health plans in California for 20 years and noted that Aetna had not been a difficult payer until recently.

Last year, Tooch sued Aetna on behalf of the California Medical Association and the Los Angeles County Medical Association, claiming that Aetna was terminating providers for making out-of-network referrals whether or not their patients had out-of-network benefits. It is seeking damages for false advertising, breach of contract, and unfair business practices.

"It's a growing issue, and I think it is another manifestation of narrow networks [that] payers believe they can use to better control costs for themselves and for their beneficiaries."
—Rina Wolf, XIFIN

According to Tooch and the lawsuit, Aetna discourages its provider network if they make out-of-network referrals, often threatening them with termination. The suit also claims that Aetna pays minimal amounts for out-of-network care and often delays authorization. That's despite the fact Aetna markets the plans to prospective patients as providing the flexibility to choose their providers.

Although filed in Los Angeles Superior Court more than a year ago, the suit has yet to reach trial. There are no laboratories as plaintiffs.

But Tooch observed that Aetna is not the only payer taking a harder line on out-of-network referrals, which can decrease leverage they have with their in-network providers should those volumes grow too large.

"They're all doing it, and it is interfering with the right of physicians to make referrals for the patients," he said.

Rina Wolf, vice president of commercialization strategies, consulting, and industry affairs for XIFIN, a San Diego-based laboratory billing and consulting firm, agreed that the strategy is become more widespread.

"It's a growing issue, and I think it is another manifestation of narrow networks [that] payers believe they can use to better control costs for themselves and for their beneficiaries," she said.

Why Refer Out-of-Network?

Although the parties interviewed for this story acknowledged that sometimes out-of-network referrals are being made by physicians without the direct consent of their patients, they point out that physicians often have valid clinical reasons for making the referrals.

Wolf and Tooch noted that the out-of-network labs may have faster turnaround times, better attention to detail and customer service, and may provide data that the network labs do not routinely furnish in their reports.

"In the field of pharmacogenetics, some of the data provided by specialty labs can be extremely comprehensive," Wolf said. "They look at every medication the patient is taking, as well as the patient's metabolism to see how well they can respond to certain drugs."

"Most of our network contracts require providers to make in-network referrals for any type of service where possible." —Cynthia Michener, Aetna

And if the physician believes there is clinical value in making the out-of-network referral, "that is a conversation to have with patients," she observed.

The labs may also be waiving some copayments for patients in order to receive the volume—a practice that may irritate health plans but has been determined to be legal in California, according to Tooch.

For its part, Aetna is sticking to what it said in its correspondence. "Most of our network contracts require providers to make in-network referrals for any type of service where possible so that members don't incur higher out-of-pocket costs," spokesperson Cynthia Michener said in an e-mail.

Some Labs Hurt

But if the health plans are feeling pressure to keep costs down, it is hurting out-of-network labs. Officials with one regional specialty lab who declined to be named said the pressure on providers to remain in-network is costing them business—and possibly the chance to expand into other regions. Officials with that lab did not want to go on the record for fear of hurting their business further.

Tonya Mallory, Health Diagnostic Laboratory's chief executive officer, suggested the out-of-network referrals to her lab is a testimonial to the quality of services it is providing.

"Clearly many physicians and other such providers are recognizing that Health Diagnostic Laboratory offers a more advanced, more insightful cardio-metabolic risk profile paired with behavior modification and health coaching not offered by any other lab company," she said. Mallory claimed that using such tests can reduce a patient's health care spending by 23 percent within two years.

By contrast, Wolf noted that it is challenging for larger national labs, with their extensive testing menus, to provide such granular information.

"Can they truly be an expert in all things?" she asked.

■ **Laboratory M&A: A Shrinking Window of Opportunity**, *from page 1*

gap-filling new molecular pathology test codes in lieu of the older code-stacking payment methodology.

"You have quite a few headwinds in the industry right now. Private equity-backed labs are taking a breather and many of the previous acquirers are no longer active," said England & Co. Managing Director Tim Johnson.

Two of the leading firms in that arena in prior years—Aurora Diagnostics and Solstas Lab Partners—have not consummated a deal since 2011, when combined they were involved in nine transactions. And Regional Diagnostic Laboratories (RDL), founded last year to focus on the hospital outreach market and backed with $250 million in capital from Warburg Pincus, has not pulled the trigger on a single deal. Brian Carr, RDL's chief executive officer, told *Laboratory Industry Report* in May that the company was on the sidelines.

M&A Activity, First Half of 2013

Month Closed	Acquirer-Acquired
January	Quest Diagnostics-UMass Memorial Medical Center
January	Ascend Clinical-PathCentral
January	Access Genetics-OralDNA
January	Selah Genomics-Lab 21 Ltd. (SC)
April	LabCorp-United West Laboratories (AZ)
May	Quest Diagnostics-Concentra
June	Quest Diagnostics-Dignity Health Lab Outreach (CA and NV)

Sources: Haverford Healthcare Advisors, England & Co.

Quest Diagnostics is the most active of the acquirers, having closed three of the seven deals during the first half. They included the Dignity Health outreach business in California and Nevada, the laboratory business of Humana subsidiary Concentra Health, and the laboratory business of University of Massachusetts Memorial Medical Center. Although the UM Memorial deal was announced in 2012, it did not officially close until January.

That the nation's two largest labs had their hands in the majority of the deals is even more of an indicator of how stilled the M&A landscape is at the moment, according to Thomas Hirsch, president of Laboratory Billing Solutions (Portsmouth, N.H.) and a senior consultant with Nichols Management Group (York Harbor, Maine).

"Most of the deals happening are now strategic in nature," Hirsch said, with publicly traded companies such as Quest and LabCorp under pressure from shareholders to make deals in order to beef up what have been relatively flat bottom lines as of late. Johnson also noted that Quest and LabCorp are making deals as part of their plans to grow revenue.

Moreover, Hirsch noted that unlike hospitals, laboratories tend not to gain the same kind of leverage with insurers by becoming larger, creating some disincentives toward merging. G2

INDUSTRY BUZZ

More Labs Offering BRCA Testing

The landmark ruling by the U.S. Supreme Court earlier this month on the right of businesses to patent human genes has continued to prompt laboratories to wade into the molecular breast cancer testing market.

The high court invalidated the patents Myriad Genetics had held on the BRCA1 and BRCA2 genes, ruling that unaltered genetic material could not be patented (*LIR, June 20, 2013, p. 1)*. It allowed Myriad to essentially hold the entire molecular testing market for genetic markers for breast cancer. Altered genetic material could still be patented, however.

Within hours of the court's ruling, at least three laboratories—including the nation's largest laboratory, Quest Diagnostics—announced that they would be offering BRCA testing, and others chimed in during the days after.

San Diego-based Pathway Genomics announced two days after the Supreme Court ruling it would offer the BRCA1 and BRCA2 tests as part of a genetic cancer panel it will release in August. It did not announce the price but said in a statement that it would be "substantially lower than the competition."

Ambry Genetics, another San Diego-area laboratory, said it would also offer BRCA testing as part of a $2,200 panel of gene-based cancer testing.

"The relationship between BRCA1/2 and breast cancer risk was not discovered by a single patent holder, it stood on the shoulders of years of work by our scientific colleagues," said Elizabeth Chao, M.D., Ambry's chief medical officer. "This provides us with a strong basis for a variant classification program that will be second to none."

GeneDx, a subsidiary of Bio-Reference Laboratories (Elmwood Park, N.J.), and DNA-Traits, an affiliate of Gene By Gene (Houston), also announced they would offer BRCA testing within hours of the Supreme Court decision.

Although LabCorp has yet to announce whether it will offer the BRCA testing, Darren Lehrich, a managing director with Deutsche, suggested in a recent analyst note that it was a possibility.

Lehrich noted that given Quest and LabCorp each have about a 10 percent to 12 percent market share of the laboratory business nationwide, BRCA testing for both of them could eventually add one-half to 1 percent of revenue growth "if their national market shares were commensurate in this arena."

References

Aetna 800-872-3862

England & Co.
202-386-6500

Haverford Healthcare Advisors
610-407-4024

Health Diagnostic Laboratory
804-343-2718

Hooper, Lundy & Bookman
310-551-8111

LabCorp
336-229-1127

Pathway Genomics
877-505-7374

Quest Diagnostics
800-222-0446

XIFIN
858-793-5700

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 Laboratory Industry Report (ISSN 1060-5118) is published by G2 Intelligence, 24 Railroad Street, Keene, NH 03431-3744 USA. Tel: 800-531-1026. Fax: +1-603-357-8111. Web site: www.G2Intelligence.com.

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