Jondavid Klipp, Editor, labreporter@aol.com

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LABORATORY ECONOMICS

Competitive Market Analysis For Laboratory Management Decision Makers

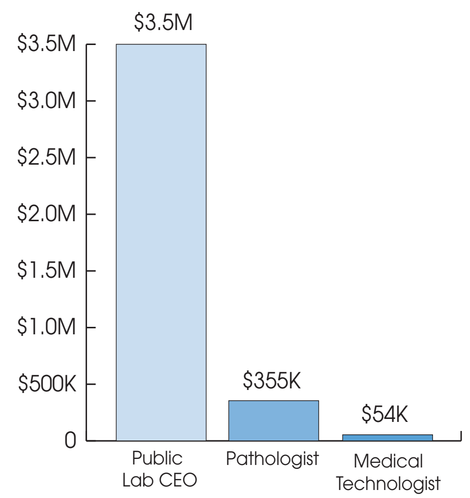
WARBURG PINCUS TO INVEST UP TO $250M IN NEW LAB OUTREACH COMPANY

The investment firm Warburg Pincus has agreed to invest up to $250 million of equity capital into newly launched Regional Diagnostic Laboratories (Brentwood, TN). RDL plans to acquire and manage hospital-based outreach labs. The new company is expected to close its first transaction within the next 90 days. Brian Carr, chairman and chief executive of RDL, says the company is targeting outreach programs with annual revenue of more than $10 million based in the Midwest, Southeast and Mid-Atlantic. *More details on page 3.*

PUBLICLY-TRADED LAB CEOs PAID AVERAGE OF $3.5M

The chief executives at 12 publicly-traded lab companies were paid an average of $3.5 million each last year, according to an analysis of shareholder proxy statements by *Laboratory Economics*. That's about 10 times the average annual compensation of $355,000 for pathologists and 65 times the average $54,000 per year paid to medical technologists, according to the latest surveys from the American Medical Group Management Association (AMGA) and the American Society for Clinical Pathology (ASCP). *Full details on pages 5-7.*

Compensation Comparison



Source: *Laboratory Economics* and surveys by AMGA and ASCP

AETNA RELAXES ACCREDITATION RULES FOR DERMS

Aetna has announced that it has eliminated its new dual certification requirement for dermatology groups with in-office pathology labs, meaning payment of anatomic pathology services will continue without the need for additional accreditation. However, Aetna is still requiring other specialty groups with pathology labs, including urology and gastroenterology groups, to be CLIA certified and accredited by CAP or The Joint Commission in order to be paid. *Continued on page 2.*

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AETNA RELAXES ACCREDITATION RULES (*cont'd from p. 1*)

Aetna made dermatology groups exempt from its new accreditation requirement after protest from the American Academy of Dermatology (Schaumburg, IL), which represents 17,000 dermatologists worldwide, and the American College of Mohs Surgery (Milwaukee, WI).

Aetna is requiring all other physician practices with in-office pathology labs to get accredited by CAP or The Joint Commission (TJC) by August 1, 2012. The requirement applies to both the technical and professional components of services billed for CPT codes 88300-88314 and 88342.

Meanwhile, the California Medical Association (CMA) says the change will be overly burdensome to physicians. CMA says that although CMS recognizes CAP and TJC as approved accreditation organizations, CMS does not require both a CLIA certificate and a specialty society accreditation to perform in-office pathology testing.

Further, CMA is concerned that physician groups will not be able to obtain CAP or TJC accreditation prior to the August 1 deadline. For example, CAP says that it can take up to a year for a lab to receive accreditation. Costs for CAP accreditation include a one-time $799 application fee plus annual fees of about $1,500. The time and expense associated with getting accreditation could become a major barrier for smaller in-office pathology labs, notes *Laboratory Economics*.

Last year, 17 physician-office-based pathology labs received CAP accreditation. This was more than the total number for all prior years combined. The number of CAP-accredited POLs is expected to skyrocket over the next 12 months.

Groups recently receiving CAP accreditation include **High Desert Gastroenterology** (Lancaster, CA), with six gastroenterologists; **Advanced Urology Associates** (Joliet, IL), with 10 urologists; and **Northeast Indiana Urology** (Fort Wayne, IN), with eight urologists.

In-Office Pathology Labs that Earned CAP Accreditation in 2011

Group Name	*Lab Medical Director*	*CAP Accreditation*
High Desert Gastroenterology	Canagaratnam Pathmarajah, MD	December 2011
Advanced Urology Associates	John M. Abran, MD	September 2011
Northeast Indiana Urology	Scott A. Wagner, MD	September 2011
Academic Urology of Pennsylvania	Maysoun Ghabra, MD	August 2011
Arizona Digestive Health	Daniel M. Jondle, MD	August 2011
South Jersey Gastroenterology	Linda A. Murakata, MD	August 2011
Dermatologists of Greater Columbus	Michael P. Conroy, MD	July 2011
Urological Services PC	Nader H. Bassily, MD, PhD	July 2011
Urology of Indiana	Samuel Thompson, MD	July 2011
Capital Urology Associates	John P. Jones, MD	May 2011
Great Lakes Gastroenterology	David J. Keep, MD	May 2011
Illinois Gastroenterology Group	Thomas F. Mientus, MD	May 2011
MacInnis Dermatology	Colleen MacInnis, MD	May 2011
Michigan Gastroenterology Institute	Wilhelm T. Lawrence, MD	May 2011
The Gastroenterology Group	David E. Kardon, MD	April 2011
Urologic Physicians	Harold J. Hoppmann, MD	March 2011
Altman Dermatology Associates	Jeffrey S. Altman, MD	January 2011

Source: *Laboratory Economics* from CAP

WARBURG PINCUS TO INVEST UP TO $250M IN RDL (*cont'd from page 1*)

RDL is expected to bring professional management, sales and marketing, information technology, and billing and collection expertise to lab outreach programs. The tens of millions of dollars that RDL will pay for lab outreach programs will provide hospitals with capital to invest in other projects while keeping lab services local, according to Carr. He notes that many hospitals are looking for capital to purchase surrounding physician practices.

RDL generally plans to acquire a 100% ownership stake. In some cases, the selling health systems may keep a minority stake in their outreach lab. Carr says the labs will be operated as freestanding independent. He says RDL has about 9-10 targets in its acquisition pipeline. Haverford Healthcare Advisors (Paoli, PA) is acting as advisor. Carr, age 50, started his lab career with Allied Clinical Laboratories, which was sold to National Health Laboratories in 1994. NHL then merged with Roche Biomedical Labs to become LabCorp in 1995.

From March 1997 to November 2000, Carr was chief executive of InformDX, a pathology practice management company that was sold to AmeriPath in December 2000. AmeriPath was then sold to Quest Diagnostics in May 2007.

Carr then helped found and was chief executive of American Esoteric Laboratories from June 2003 until January 2007 when it was acquired by Sonic Healthcare. Finally, Carr co-founded and was chief executive of OralDNA Labs from May 2008 to August 2009 when it was sold to Quest Diagnostics.

RDL management also includes John Mazzei, who will serve as president and chief operating officer; Mark Farrington, chief information officer; and Sam Daniel, chief financial officer.

Over the past 12 years, hospital-based outreach labs have sold for an average of approximately 1.4 times annual revenue. Most recently, Quest Diagnostics acquired SED Medical Labs (Albuquerque, NM) for $50 million in January 2012. Quest is laying off 25% of the 450 employees at SED with most of the cuts coming at SED's core lab in Albuquerque (see *LE*, February 2012, p. 9).

Hospital-Based Outreach Lab Acquisitions ($ millions)

Date	Buyer	Target	Purchase Price	Acquired Revenue	Price/ Revenue
Jan-12	Quest Diagnostics	SED Medical Labs	$50	$50	1.0
Feb-10	Solstas Lab Partners	Carilion Labs	NA	110	NA
Nov-09	LabCorp	Centrex Clinical Labs	NA	43	NA
Nov-09	Welsh Carson	Spectrum Laboratory	230	182	1.3
Sep-09	Quest Diagnostics	Caritas Medical Laboratories	NA	20	NA
Aug-09	Sonic Healthcare USA	Piedmont Medical Labs	NA	12	NA
Sep-08	Sonic Healthcare USA	Clinical Labs of Hawaii	121	110	1.1
Aug-08	LabCorp	Stanford Outreach Lab	30	30	1.0
Oct-07	LabCorp	PA Labs	74	40	1.9
Aug-07	LabCorp	DSI Laboratories	76	39	1.9
Feb-07	Carilion Labs	Presbyterian Reference Lab	42	45	0.9
Jan-07	Sonic Healthcare USA	American Esoteric Labs	180	100	1.8
Jan-06	Apax Partners	Spectrum Laboratory	NA	120	NA
Dec-04	Spectrum Lab	Medex Regional Labs	13.5	24.5	0.6
Jan-04	LabOne	Alliance Lab Services	42.4	50	0.9
Dec-02	LabOne	Central Plains Laboratories	12.6	12	1.1
Jul-02	LabCorp	Dynacare	500	238	2.1
Apr-01	LabCorp	Path Lab	108	51.6	2.1
Average					1.4

Source: *Laboratory Economics*

BIO-REFERENCE BACKS INCELLDX

Bio-Reference Labs (Elmwood Park, NJ) has made a $6 million investment in the private company InCellDX (Menlo Park, CA). The agreement includes a $4 million cash equity investment and a $2 million promissory note—giving Bio-Reference a 20% to 25% ownership stake in InCellDx. Bio-Reference chief executive Marc Grodman, MD, has become chairman of the board at InCellDx.

Concurrent with the investment, Bio-Reference announced the launch of GenServ (which uses ASR probes and reagents purchased from InCellDx). GenServ is the brand name of a laboratory-developed test designed to confirm whether patients with indeterminate Pap tests have cervical cancer—thus avoiding unnecessary cervical biopsies. Bio-Reference will market the test through its women's health division (GenPap), which includes 100 sales reps. The test, which is performed from liquid Pap test residual fluid, is expected to have a list price of between $75 and $100. Other reference labs that market the InCellDx assay include LabCorp, Solstas Lab Partners, Enzo Clinical Labs and ConvergeDx.

InCellDx was founded in 2004 by Bruce K. Patterson, MD, former medical director of diagnostic virology at Stanford University Hospitals and Clinics and associate professor at Stanford University.

According to their 2005 publication, Patterson and co-author Roberto Narimatsu, MD, determined that quantifying E6 and E7 gene expression via FISH enabled stratification of risk levels between low-risk and high-risk HPV infections; the gene expression increased as the level of severity of cervical lesion increased. According to the publication, HPV FISH for E6 and E7 mRNA demonstrated 83.3% sensitivity and 91.3% specificity for high-grade squamous intraepithelial lesion, compared with the Pap test from 231 liquid-based cytology samples from two cohorts. InCellDx is preparing to initiate its first FDA clinical trial for the assay by the end of the year.

FLORIDA TO RE-BID STATE LAB CONTRACT

The Florida Department of Health will re-bid a multi-million-dollar contract for lab services throughout the state, following a decision by Administrative Law Judge F. Scott Boyd issued on May 7.

Late last year the Florida Department of Health issued a request for proposals for a contract to provide lab test services to the state's county health departments. The contract requires daily couriers to pick up specimens at state clinics for tests such as Pap tests, metabolic panels, rubella screens, hepatitis, HIV and syphilis. Approximately 861,000 tests per year would be performed under the contract. In fiscal year 2010-2011, the total amount received under the existing contract (held by LabCorp) was $9.3 million.

The Department announced its intent to award the new contract to LabCorp on January 20, 2012. LabCorp's winning bid was $6.235 million. Quest was runner up with a bid of $7.923 million.

Quest protested the award claiming that it did not receive all the information it had requested prior to making its bid. The Department chose to reject all bids and start over. LabCorp protested this decision, but Judge Boyd has upheld the Department's decision to re-bid the contract.

This is a small contract in relation to the size of Quest and LabCorp. However, the dispute offers a rare glimpse into the intense pricing competition that still prevails between Quest Diagnostics and LabCorp. The re-bid contract is likely to fall below $6 million per year—a drop of 35% from the current contract's value $9.3 million per year.

COMMERCIAL LAB CEOs PAID AVERAGE OF $3.5M *(cont'd from page 1)*

Quest Diagnostics' Surya Mohapatra, PhD, $12.8 million, and **LabCorp's David King**, $11.1 million, were the highest paid lab company CEOs in 2011.

Quest's Mohapatra, age 62, received total compensation of $12.8 million last year. In addition, Mohapatra received a "golden parachute" severance package of $16 million when he was forced to resign effective April 30, 2012. Net income at Quest fell by 35% to $471 million in 2011; revenue was up 2% to $7.5 billion. Quest's stock price rose by 8% last year.

LabCorp's King, 55, received six categories of compensation last year that totaled $11.1 million. These included: 1) salary of $993,800; 2) stock awards of $4.5 million; 3) stock options worth $3.3 million; 4) management incentive bonus of $2 million; 5) pension plan value increase of $188,782; and 6) "other" compensation of $25,660, which included financial planning services, 401K matching contributions and a car allowance of $200 per month. Net income at LabCorp decreased by 7% to $520 million in 2011; revenue was up 11% to $5.5 billion. LabCorp's stock price fell by 2% last year.

The third-highest paid was **Peter Meldrum**, 64, president and CEO of **Myriad Genetics**. Meldrum earned $4.9 million, including a salary of $870,504, a bonus of $956,312, stock options valued at $3 million, plus other compensation of $9,866. In the fiscal year ended June 30, 2011, Myriad reported net income of $100.7 million, down 34% from $152.3 million in 2010; revenue increased by 11% to $402.1 million; its stock price fell 8% in 2011.

Quest's **Joan Miller**, 56, senior vice president, pathology and neurology, earned a total of $2.95 million in 2011. Miller, who is in charge of AmeriPath, received a salary of $501,120 plus incentives of $322,782, and stock and option awards worth $2.1 million.

Bio-Reference Labs' chairman and CEO **Marc Grodman, MD**, 60, earned $2.7 million last year. Bio-Reference reported net income of $36.4 million for the fiscal year ended Oct. 31, 2011, up from $26.4 million the previous year. Bio-Reference increased its revenue by 22% to $558.6 million. Its stock price fell by 27% in 2011.

Execs Reap Millions from Golden Parachutes

Several chief executives reaped lucrative severance packages over the past year triggered by their resignation and/or sale of their company. As mentioned above, Mohapatra got a $16 million severance package when he was forced to resign effective April 30, 2012. Tina Nova, PhD, got a $9.6 million "golden parachute" when Genoptix was sold to Novartis in early 2011. Thomas Bologna received $3.9 million when Orchid Cellmark was acquired by LabCorp in December 2011. Joseph Limber got $2.4 million when Prometheus RxDx was sold to Nestle in May 2011. And James New got a $500,000 cash payout when he resigned as chief executive of Aurora Diagnostics effective September 30, 2011.

Golden Parachutes

Executive	*Company*	*Trigger*	*Severance ($ Mill)*
Surya Mohapatra, PhD	Quest Diagnostics	Termination by Board	$16.0
Tina Nova, PhD	Genoptix	Sale to Novartis	9.6
Thomas Bologna	Orchid Cellmark	Sale to LabCorp	3.9
Joseph Limber	Prometheus RxDx	Sale to Nestle	2.4
James New	Aurora Diagnostics	Resignation as CEO	0.5

Source: *Laboratory Economics* from SEC reports

2011 Laboratory Executive Total Compensation

Company/Executive	Salary	Bonus and Incentives	Value of Stock & Option Awards	Other Comp*	2011 Total Compensation	2011 Revenue Growth	2011 Stock Total Return
AURORA DIAGNOSTICS James New, 66, Chairman and former CEO	$424,038	$934,400	$0	$39,770	$1,398,208	30%	NA
BIO-REFERENCE LABS Marc Grodman, MD, 60, Chairman and CEO	1,059,044	1,384,784	0	229,638	2,673,466	22%	-27%
COMBIMATRIX R. Judd Jessup, 64, President and CEO	420,000	0	0	0	420,000	28%	-7%
ENZO BIOCHEM Elazar Rabbani, PhD, 68, Chairman and CEO	551,549	533,000	60,554	173,153	1,318,256	5%	-58%
GENOMIC HEALTH Kim Popovits, 53, Chairman and CEO	490,000	109,800	1,233,805	0	1,833,605	16%	19%
LABCORP David King, 55, Chairman and CEO	993,800	2,208,318	7,831,220	25,660	11,058,998	11%	-2%
MEDTOX SCIENTIFIC Richard Braun, 67, Chairman and CEO	390,000	645,783	0	163,331	1,199,114	11%	7%
MYRIAD GENETICS Peter Meldrum, 64, President and CEO	870,504	956,312	3,029,902	9,866	4,866,584	11%	-8%
NEOGENOMICS Douglas VanOort, 56, Chairman and CEO	325,000	175,000	86,274	0	586,274	27%	8%
PSYCHEMEDICS Raymond Kubacki, Jr., 67, Chairman and CEO	403,142	100,800	190,570	8,461	702,973	20%	17%
QUEST DIAGNOSTICS Surya Mohapatra, PhD, 62, Chairman and CEO	1,231,122	3,665,741	7,765,627	118,231	12,780,721	2%	8%
QUEST DIAGNOSTICS Joan Miller, 56, Senior VP, Pathology	501,120	322,782	2,082,843	43,937	2,950,682	2%	8%
Totals, 12 executives	7,659,319	11,036,720	22,280,795	812,047	41,788,881		
Averages, 12 executives	$638,277	$919,727	$1,856,733	$67,671	$3,482,407	15%	-4%

*Other compensation includes changes in pension value plus reimbursement for financial planning services, 401K matching, car allowance, personal liability insurance premiums, executive physical exams, home security systems, country club memberships, personal use of company jets and other perks.

Source: *Laboratory Economics* from shareholder proxy statements

TOP IVD EXECS TAKE HOME AVERAGE OF $8 MILLION

The CEOs at twelve publicly traded lab instrument and reagent manufacturers earned an average of $8.3 million each last year, according to an analysis of shareholder proxy statements by *Laboratory Economics*. **Johnson & Johnson's William Weldon**, 63, chairman and chief executive, was the highest paid IVD executive in 2011. Weldon earned total compensation of $26.8 million. Next was **Abbott Labs' Miles White**, 57, chairman and chief executive, who received a total of $24 million.

2011 IVD Executive Total Compensation

Company/Executive	Salary	Bonus and Incentives	Value of Stock & Option Awards	Other Comp*	2011 Total Comp	2011 Revenue Growth	2011 Stock Total Return
ABBOTT LABORATORIES Miles White, 57, Chairman and CEO	$1,900,000	$9,619,080	$11,595,539	$896,283	$24,010,902	10%	22%
BECTON DICKINSON Edward Ludwig, 60, Chairman and CEO	1,092,500	2,598,278	6,362,694	37,801	10,091,273	8%	-10%
BIO RAD LABORATORIES Norman Schwartz, 62, President and CEO	770,000	154,962	2,904,222	15,814	3,844,998	7%	-8%
GEN-PROBE INC. Carl Hull, 55, Chairman and CEO	750,000	690,000	3,237,540	48,799	4,726,339	6%	1%
HOLOGIC Robert Cascella, 57, President and CEO	885,403	902,187	2,996,602	1,254,107	6,038,299	8%	-7%
ILLUMINA Jay T. Flatley, 59, President and CEO	779,423	650,988	8,497,348	16,388	9,944,147	17%	-52%
JOHNSON & JOHNSON William Weldon, 63, Chairman and CEO	1,907,215	17,771,394	6,798,177	321,153	26,797,939	6%	10%
LUMINEX Patrick Balthrop, Sr., 55, President and CEO	513,674	716,575	2,531,443	11,000	3,772,692	30%	16%
MERIDIAN BIOSCIENCE John Kraeutler, 63, CEO	546,000	0	228,300	69,111	843,411	15%	-16%
ORASURE TECHNOLOGIES Douglas Michels, 55, President and CEO	516,827	369,000	1,110,959	4,000	2,000,786	9%	59%
QUIDEL Douglas Bryant, 54, President and CEO	479,880	327,016	936,943	8,468	1,752,307	40%	5%
THERMO FISHER SCIENTIFIC Marc Casper, 44, President and CEO	1,000,000	1,300,000	3,064,050	152,517	5,516,567	9%	-19%
Totals, 12 executives	11,140,922	35,099,480	50,263,817	2,835,441	99,339,660		
Averages, 12 executives	928,410	2,924,957	4,188,651	236,287	8,278,305	14%	0%

*Other compensation includes changes in pension value plus reimbursement for financial planning services, 401K matching, car allowance, personal liability insurance premiums, executive physical exams, home security systems, country club memberships, personal use of company jets and other perks.

Source: *Laboratory Economics* from shareholder proxy statements

MEDICARE PART B LAB SPENDING WAS FLAT IN 2011

Medicare Part B spending on clinical laboratory services was flat at $8.9 billion in calendar-year 2011, according to data from CMS's 2012 Medicare Trustees Report.

Intermediary labs (i.e., hospital lab outpatient/outreach) provided $4.369 billion of Part B lab services in 2011—an increase of 5.8% compared with $4.131 billion in 2010. Carrier labs (i.e., independent labs and POLs) accounted for $4.556 billion, down 5.2% from $4.808 billion.

Total Medicare spending in 2011 was $549.1 billion, up 5% from $522.9 billion in 2010. The number of Medicare beneficiaries increased by 2.5% to 48.7 million.

Part B lab services represented 1.6% of overall Medicare program expenditures in 2011.

Part B lab expenditures increased at an average rate of 4.3% per year between 2006 and 2011. This compares with an average rate of growth of 6.1% per year for total Medicare program expenditures over the same time frame.

The Medicare Trustees Report is compiled by actuaries from the Centers for Medicare and Medicaid Services (CMS). This annual report is required by law and constitutes the government's official report on the status of the Medicare program.

Medicare Part B Spending on Lab Services, 2006-2011 ($ millions)

	2011	2010	2009	2008	2007	2006	5-Year CAGR*
Intermediary Labs (hospitals)	$4,369	$4,131	$3,999	$3,615	$3,471	$3,541	4.3%
Carrier Labs (independents)	4,556	4,808	4,671	4,260	4,144	3,694	4.3%
Total Part B Lab Spending	8,925	8,939	8,670	7,875	7,615	7,235	4.3%

*CAGR=compound annual growth rate

Source: 2012 Medicare Trustees Report

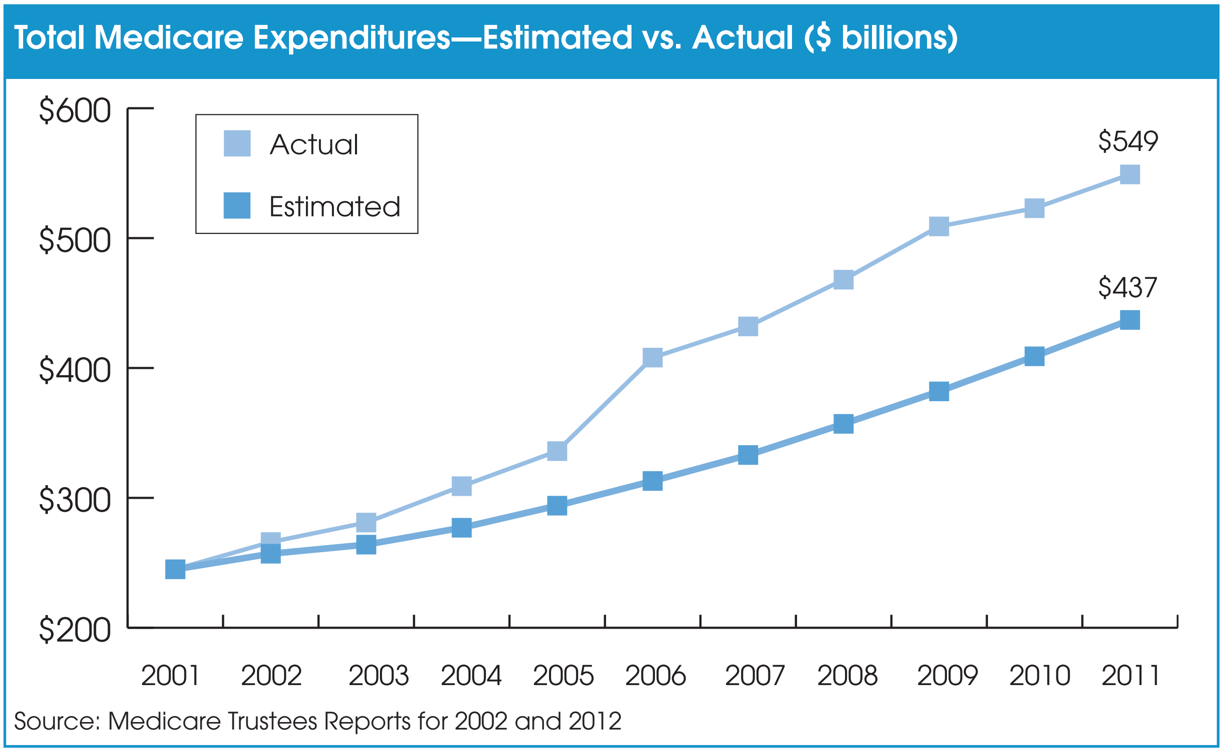
Unrealistic Medicare Spending Growth Estimates

Over the next 10 years, 2011-2021, The Medicare Trustees Report predicts that the annual growth in total Medicare spending will slow to an average of 6.2% per year. The projected growth rate is unrealistically low because it is based on physician payment cuts that are unlikely to occur. For example, current law requires a reduction in Medicare payment rates for physician services (including pathologists) of 31% effective January 1, 2013. It is nearly certain that Congress will override this scheduled cut.

Part B physician fee schedule reductions have been scheduled for every year since 2002 under the sustainable growth rate (SGR) system. The SGR system was enacted as part of the Balanced Budget Act of 1997 with the intent of limiting growth in spending on physician services to a sustainable rate, roughly in line with overall economic growth.

An update of -4.8% was required and allowed to take effect in 2002—the only historical year in which a negative update was implemented under the SGR. For the past nine years (2003-2011), scheduled physician fee cuts of at least -5% have been overridden by new legislation, which provided updates that have averaged +1% per year.

The inability of Congress to make tough and politically unpopular decisions has allowed Medicare spending to consistently rise faster than estimates. For example, the Medicare Trustees Report for 2002 had predicted that total Medicare expenditures would rise by an average of 6% per year to reach $437 billion in 2011. The actual growth rate turned out to be 8.4% per year with total spending of $549 billion (*see graph on page 9*).



The $27 Trillion Unfunded Obligation

The first of 77 million Baby Boomers turned 65 last year. Medicare enrollment will grow from 48.7 million in 2011 to 70 million in 2025. This swell of beneficiaries will rely on the taxed earnings of working Americans to pay for their Medicare benefits.

When Congress first enacted the Medicare program in 1965 there were approximately four working-age Americans for every beneficiary. However, a decline in U.S. birth rates combined with the retirement of the Baby Boomers means that there will be only 2.5 working Americans per Medicare beneficiary in 2025.

The shrinking worker-to-beneficiary ratio—combined with ever increasing medical costs per beneficiary—has created an unfunded obligation of $27 trillion. In other words, the United States would need to deposit $27 trillion into Medicare's trust fund accounts today in order to cover benefits in full over the next 75 years.

This amount of underfunding is staggering. Raising the $27 trillion (or $27,000,000,000,000) needed to shore up Medicare would require every U.S. household to pay a $234,000 tax right now.

As worrisome as these numbers are, they are unrealistically optimistic because the $27 trillion estimate by the Trustees counts on cost-cutting plans that are not likely to occur—such as the 31% physician fee schedule cut.

The Trustees' alternative projection assumes that physician fee schedule would be held to a 1% annual increase instead of next year's 31% cut, and that "productivity" cuts in other providers' payments would be phased down starting in 2020. Under these more realistic assumptions, Medicare's unfunded liability increases to $37 trillion (or $321,000 per U.S. household).

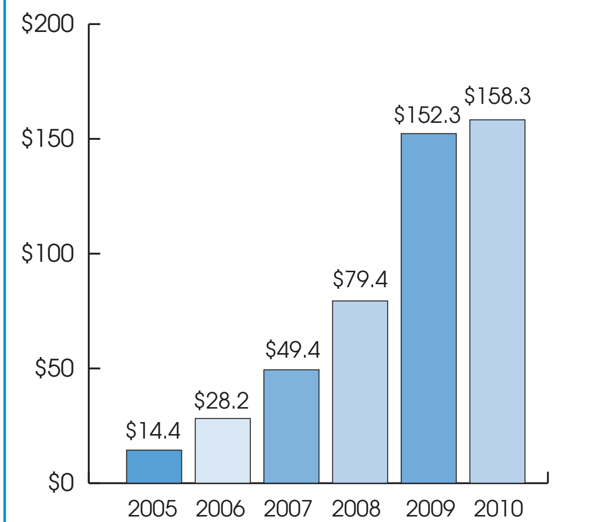
"Congress and the executive branch must work closely together with a sense of urgency to address the exhaustion" of the Medicare trust fund and growth in spending, according to the Trustees Report.

WAUD CAPITAL BUYS STERLING REFERENCE LABS

The private equity firm Waud Capital Partners (Chicago, IL) has acquired Sterling Reference Labs (Tacoma, WA) for an undisclosed sum. Established in 2002, Sterling is a CLIA and SAMHSA-certified reference lab focused on drugs-of-abuse testing for the criminal justice and employment screenings markets.

The four owner-managers at Sterling, including Evans Calas, will maintain minority stakes in the company and management roles. David Lowenberg joins Sterling as its chairman and Sue Sommer has become president. Lowenberg was a former executive at Express Scripts. Sommer was previously vice president of both intersegment management and Medicare solutions at UnitedHealth Group.

Medicare Part B Carrier Spending on Drug Screens ($ millions)

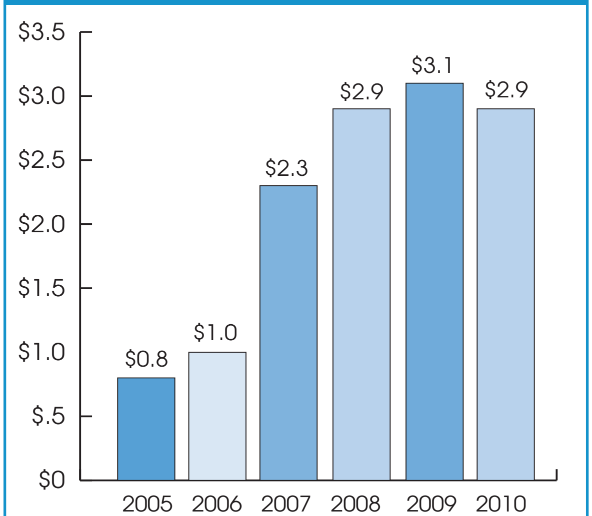


Source: CMS

WCP's investment in Sterling occurs as some of its competitors have come under increased regulatory scrutiny related to their sales practices for pain management drug testing.

- Earlier this year, Calloway Laboratories (Woburn, MA) agreed to pay $20 million to Massachusetts to resolve allegations that it billed the state's Medicaid program for unnecessary urine drug tests.
- In late 2010, Ameritox (Baltimore, MD) agreed to pay $16.3 million to the federal government and several states to settle allegations that it paid kickbacks to physicians in order to induce them to refer Medicare business.

U.S. Sales of OxyContin ($ billions)



Source: IMS Health

Drug Screening Boom

Pain management drug testing has been a booming business. Medicare Part B carrier spending on drug screens (CPT 80101/G0431) grew at an annual rate of 62% during the five-year period 2005-2010. The big driver has been increased testing to monitor appropriate patient use of prescription painkillers (e.g., codeine, hydrocodone, methadone, oxycodone, oxymorphone, et al.).

The surge in pain management drug testing has followed the growth in sales of prescription painkillers. For example, sales of OxyContin (made by Purdue Pharma) increased by 30% per year to $2.9 billion during the five-year period 2006-2011, according to IMS Health.

CANCER GENETICS SEEKS $48 MILLION FROM IPO

Cancer Genetics Inc. (CGI-Rutherford, NJ) plans to raise $48 million by offering four million shares at a price range of $11-$13 per share. At the midpoint of the proposed range, CGI would command a market value of $112 million. The IPO is being managed by William Blair, Baird, Needham & Company and First Analysis Securities Corp.

CGI operates an 18,000-square-foot CLIA-accredited lab in Rutherford, New Jersey, that provides routine histology, IHC, flow cytometry and FISH testing. CGI began marketing proprietary laboratory-developed tests for leukemia and lymphoma under the brand name MatBA in early 2011. The company is also developing proprietary tests for kidney, prostate and bladder cancer, as well as for uterine, ovarian and cervical cancer.

CGI has accumulated net losses totaling $43.3 million since its inception in April 1999 through March 31, 2012. The company reported a net loss of $19.9 million in 2011 versus a net loss of $8.4 million in 2010; revenue increased to $3 million from $2.5 million. The company's average revenue per test is approximately $500-$700.

In January 2012, CGI agreed to pay $1 million to the U.S. Department of Justice to settle claims that it billed Medicare for tests that were medically unnecessary and improperly coded.

Proceeds from the IPO would be used to fund ongoing operations ($14 million), repay outstanding debt ($9 million), expand sales and marketing ($10 million), and to fund research and new joint venture with Mayo Foundation ($9 million).

CGI has about 50 employees, including five sales reps. Panna Sharma, age 41, is chief executive. Prior to joining CGI in May 2010, Sharma was managing partner at the life sciences consulting firm TSG Partners (Atlanta, GA) from 2001 to 2010.

CGI's principal shareholders are board member John Pappajohn, who owns a 42% stake, and founder and chairman Raju S.K. Chaganti, PhD, who has a 25% stake. Sharma owns a 4.3% stake in CGI.

Aurora Diagnostics and LipoScience

Meanwhile, executives at Aurora Diagnostics (Palm Beach Gardens, FL) and LipoScience Inc. (Raleigh, NC) are waiting for stock market conditions to improve so they can complete their IPOs.

Aurora filed with the SEC to raise up to $150 million from a public offering in May 2010. In the three months ended March 31, 2012, Aurora reported a net loss of $2.1 million versus a net loss of $2 million in the same period a year ago; revenue increased 15% to $72.1 million.

LipoScience, which specializes in advanced lipid testing, filed to raise $86 million from an IPO in June 2011. The company reported a net loss of $1.2 million in 2011 versus a net profit of $920,000 in 2010; revenue was up 16% to $45.8 million.

The last lab company to successfully complete an IPO was Genoptix Inc. (now owned by Novartis), which raised $85 million in October 2007.

LAB STOCKS UP 11% YEAR TO DATE

Ten lab stocks have risen by an unweighted average of 11% so far this year. Shares of MedTox Scientific have performed best, up 50%, followed by Bio-Reference Labs, up 33%. In comparison, the S&P 500 Index is up 8% and the Nasdaq is up 13% year to date through May 11. In terms of valuation, Quest Diagnostics is currently trading at 1.2x its annual revenue and 8.3x its trailing EBITDA (earnings before taxes, interest, depreciation and amortization). LabCorp trades at 1.5x annual revenue and 8.1x trailing EBITDA.

Company (ticker)	Stock Price 5/11/12	Stock Price 12/30/11	2012 Price Change	Market Capitalization ($ millions)	Enterprise Value/ EBITDA	Price/ Sales
Bio-Reference (BRLI)	$21.70	$16.27	33%	$603	7.7	1.0
CombiMatrix (CBMX)	1.01	2.00	-50%	11	NA	2.2
Enzo Biochem (ENZ)	2.21	2.24	-1%	85	NA	0.8
Genomic Health (GHDX)	31.33	25.39	23%	942	53.9	4.3
LabCorp (LH)	86.72	85.97	1%	8,395	8.1	1.5
Medtox Scientific (MTOX)	21.04	14.05	50%	189	12.7	1.7
Myriad Genetics (MYGN)	25.90	20.94	24%	2,198	9.4	4.7
NeoGenomics (NGNM)	1.71	1.40	22%	77	49.3	1.5
Psychemedics (PMD)	9.90	9.10	9%	52	7.7	2.1
Quest Diagnostics (DGX)	57.21	58.06	-1%	9,076	8.3	1.2
Unweighted Averages			**11%**	**$21,628**	**19.6**	**2.1**

Source: Bloomberg