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LABORATORY ECONOMICS

Competitive Market Analysis For Laboratory Management Decision Makers

MEDICARE LAB FEE SCHEDULE TO BE CUT BY ANOTHER 2%

Congress has passed new legislation that will cut the Medicare Part B Clinical Lab Fee Schedule by 2% effective January 1, 2013. The lab cut will help pay for a 10-month delay in the scheduled 27% reduction to the Medicare physician payment rate that was to take effect March 1.

However, Congress will have to return to the physician fee issue later this year to avert an even larger Medicare pay cut, estimated to top 30%, in 2013.

The 2% lab cut has been labeled as a "rebase to Medicare clinical laboratory payment rates." Previously scheduled cuts under the Affordable Care Act of 2010 (aka ObamaCare) and the Budget Control Act of 2011 will still be applied as well. *More details on page 4.*

MICHIGAN SUES QUEST TO RECOVER MILLIONS FROM ALLEGED MEDICAID FRAUD

The State of Michigan has intervened as a plaintiff in a civil lawsuit, *Michigan ex rel. Hunter Laboratories LLC v. Quest Diagnostics Incorporated, et al.*, filed in Michigan Superior Court. The suit, originally filed by whistleblower Chris Riedel and his company Hunter Labs, alleges that Quest overcharged Michigan's Medicaid program.

The case is very similar to Riedel's lawsuits against Quest, LabCorp and six small labs in California for allegedly overcharging Medi-Cal. The California attorney general's office joined Riedel in these suits. Ultimately, the labs paid settlements totaling approximately $300 million with Riedel receiving more than $75 million. *More details on page 9.*

TEXAS JUDGE AWARDS $700K TO EX-AMERIPATH PATHOLOGIST

A Texas court has ordered AmeriPath to pay more than $700,000 to Steven Hebert, MD, to cover his legal costs involved with a dispute over an alleged non-compete contract. *Continued on page 2.*

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JUDGE AWARDS $700K TO EX-AMERIPATH PATHOLOGIST (*cont'd from p. 1*)

Judge Don Jarvis, sitting in the 199th District Court in McKinney, Texas, issued the ruling in Steven Hebert MD vs. AmeriPath Inc. (case 199-03680-2009) on January 13. Judge Jarvis had previously dismissed all of AmeriPath's claims against Dr. Hebert arising from his resignation from AmeriPath in late 2009.

AmeriPath, which was acquired by Quest Diagnostics in May 2007, was ordered to compensate Dr. Hebert after the court found that AmeriPath's non-compete agreement with Dr. Hebert was made with a company that never legally existed.

Quest strongly disagrees with the court's ruling. Dr. Hebert's allegation that his employment contract was invalid runs contrary to multiple tenets of Texas law, according to Wendy Bost, spokesperson for Quest. She says, "The plaintiff made this argument only after he had received many years' worth of lucrative compensation and other benefits under the contract, and only after an arbitration concerning the contract resulted in a substantial award in AmeriPath's favor." On February 10, AmeriPath filed a bond to suspend enforcement of the judgment so that the company can appeal without having to pay the judgment during the appeal. In addition, Bost says AmeriPath will seek enforcement of the arbitration award against Dr. Hebert.

Dr. Hebert originally signed an employment agreement with an AmeriPath subsidiary in North Texas named "DFW 5.01(a) Corporation" in September 1998. In early 2008, Dr. Hebert signed a new contract, not with DFW 5.01(a) Corporation, but instead with an entity named "AmeriPath DFW 5.01(a) Corporation." Dr. Hebert's 2008 contract with AmeriPath DFW 5.01(a) Corporation said that it "completely replaces and supersedes" all previous employment agreements.

For the first nine years of his employment with AmeriPath, Dr. Hebert worked at Richardson Regional Medical Center (North Dallas, TX). He became managing director for AmeriPath in North Texas in January 2008. Shortly thereafter AmeriPath fired its medical director at HCA-affiliated Medical Center of McKinney (MCM). Hebert filled the vacancy and helped AmeriPath maintain its contract to provide pathology services to MCM.

However, Hebert became increasingly frustrated with unexpected physician turnover and understaffing following Quest's takeover of AmeriPath. He resigned from AmeriPath in August 2009. In his resignation letter, Hebert wrote: "The role of hospital medical director is a full time position and leaves me no time to address management issues in North Texas. We have a large number of physician contracts which have expired and I feel I can no longer offer these professionals any hope of a better future. Most of our pathologists deeply resent the Quest buyout."

Later in 2009, Hebert joined AmeriPath's rival ProPath (Dallas, TX) and resumed providing pathology services to MCM. AmeriPath challenged his right to continue working at the hospital. Dr. Hebert filed a lawsuit in September 2009 seeking to have his alleged non-compete contract nullified. And AmeriPath sued to prevent Dr. Hebert from working at MCM.

Dr. Hebert tried to negotiate an agreed departure with Quest, according to Stephen Fink of Thompson & Knight, lead counsel for the pathologist. "But Quest's lawyers in New Jersey insisted that because of his purported non-competition agreement he could not continue to work at the Medical Center of McKinney without paying Quest a ton of money—far, far more than he could

possibly afford. Since the hospital wanted him to stay and he very much wanted to stay there too, he felt he had no choice but to go to court," says Fink.

"A year into the case we discovered that AmeriPath had given Dr. Hebert employment agreements to sign with a company that never existed [AmeriPath DFW 5.01(a) Corporation]," says Fink. "The court concluded that meant Dr. Hebert did not have a non-competition agreement at all with AmeriPath. It's extraordinary that Dr. Hebert had to be the one to tell a company the size of Quest that many of AmeriPath's supposed employment agreements with physicians in North Texas were unenforceable. It's even more extraordinary that, after learning that fact, AmeriPath re-doubled its efforts to prevent Dr. Hebert from working at the hospital."

Laboratory Economics asked Mr. Fink and Dr. Hebert, "Why would Quest spend so much time and money over a single pathologist?"

Mr. Fink answered: "Pathologists are far and away AmeriPath's most valuable asset. The value of those assets is directly related to AmeriPath's ability to keep them from leaving and practicing medicine other than at AmeriPath. That's hard to do with AmeriPath having to pursue the continuous cost-cutting that ownership by a corporation like Quest entails. So in our opinion, Quest is simply trying to make an example of Dr. Hebert. As expensive as that process is, threatening legal action is still a cheaper way to keep pathologists on board than increasing their salaries."

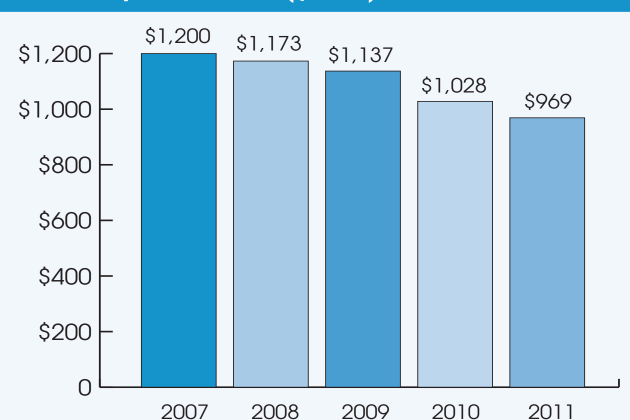
Dr. Hebert's answer was more succinct: "Pathologists are the geese that lay the golden eggs, and Quest is killing the geese."

PROJECTIONS VS. REALITY AT QUEST/AMERIPATH

Quest Diagnostics purchased AmeriPath in May 2007 for $2 billion. At the time of the acquisition, Quest executives thought they could grow AmeriPath's revenue by 10% per year. But it hasn't worked out that way. Anatomic pathology revenue at Quest/AmeriPath decreased by an annual average of 6.2% in the three years ending December 2011.

Anatomic pathology revenue at Quest/AmeriPath would have grown to $1.561 billion if the 10% target had been achieved. That's about $600 million above the actual reported revenue of $969 million in 2011. The shortfall has put tremendous pressure for cost cutting on Quest/AmeriPath.

Insourcing by specialty groups has hurt, but so has pathologist turnover.



MEDICARE LAB FEE SCHEDULE TO BE CUT (*cont'd from page 1*)

Alan Mertz, president of the American Clinical Laboratory Association, said word of the 2% cut came at the last minute and gave ACLA and other lab associations only 24 hours to rally against it. Including scheduled cuts from The Affordable Care Act of 2010 (ACA), the Medicare Part B clinical lab fee schedule (CLFS) will be reduced by approximately 20% over the next 10 years. Mertz says the cuts will hurt smaller labs disproportionately because Medicare accounts for a significant percentage of their revenue.

The CLFS is supposed to receive an inflation update each year based on the consumer price index for urban areas (CPI-U). The latest legislation will rebase the CLFS by -2% in 2013. The ACA requires two other additional cuts. In addition, the Budget Control Act of 2011 calls for an automatic sequester cut of 2% in 2013. So next year there will be a total of four cuts:

1. Under the ACA, CMS must reduce the inflation update to the Part B lab fee schedule by a "productivity adjustment" of about 1.3% per year from 2011-2020.
2. ACA requires an additional 1.75% decrease in the CPI update each year from 2011-2015.
3. Effective January 1, 2013, the CLFS will be subject to a one-time 2% cut to help pay for a 10-month freeze in Medicare payment rates to physicians.
4. Finally, the Budget Control Act of 2011 calls for an automatic sequester cut of 2% to the CLFS in 2013.

For example, the CPI-U was up 2.9% for the 12 months ended January 2012. Assuming this rate of inflation means that the CLFS will be slashed by 4.15% next year.

The Part B clinical lab fee schedule has essentially been frozen since 2000. If the Part B clinical lab fee schedule had been adjusted with the inflation rate since 2000, a hypothetical $10 test would be reimbursed at about $14 next year.

Medicare Part B Clinical Lab Fee Schedule Changes

Year	Part B Clinical Lab Fee Schedule Change	Hypothetical $10 Test
2000	0.00%	$10.00
2001	0.00%	$10.00
2002	0.00%	$10.00
2003	+1.10%	$10.11
2004	0.00%	$10.11
2005	0.00%	$10.11
2006	0.00%	$10.11
2007	0.00%	$10.11
2008	0.00%	$10.11
2009	+4.50%	$10.56
2010	-1.90%	$10.36
2011	-1.75%	$10.18
2012	+0.65%	$10.25
Est'd 2013	-4.15%	$9.82

Source: *Laboratory Economics*

Extension on TC Grandfather Clause

Meanwhile, the new legislation extends the technical component "grandfather" clause through June 30, 2012. After June 30, independent labs that provide technical services to hospitals for certain surgical pathology procedures will have to bill the hospital as opposed to billing Medicare.

PATHOLOGY INSTITUTE HIGHLIGHTS

Nearly 200 pathologists and executives gathered in Fort Lauderdale, Feb. 9-10, for the inaugural Pathology Institute conference put together by *Laboratory Economics* and G2 Intelligence. The conference featured revealing presentations from some heavy hitters in pathology. Here are some highlights:

Cory Roberts, MD, chairman and president at **ProPath** (Dallas, TX), said ProPath increased its revenue by more than 5% to approximately $75 million in 2011. The company currently processes 1,500 blocks and 1,100 Pap tests per day. Its fastest growing areas are off-the-vial testing (HPV, CT, NG, TV), up 16% to 224,012 tests in 2011, and molecular diagnostics (HSV, KRAS, JAK2, TCR, etc.), up 174% to 808 tests.

ProPath has 36 pathologists and is wholly physician-owned. Roberts said ProPath has met with potential investors and competitors. But ProPath is inclined to stay independent. "We're not convinced that outsiders could make us more successful," said Roberts.

The key to success is good people, not bricks and mortar or wordsmithing (e.g., mission statements), according to Roberts. "Choose your employees wisely and then incentivize all that you can. If key people can't be owners, then treat them like one through performance-based bonuses," he advised.

ProPath at a Glance

Revenue 2011	~$75M
Daily volume	1500 blocks+1100 Paps
Employees	300
Pathologists	36
Hospital contracts	20

Source: ProPath

Ben Davis, MD, chairman and chief executive of **PathGroup** (Nashville, TN), said PathGroup increased its test volume by 20% in 2011 to 4.25 million tests, including 1.75 million anatomic and molecular tests and 2.5 million clinical lab tests. The company's revenue exceeded $125 million.

PathGroup's fastest growth is occurring at its molecular laboratory, which has its own medical director, Vladimir Kravtsov, PhD, MD, and 30 employees. Molecular oncology volumes increased by more than 100% last year led by FISH and cytogenetics testing (36,000 CPT's per year).

Davis said PathGroup's growth strategy is weighted toward organic growth. However, the company did make two small acquisitions last year: Associates in Laboratory Medicine (Dalton, GA), with two pathologists in August, and Pathology & Forensic Consultants (Fort Wayne, IN), with four pathologists in December.

PathGroup at a Glance

Revenue 2011	~$125M
Test volume 2011	4.25M
Employees	700
Pathologists	65
Hospital contracts	70

Source: PathGroup

Joe Plandowski, co-founder of **In-Office Pathology LLC** (Lake Forest, IL), said the average office-based gastroenterologist bills 1,250+ pathology CPT codes (88305s and specials stains) per year: urologist, 1,500 codes; and dermatologist, 2,000 codes. Insourcing represents a tremendous opportunity for hospital-based pathologists to win back business that has been sent out to national labs such as Quest, LabCorp, Caris, OUR Lab, Bostwick, etc., according to Plandowski.

Plandowski noted that in-office labs require local pathologists for professional services. His consulting company (IOP) has helped install 50 histology labs at GI, urology and derm groups

over the past seven years. "Once a group gets more than four doctors, they start talking about an in-office lab….Our busiest time now is with derm groups that want to open a lab," he said.

Plandowski said IOP clients typically bill globally and pay pathologists about $26 per slide interpretation. This amount is equal to the full Medicare professional component ($36) minus the practice expense ($10).

"You get paid in 30 days and it's much higher than TC/PC and client bill arrangements," said Plandowski. In TC/PC arrangements, he said, the $36 PC fee is split between the pathologist and specialty physician ($18 apiece). And he has seen client billing fees as low as $27 for a global 88305.

Plandowski said pathologists should identify specialty groups (4+ docs) in their area that send specimens to a competing group or outside reference lab. "Ask about their interest in having an in-office histology lab and contact IOP or others for assistance," he advised. He cautioned pathologists to make certain that their hospital contract allows them to work at an in-office lab and that their existing insurance covers it.

Regarding overutilization and potential abuse at in-office labs, Plandowski urged pathologists to report any abuse they see to the Office of the Inspector General. "I'll bet nobody in the audience has filed more complaints with the OIG than me," he said.

James Richard, MD, DO, partner at **CAP Lab**, an independent group with three pathologists located in Lansing, Michigan, said, "Show them the money." He said pathologists should reach out to their physician office clients about partnerships for in-office labs. Proposals should be tailored to benefit both parties.

CAP Lab serves as medical director and provides professional services to three in-office histology labs, including a urology, gastroenterology and dermatology group. CAP Lab leases its histotechs at an hourly rate to these groups. These groups bill for the technical service and CAP Lab bills for professional services.

According to Richard, physician office clients want: 1) to stay local; 2) make a reasonable profit; and 3) have a hassle-free operation. "They will make an ethical choice, if it's reasonable and if they're given the chance," he noted.

Richard said pathologists should treat these partnerships like a small hospital that has a histology lab where they (the pathology group) provide professional services.

Al Parker, administrator at **KWB Pathology Associates** (Tallahassee, FL), said KWB has had four big clients (3 derm groups and 1 endoscopy center) insource histology over the past three years. The first was Dermatology Associates of Panama City, with four dermatologists, in the fall of 2009. This group has its own histology lab, but KWB still performs and bills for professional services.

Three other groups—Dermatology Associates of Tallahassee, Gulf Coast Dermatology, and Digestive Disease Clinic—opened in-office histology in 2010. These groups hired or contracted with other pathologists.

Parker said KWB's first reaction was anger and disbelief at the lack of loyalty. In one case a KWB pathologist resigned and went to work for Dermatology Associates of Tallahassee.

However, after the initial shock, KWB chose to continue relationships with all four clients. The four clients had together represented $7.7 million in annual business for KWB. Despite insourcing, KWB has been able to retain $4.6 million, or 59%, of its annual revenue from these clients. "You can maintain more revenue than you think," Parker noted.

Parker said most in-office labs have limited capacity, and KWB covers the overflow. In addition, some health plans, including BCBS BlueOptions and Capital Health Plan, require pathology testing to be performed by a traditional pathology lab. Finally, Parker said there is typically increased volume/utilization from those practices after they put in their own labs.

Mick Raich, president of **Vachette Pathology** (Blissfield, MI), said that about 70% of managed care contracts with pathologists are based on Medicare rates. Some managed care payers reimburse up to 125% of Medicare, while others pay as low as 39%. This means that global reimbursement for CPT 88305 ranges between $40 and $129 depending on the payer. Medicare reimbursement for CPT 88305 for 2012 is $105.86 (unadjusted for geography).

"Many times the group just accepts what the plan is willing to pay; they simply do not negotiate better rates," noted Raich. He said that pathology groups should consider going non-par with managed care payers that represent less than 7% of their revenue.

Raich said that pathology labs negotiate better contract terms with their biggest managed care payers. He advised scheduling a face-to-face meeting with your managed care rep at your lab. In addition to seeking higher rates, he said pathology groups should ask for annual cost-of-living adjustments, a 60-day termination clause without cause, a 60-day appeal limit for denied claims and a 120-day filing limit.

Christian Stevens, marketing director at **SkinPath Solutions** (Smyrna, GA), said, "A salesperson is an evangelist. They need to believe in the product or service they are selling."

SkinPath is a dermatopathology lab started by former AmeriPath lab director Robert Wesley Wetherington, MD, in early 2010. Prior to joining SkinPath, Stevens was regional sales manager for AmeriPath/DermPath in Atlanta.

In Stevens' opinion Quest made several mistakes after acquiring AmeriPath, including lowering sales rep compensation and trying to cross-sell clinical lab test services to anatomic pathology clients.

Amanda Lowe, president of **Digital Pathology Consultants** (Broomfield, CO), said there are "not a lot of concrete examples" of pathology labs making money from digital pathology. "The success stories will come in a couple of years," she said. Lowe noted that the FDA has determined that digital pathology systems for primary diagnosis will need premarket approval as a Class III device, although some labs are already doing it as a CLIA laboratory-developed test.

Lowe said barriers to widespread adoption by pathology labs include the large capital investment (up to $250,000-$300,000). Ninety percent of digital pathology systems are paid for as a capital investment or lease—the "pay-per-click" model never took off, according to Lowe.

Meanwhile, Lowe said that academic medical centers have embraced and are strong supporters of digital pathology. The most popular applications for AMCs today are tumor boards, department conferences and grand rounds, secondary consultations, frozen section review, resident and medical student education, and quantitative analysis of immunohistochemistry for HER2 and ER/PR.

In addition, Lowe said the use of digital pathology is widespread among pharmaceutical and biotech companies. Tissue based research is at the heart of the drug development process, and digital pathology images allow pathologists and researchers from different offices, typically in locations around the world, to collaborate.

Robert Goulart, MD, director of surgical pathology at **New England Pathology Associ-**

ates (Springfield, MA), discussed NEPA's joint venture for 50-50 ownership of the histology and cytopathology labs at Mercy Medical Center (MMC).

The joint venture, named LifePath Partners LLC, was formed in 2002. At that time, the medical staff at MMC was dissatisfied with its three general pathologists and had no Part A support, according to Goulart. MMC gave up 50% ownership of its histology and cytopathology labs to the joint venture in exchange for increased pathologist coverage (NEPA currently has nine pathologists), including a full-time medical director for the hospital's clinical lab. Operating expenses for the lab are paid by NEPA and MMC based on utilization.

In addition, Goulart noted that NEPA has partnerships with two urology groups with in-office labs: Urology Group of Western New England and Glazier Urology. The urology groups own their labs and bill for technical services. NEPA manages these labs and performs and bills for professional services. Goulart said NEPA may form a similar arrangement with a local Ob/Gyn group.

Jane Pine Wood, member at the law firm **McDonald Hopkins**, said some urology and GI groups are now trying to move their hospital patient specimens to their in-office labs. Hospitals have begun putting more restrictive covenants in their contracts with pathologists to stop them from working for in-office labs, according to Wood. She does not expect the Stark in-office exception rules to be changed any time soon. Wood believes restrictions from private insurance payers are "the best chance to eliminate in-house labs."

Mergers & Acquisitions

Pathology Institute 2012 also featured an M&A workshop. Here are a few highlights from some of the speakers:

Jennifer Stapleton, associate at **McDonald Hopkins**, noted that contingent consideration is often used to bridge the gap between what a seller wants and what a buyer is willing to pay. Contingent consideration (aka earn-out goals) are paid to the seller over a three- to five-year period based on the achievement of certain revenue or profit goals. However, Stapleton advised sellers not to rely on contingent consideration because it is influenced by how well the new owner operates your business. "You really have to get to know your buyer and ask yourself: 'Can I work for someone else?'"

Tim Johnson, managing director at the private equity firm **England & Company** (Washington, DC), said that when considering acquisitions, "The big labs are pretty confident of themselves that they can run your lab better than you." He said Quest and LabCorp value acquisitions based on acquired revenue because they believe they can bring cost-saving synergies. But the big labs are not good at keeping acquired revenue and lose an average of about 30% of an acquired lab's business in the first year, according to Johnson.

Johnson said private equity firms can't bring synergies, so they value labs based on EBITDA (earnings before interest, taxes, depreciation and amortization). He has seen lab valuations range from 4x to 10x EBITDA. Private investors typically want to triple or quintuple their investment over a 5-7 year horizon.

Johnson said private equity firms are looking for labs with $20 million or more in annual revenue, while Quest and LabCorp are looking for a minimum of $50 million. "The valuations being placed on labs are very good. It's a good time to sell," he added.

Rick Cooper, member at **McDonald Hopkins**, said the biggest things that scare off potential buyers and/or lowers lab acquisition values are billing issues and improper referral source relationships. "Buyers heavily scrutinize legal compliance issues," he noted.

MICHIGAN SUES QUEST DIAGNOSTICS (*cont'd from page 1*)

The suit was originally filed in 2008 under the Michigan Medicaid False Claims Act by Riedel and Hunter Labs, who alleged that Quest submitted false claims by billing the Michigan Medicaid program more for lab tests than it charged to private payers.

According to the original complaint, Quest charged private payers lower prices to ensure a continued stream of business, and then "subsidized" their losses by charging the Michigan Medicaid program higher prices in violation of Medicaid guidelines. In some cases, the complaint alleged that Quest charged the Medicaid program more than three times the cost charged to private payers.

The Michigan Medicaid program covers about two million beneficiaries.

Riedel and Hunter Labs are represented by Niall McCarthy of Cotchett, Pitre & McCarthy (Burlingame, CA). This is the same law firm that Riedel used in his Medi-Cal lawsuit.

Assistant Attorney General Elizabeth Valentine is handling the case on behalf of Michigan Attorney General Bill Schuette. The case is *The State of Michigan ex rel. Riedel, et al. v. Quest Diagnostics, Inc., et al.,* Case No. 08-330-CZ (Ingham County Circuit Court).

LabCorp, which does no business with the Michigan Medicaid program, is not included as a defendant.

QUEST TO LAY OFF 25% IN NEW MEXICO

Quest Diagnostics has announced that it is laying off a quarter of its 450-person workforce in New Mexico in the next six months. Quest, which purchased SED Medical Labs earlier this year (see *LE*, January 2011, pp. 1-2), said most of the cuts will occur at SED's main lab in Albuquerque. When the layoffs are completed, SED will have 325 employees at 20 locations in New Mexico, according to Quest. SED performs more than 7.5 million tests per year. *Laboratory Economics* had estimated that the acquisition would bring $75 million of annual revenue to Quest. But Quest's chief financial officer Robert Hagemann has said the acquired revenue is in the range of $25 million to $30 million.

SOLSTAS BUYS HAYES CLINICAL LAB IN FLORIDA

Solstas Lab Partners (Greensboro, NC), formed by the merger of Spectrum Labs and Carilion Labs in February 2010, has purchased Hayes Clinical Laboratory (Boynton Beach, Florida) effective December 1, 2011. The Hayes acquisition follows SLP's recent purchase of Oracle Clinical Laboratories (Davie, Florida) in August 2011.

PAML HIRES A NEW CEO

Pathology Associates Medical Laboratories (PAML-Spokane, WA) has hired Francisco "Frank" Velázquez as chief executive. He previously served as managing director of Quest Diagnostics' Nichols Institute and was a managing director/vice president for Focus Diagnostics in California. PAML's long-time CEO Thomas Tiffany, PhD, announced his retirement late last year.

QUEST DIAGNOSTICS WRAPS UP ANOTHER SUB-PAR YEAR

Quest Diagnostics (Madison, NJ) reported net income of $470.6 million for full-year 2011, down 35% from $720.9 million in 2010. Profits were hurt by the company's $241 million settlement with Medi-Cal as well as $42 million in write-offs associated with employee layoffs.

Quest's reported revenue increased by 1.9% to $7.511 billion in 2011. However, Quest's organic revenue was down 0.3% after adjusting for the acquisitions of Athena Diagnostics (April 2011) and Celera Corp. (May 2011).

On January 24, the company held a conference call with analysts and investors to discuss its year-end results. Here's a summary of some key topics:

CEO Search

Quest continues to search for a new chief executive. "This is a top priority for our board.…by April 30, we'll have a new CEO," said current chief executive Surya Mohapatra, PhD.

Anatomic Pathology

Quest reported that its anatomic pathology revenue decreased by 5.7% to $969 million in 2011. The company cited continued pressure from insourcing at specialty groups. "We do have access to certain members of congress to educate them on the impact that self-referral has in a physician's office, not only on the cost of the test, but also the utilization of testing," said Kathleen Valentine, director of investor relations.

Quest Diagnostics Financial Summary ($ millions)

Revenue by product	2011	2010	% Chg
Gene-based and esoteric	$1,843	$1,656	11.3%
Anatomic pathology	969	1,028	-5.7%
Routine	3,822	3,885	-1.6%
Drugs of abuse	180	170	5.9%
Other	696	630	10.5%
Total revenue	7,511	7,369	1.9%
Cash from operations	896	1,118	-19.9%
Pretax income	856	1,184	-27.7%
Net income	471	721	-34.7%
Diluted EPS	2.92	4.05	-27.9%
Total debt	4,025	2,990	34.6%
Cash & securities	165	449	-63.3%
Shareholders' equity	3,715	4,054	-8.4%
Bad debt %	3.7%	4.0%	-7.5%
Days sales outstanding	45	44	2.3%
Est'd number of requisitions	146.5	146.5	0.0%
Est'd revenue per requisition	$45.77	$44.87	2.0%

*Other revenue includes clinical trials testing, information technology services and testing services for life insurance companies

Source: Quest Diagnostics and requisition estimates from *Laboratory Economics*

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Electronic Health Records

Quest's Care360 EHR system has met the criteria for "meaningful use," which enables physicians that use the system to potentially receive Medicare incentives totaling $44,000 per doctor between 2011 and 2015. The Care360 EHR is now used by 4,400 physicians, up from 1,800 physicians a year ago, according to Mohapatra. In addition, he said Quest recently began marketing its Care360 EHR grant program. The program subsidizes 85% of the retail price of the Care360 EHR, including implementation and training, to non-hospital-owned physician practices with at least one primary care physician (e.g., family practice, pediatrics, Ob/Gyn and geriatrics).

Growth Areas

Mohapatra said testing volume for SureSwab was up 40% in 2011. SureSwab is a panel of STDs performed from residual fluid from liquid-based Pap tests. In addition, he said vitamin D test volumes were up 12%, ImmunoCap allergy testing was up 4%, and drugs of abuse testing was up more than 5%. Quest anticipates organic revenue growth of 1% in 2012.

LACKLUSTER RESULTS AT LABCORP

LabCorp (Burlington, NC) reported net income of $519.3 million for full-year 2011, down 6.9% from $558.2 million in 2010. Profits were lowered by the company's $49.5 million settlement with Medi-Cal. LabCorp's reported revenue increased by 10.8% to $5.542 billion in 2011. Organic revenue grew by an estimated 2% after adjustments for numerous acquisitions, including Orchid Cellmark, Genzyme Genetics, Clearstone, CLM, FirstSource, MDL, DCL, Westcliff, and Diamond Reference Lab.

Outlook for 2012

LabCorp anticipates overall revenue growth of 1% to 2.5% in 2012 (after adjusting for the acquisition of Orchid Cellmark in December 2011). The company's right to use Genzyme's name expired in 2011. LabCorp has rebranded and combined Genzyme's businesses with LabCorp's existing histology labs under the name Integrated Oncology. The company's histology business is expected to be flat this year.

LabCorp Financial Summary ($ millions)

	2011	2010	% Chg
Revenue	$5,542	$5,004	10.8%
Cash from operations	856	884	-3.2%
Pretax income	866	916	-5.4%
Net income	520	558	-6.9%
Diluted EPS	5.11	5.29	-3.4%
Total debt	2,221	2,188	1.5%
Cash & securities	159	231	-30.9%
Shareholders' equity	2,504	2,466	1.5%
Bad debt %	4.6%	4.8%	-4.2%
Days sales outstanding	46	43	7.0%
Est'd number of requisitions	123.9	119.7	3.5%
Est'd revenue per requisition	$44.75	$41.82	7.0%

Source: LabCorp and requisition estimates from *Laboratory Economics*

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LAB STOCKS UP 12% YEAR TO DATE

Ten lab stocks have risen by an unweighted average of 12% so far this year. The combined market capitalization for the group is up 1% to $21.2 billion. In comparison, the S&P 500 Index is up 8% and the Nasdaq is up 13% year to date through February 17. In terms of valuation, Quest Diagnostics is currently trading at 1.2x its annual revenue and 10.2x its trailing EBITDA (earnings before taxes, interest, depreciation and amortization). LabCorp trades at 1.6x annual revenue and 9.7x trailing EBITDA.

Company (ticker)	Stock Price 2/7/12	Stock Price 12/30/11	2011 Price Change	Market Capitalization ($ millions)	Enterprise Value/ EBITDA	Price/ Sales
Bio-Reference (BRLI)	$19.39	$16.27	19%	$542	7.4	1.0
CombiMatrix (CBMX)	1.68	2.00	-16%	18	NA	3.7
Enzo Biochem (ENZ)	2.99	2.24	33%	115	NA	1.1
Genomic Health (GHDX)	28.39	25.39	12%	839	66.5	4.1
LabCorp (LH)	87.94	85.97	2%	8,715	9.7	1.6
Medtox Scientific (MTOX)	17.00	14.05	21%	152	14.0	1.4
Myriad Genetics (MYGN)	23.80	20.94	14%	1,578	8.8	4.6
Neogenomics (NGNM)	1.80	1.40	29%	78	133.6	1.8
Psychemedics (PMD)	9.60	9.10	5%	50	7.7	2.1
Quest Diagnostics (DGX)	57.29	58.06	-1%	9,071	10.2	1.2
Unweighted Averages			**12%**	**$21,158**	**32.2**	**2.3**

Source: Bloomberg

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