

# Pathology Consolidation Underway in Washington

➤ This month, two regional super-practices each acquired a smaller private pathology group

➤➤ **CEO SUMMARY:** *Two regional pathology super-practices have emerged in Washington State. In each case, acquisitions and mergers are fueling the growth of the two large pathology groups. In Western Washington and the Seattle metro, CellNetix is the dominant pathology group, with 53 physicians. The sphere of influence for Incyte Diagnostics and its 40 pathologists is Central and Eastern Washington. Consolidation is happening in Washington because smaller pathology groups lack the capital to compete effectively.*

**I**F CONSOLIDATION OF PRIVATE PATHOLOGY GROUP PRACTICES nationally is underway, then Washington state may be ground zero for this important trend.

In recent weeks, two smaller pathology groups were absorbed by bigger brothers in their respective regions. On May 1, **Incyte Diagnostics** (formerly Incyte Pathology) of Spokane, announced that it had acquired **Medical Center Laboratory** (MCL), a pathology group in Yakima.

Just four days later, on May 5, **CellNetix** of Seattle and **Highline Pathology Associates** (HPA) of Burien announced what they termed a merger.

In recent years, both CellNetix and Incyte have been serial acquirers of smaller pathology groups in the Northwest. In the wake of the HPA merger, CellNetix now has 53 pathologists. Also, it says that it “serves 19 hospitals and large clinics in Washington and Alaska.”

Following the purchase of MCL, Incyte now has 40 pathologists and provides anatomic pathology services to 30 hospitals in eastern and southeastern Washington

State, Bellevue in western Washington, and northern Idaho. Incyte Diagnostics has medical directorships at 13 hospitals.

Incyte’s acquisition of MCL came following the retirement of John Onstad, M.D., who was one of its four pathologists. With the transaction, Incyte Diagnostics acquired a core laboratory in Yakima, along with grossing facilities and support staff in four hospitals in and around Yakima, said Sanjay Logani, M.D., a vice president of Incyte Diagnostics.

## ➤ **Medical Directorships**

“In addition, Incyte Diagnostics assumes the medical laboratory directorships in three hospitals that MCL’s pathologists previously served and is negotiating with a fourth,” stated Gary Gemar, Incyte’s COO. “The three facilities are **Yakima Valley Memorial Hospital, Yakima Regional Medical and Cardiac Center, and Toppenish Community Hospital**. Incyte is negotiating with **Sunnyside Community Hospital**.”

Joining Incyte Diagnostics from MCL are Jayanthi Kini, M.D.; Jose D. Masi, M.D.; and Harold H. McCartney, M.D.

“Incyte is following a cautious path because no one is sure how the accountable care model will roll out and how pathology services will be reimbursed,” commented Gemar. “We are waiting to see what will happen in 2015 and 2016. In the meantime, like other pathology groups, we are doing our best to cope with whatever downward reimbursement pressure comes each year.”

### ► Expanding Statewide

At CellNetix, the merger adds the three pathologists from MCL. They are Kin Ritchie, M.D., Ph.D.; Garret Alcorn, M.D.; and Thomas Dean, M.D. The pathology group will also gain access to **Highline Medical Center**, which is a 154-bed acute care hospital and a 115-bed specialty center. Highline Medical Center is part of the six-hospital **Franciscan Health System**.

The consolidation of smaller pathology groups happening in Washington are mirrored in several other states around the nation. Basically, the smaller groups of five or fewer pathologists that are often involved in these types of mergers and acquisitions must resolve two major issues.

The first problem is to replace a retiring partner by recruiting a young pathologist into the group. However, it is often difficult to attract the right candidate, particularly to rural communities.

The second problem is access to capital. Smaller pathology groups are confronted with the need to invest more in information technology to stay linked to their hospitals and office-based physician clients. At the same time, the expansion of the pathology test menu to include molecular and genetic tests is expensive, since the pathology group must buy the necessary instrument systems.

### ► Third Issue For Path Groups

“You can add a third major issue to that list,” observed Incyte’s Logani. “Within the pathology profession, many consolidations are being done in part because

there is so much downward reimbursement pressure on smaller pathology groups. Payment from the government has taken a nose dive in the last few years and that is driving consolidation.

“At the same time, new molecular tests and personalized medicine are shifting the practice of anatomic pathology,” he continued. “Pathology practices in small rural communities find it hard to recruit the pathology specialists they need without aligning with larger groups or with groups affiliated with large hospitals.”

Gemar agreed with these points and stated that “our acquisition of MCL is a reflection of those trends. In this case, MCL wanted to replace Dr. Onstad upon his retirement, but it learned that few pathologists want to practice in small rural towns.

“Declining revenue was also an issue,” continued Gemar. “For 40 years, MCL had been one of the leading pathology practices in Yakima but the declines in reimbursement in recent years were a problem. MCL saw a further reduction in revenue when a gastroenterology group in Yakima installed an in-office pathology department, causing MCL to lose that specimen volume. These two factors led MCL to start talking with us and those talks led to the acquisition.”

### ► Similar Issues At Highline

Similar issues were involved with CellNetix and Highline. “When we merged with Highline Pathology Associates, the three pathologists became part of our professional organization and we took over the technical business and their hospital contracts,” explained Donald R. Howard, M.D., Ph.D., CEO and Chairman of CellNetix. “Since our founding in 2005, we’ve recognized the importance of being larger and consolidated because it gives us economies of scale and the ability to compete.”

Consolidation has been a key business strategy at CellNetix. “In 2005, several pathology groups came together to form

one group,” said Howard, “Next, in 2007, we opened our own technical laboratory in Seattle.

“Since that time, CellNetix has merged with six or more other pathology practices,” he continued. “Generally our model is to merge our practice with another and then share equity in our laboratory.

“We prefer merging as opposed to buying practices because we are completely self-funded and primarily pathologist-owned,” added Howard. “We don’t have any private equity money to spend on acquiring pathology practices.

### ► Aligns Everyone’s Goals

“Another benefit is that the business model we have aligns everyone’s goals in the best possible way,” he noted. “The pathologists who join our group become equal partners in our professional company and they become shareholders in our laboratory. That’s what Drs. Ritchie, Alcorn, and Dean did.”

Compared to other medical specialties, the anatomic pathology specialty is late to the practice consolidation game. Virtually all other medical specialists underwent extensive consolidation during the 1990s. This was in response to the capitulated, full-risk managed care contracting policies of the gatekeeper HMOs during that decade.

During the 1990s, pathologists in the largest metropolitan markets and smaller cities managed to avoid the widespread consolidation happening in primary care, internal medicine, urology, gastroenterology, etc. These smaller pathology groups have kept their independence. However, current trends in healthcare make it likely that the era of the independent pathology group practice is coming to an end.

THE DARK REPORT is aware of similar pathology group consolidations taking place in other regions of the United States. As noted above, declining revenue and the inability to replace retiring pathologists are among the most common reasons why smaller pathology groups decide that sell-

## Why One Pathologist Predicts More Group Consolidation

**P**ATHOLOGISTS OUTSIDE OF WASHINGTON are contacting CellNetix to gain insight on how private group practices should best respond to trends of declining reimbursement, narrow payer networks, and the need to invest in information technology and sophisticated molecular diagnostic capabilities.

“We regularly field calls from pathologists in other parts of the country,” said Don Howard, M.D., CEO and President of CellNetix. “There is tremendous uncertainty around the country among pathology groups, particularly small and medium-sized groups.

“The future for those groups is unknown,” he continued. “I foresee that many pathologists will become employed by hospitals and some pathology groups will be acquired by national companies.

“However, in many regions there will be some pathology groups who do as we have done, which is to form a much bigger group of pathologists,” predicted Howard. “Our strategy is to have a large number of subspecialist-pathologists, currently in 25 subspecialty areas. This makes us an essential resource for the hospitals we serve.”

“That is true even if a very large hospital can employ 10 or 15 pathologists,” he explained. “That institution would find it difficult to employ the number and range of subspecialist-pathologists that we can provide to hospitals every day. There may not be enough subspecialist work for hospitals to hire all of those pathologists. Therefore hospitals find it more economical and practical to contract for that subspecialty work.”

ing or merging with a larger pathology group in their region is necessary. **TDR**

—Joseph Burns

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