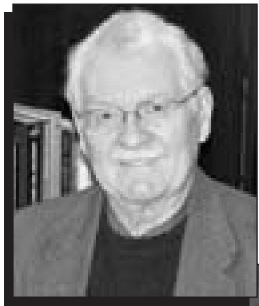
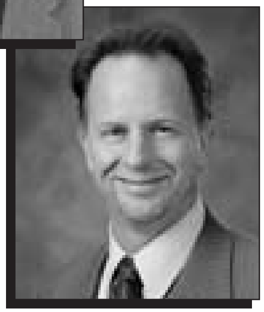


Thomas Tiffany, Ph.D.



Noel Maring

NEWSMAKERS INTERVIEW

How PAML Built a Major Business In Lab Joint Ventures with Hospitals

"A well-structured laboratory joint venture helps the hospital partner tap the unrealized value of its laboratory, because the independent lab partner provides capital, along with experience, and expertise to serve and build outreach market share."

—Thomas Tiffany, Ph.D., *CEO, Pathology Associates Medical Laboratories*

CEO SUMMARY: Earlier this month, MountainStar Healthcare Network of Salt Lake City, Utah, and Pathology Associates Medical Laboratories (PAML) of Spokane, Washington, announced a new laboratory joint venture, called MountainStar Clinical Laboratories, LLC. Two things are notable about this development. First, because MountainStar Healthcare Network is owned by Hospital Corporation of America (HCA), it represents a significant step by that for-profit hospital company to further expand its laboratory outreach programs. Second, with this agreement, PAML extends its track record as a joint venture partner in multiple laboratory outreach programs. In fact, not in two decades has the lab industry seen an independent laboratory company become a "serial joint venture partner" with so many different hospitals and health systems. In this exclusive interview with PAML CEO Thomas Tiffany, Ph.D., and Chief Marketing Officer Noel Maring, TDR Editor Robert L. Michel investigates the reasons behind PAML's success in creating lab joint ventures.

EDITOR: Laboratory testing joint ventures between a hospital and an independent laboratory company are uncommon events. In my view, that is one of three reasons why the new laboratory joint venture created last month by **Pathology Associates Medical Laboratories** (PAML) and **MountainStar Healthcare Network** in Salt Lake City, Utah, is a significant development. *(See TDR, November 19, 2007.)* The second reason is that MountainStar is owned by **Hospital Corporation of America** (HCA), the nation's largest for-profit hospital company. The third reason is that PAML has created a string of laboratory joint ventures over the past decade, which makes it unique in the United States today. Laboratory joint ventures like these are difficult businesses to create. Would you share some of the strategies that PAML uses to make these lab joint ventures happen with such regularity?

TIFFANY: Certainly. And although you are correct in pointing out that just a handful of successful, long-lasting laboratory joint ventures involving hospitals and independent lab companies operate today, we think that many more ventures are possible.

EDITOR: That comment would seem to fly in the face of 20 years worth of lab industry experience. Since the mid-1980s, only a limited number of such lab joint ventures were created, and few survived past a five-year period, typically when the first operating agreement expired.

MARING: That is an accurate characterization of those years for the lab industry at large. By contrast, PAML has five operational joint ventures right now, with 17 hospitals as participants. The oldest of these were launched 12 years ago.

EDITOR: Only one independent lab company that I know of created and sustained a comparable or greater number of similar lab joint ventures with hospitals. That was **International Clinical Laboratories** (ICL) and it was acquired by **SmithKline Beecham Clinical Laboratories** (SBCL) in the mid-1980s. By the early 1990s, **Damon Clinical Laboratories** had four hospital joint ventures with a total of eight hospitals

MARING: We would agree with that. However, a number of the ICL deals were actually lab management contracts. Notably, several of ICL's true lab joint ventures continue to operate today, more than 20 years later. I don't believe the four Damon joint ventures survived the expiration of the first five-year agreement.

TIFFANY: I would add that the longevity of these surviving ICL JVs demonstrates that it is possible to create a win-win business partnership between a hospital and an independent laboratory company.

EDITOR: If this is true, why don't more laboratory joint ventures occur between a hospital and an independent laboratory company?

MARING: That's a difficult question to answer, since every laboratory joint venture comes together for unique reasons.

EDITOR: Let's tackle that question from another direction. Why has PAML succeeded in creating multiple laboratory joint ventures with hospitals and kept them going successfully, for as long as 12 years?

TIFFANY: It was a strategy born of necessity. PAML is based in Spokane, Washington, on the east side of the state. There are few large population centers outside the Seattle-Tacoma metropolitan area. To expand and develop our business in the mid-sized cities around the state, we needed a way to serve lab clients in those areas without having to build lots of infrastructure from scratch. We developed "Shared Testing Agreements" with community-based hospitals in these regions to assist the hospitals and compete with the national labs. These agreements evolved into our Joint Venture Agreements that we utilize today with major medical centers.

EDITOR: However, over the past decade, didn't PAML acquire a number of regional laboratories in cities throughout Washington and Idaho?

TIFFANY: That is correct. Those acquisitions provided the foundation for developing a laboratory joint venture with local hospitals in those cities.

EDITOR: Please explain.

TIFFANY: One primary business strategy at PAML is to enter a new market by acquiring a local laboratory. We then look at opportunities to partner with selected hospitals to mutually build the outreach business.

EDITOR: That makes sense, particularly in the smaller cities found in Washington and Idaho. It allows your lab and the hospital to minimize the duplication of lab infrastructure. At the same time, by including inpatient test volume in the mix, it is easier to achieve economies of scale within that relatively small city.

MARING: Right on both counts. During the 1990s and into this decade, this approach allowed us to grow into the largest laboratory in the Northwest—and do it profitably.

TIFFANY: Another factor makes PAML unique. We are owned by a health system. Our core laboratory in Spokane is located across the street from one of its hospitals, the 623-bed **Sacred Heart Medical Center.** PAML and Sacred Heart have developed what we call a "virtual laboratory." PAML's core laboratory and the Sacred Heart Laboratory are highly integrated and are designed to operate as a single laboratory system. This minimizes duplication of testing, promotes increased economies of scale for both laboratories, and allows inpatients and outpatients to receive higher levels of service. This is the operational model we use in our joint ventures.

MARING: That distinction is important. Most of the larger laboratory companies in the United States are not as intimately involved in managing the complete inpatient testing needs for a sizeable hospital—who also happens to be the lab's owner!

TIFFANY: Additionally PAML manages the inpatient laboratories at two hospitals in one of our joint ventures. In that regard, although PAML is an independent lab company, it is also a hospital laboratory. We have a sophisticated understanding of the needs and demands the hospital places on its laboratory.

EDITOR: From this perspective, you are describing PAML as a hospital-owned laboratory company that has a different relationship to the hospital industry than most other independent laboratory companies.

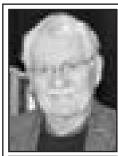
MARING: We would agree with that characterization. Because we are so intimately connected to the day-to-day issues at Sacred Heart Medical Center, our entire staff understands how to properly respond to inpatient testing issues while maintaining close relationships with outreach customers.

EDITOR: This is good background for my next question. Why Salt Lake City as the next market, and why MountainStar as a joint venture partner?

MARING: As we expanded our service area from Spokane, that led us to acquire and establish testing activities in Idaho. That's next door to Utah. As we studied the regional markets in Utah, we spotted an opportunity to enter Salt Lake City through acquisition.

EDITOR: In keeping with your strategy, the foothold into a new city is the acquisition of an existing laboratory, before looking for a hospital that would be a suitable laboratory joint venture partner.

MARING: That describes our entry into Salt Lake City. In November 2002, we purchased **Bio Labs**, which primarily served long term care facilities. In November 2003, we next acquired **Medical Drive Laboratory**, which served clients in a medical office building.



Thomas Tiffany, Ph.D.

"...although PAML is an independent lab company, it is also a hospital lab. We understand, in great sophistication, the needs and demands the hospital places on its laboratory."

EDITOR: So these two labs provided you a base upon which to build outreach business.

MARING: Yes. Our sales efforts were directed to expanding test referrals from office-based physicians and we've seen steady growth in specimen volume and revenue in the Salt Lake City market.

EDITOR: So the next step in your strategy was to identify potential hospital partners for a laboratory joint venture based in Salt Lake City. What steps did you take?

MARING: There were several health systems that we considered prospects for a joint venture. However, MountainStar caught our attention. Its hospitals are well-managed and it has good leadership. HCA has created a management environment where the regional hospital administrators have a high degree of autonomy, even as standardization is emphasized in specific areas. As an example, standardization in the laboratory means Meditech for the LIS. They have standardized buying groups too. It's an interesting mix, and it seems to be very effective.

EDITOR: When did the conversation start with the people from MountainStar?

MARING: In December 2003, I met with the CEO of **Lakeview Hospital**, one of the two MountainStar hospitals now involved in the joint venture. Administrators at Lakeview were already familiar with us, as our laboratory was located across the street from the hospital and our medical director was one of Lakeview Hospital's pathologists. At the CEO's direction, I began working with the CFO, who took us to a regional meeting of all the MountainStar CFOs. Lab managers were present at that meeting, where we presented the concept of a laboratory joint venture. One lab manager, Jane Newhall, recognized the value in a laboratory joint venture. She and the CFO at her hospital became champions for the joint venture and these two helped to carry this idea through to fruition.

EDITOR: With an expression of interest, what were the next steps?

MARING: We offered to produce a more detailed business plan of 80 to 90 pages within 60 days. When this was ready, we met again and presented this business plan.

EDITOR: Let's stop here for a moment. PAML has created a template for these joint ventures, hasn't it? Don't you propose a specific role for PAML and provide a range of services to the joint venture?

MARING: Yes to both questions. In our joint ventures, we act as the general manager. We are organized to provide all the pre-analytical and post-analytical services. That includes couriers, sales, marketing, setting up patient service centers, and accessioning. Under our agreement, we send them bar coded specimens that we can track appropriately and that are ready for them to accept and test with minimal additional lab cost. The specimens can go right on their equipment and then, using a bidirectional interface, results are reported back to PAML where we are able to deliver the results to physicians through a variety of mechanisms (such as Web reporting and to EMRs) based on the needs of specific clients.

EDITOR: Would you say something about your use of information technology to support these laboratory joint ventures?

TIFFANY: PAML has invested heavily to create an integrated suite of software capabilities that allow us to track, in great detail, work in every area of our laboratory. This proprietary system is called "Outreach Advantage" and it is a key element in our laboratory joint ventures. At the heart of Outreach Advantage is a customer relationship management (CRM) engine built on **Microsoft's** CRM and highly-customized for our needs.


Noel Maring

"Outreach programs need to be fast and efficient at building interfaces between the LIS and clients' EMRs."

EDITOR: Is this a paperless system?

TIFFANY: Yes, and more than that. It allows our staff to track specimens, claims, customer issues, and the entire spectrum of laboratory work processes, in great detail and in real time. We can spot patterns of service issues affecting individual clients—and fix them so that service to the client is close to flawless. One consequence of Outreach Advantage within PAML is that our service is extremely consistent, and client turnover due to service issues is almost zero.

MARING: The capabilities of Outreach Advantage were a big selling point for MountainStar. In particular, Jane Newhall, the lab manager I mentioned earlier, recognized very early that she would be able to substantially increase volume in her lab without a corresponding need to add staff. Within the HCA system, her greater lab volume would qualify for the lowest supplier pricing discounts.

EDITOR: What were the reasons that MountainStar entered into this new laboratory joint venture?

MARING: They would be the best ones to provide you the full answer to that question. I know that one element in their decision was that they had recently completed their own analysis of the outreach market and determined that the capital costs to expand would be significant. For example, they did not have comparable electronic connectivity solutions to physicians' offices, which we already have. They would need to expand their customer service systems, which we could quickly provide by plugging Outreach Advantage into their systems. Moreover, they had concluded that, if they did not invest in connectivity and similar services, at best, their outreach volume would stay the same, if not decline over time.

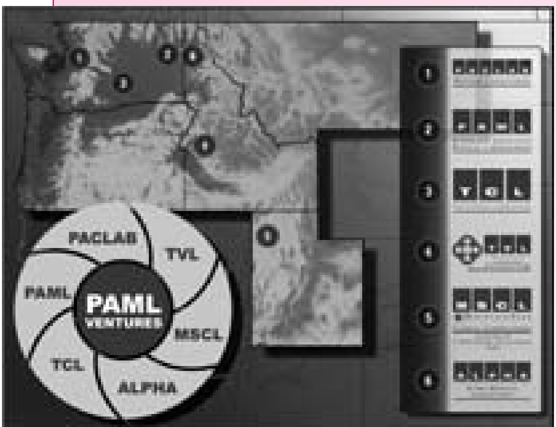
EDITOR: How does the laboratory joint venture take advantage of the hospital lab's natural competitive advantages?

MARING: The hospital lab has two strong selling points to local physicians. First is the ability to provide inpatient, outpatient, and outreach lab test data to the referring physicians. National labs don't have both inpatient and outpatient lab test data. Second is that, for a number of routine and common reference tests, hospital labs can deliver results faster than out of town lab competitors.

EDITOR: Based on your experience in operating laboratory joint ventures with hospitals, what do you recommend to a hospital administrator or lab director who wants to energize and expand a laboratory outreach program?

MARING: They should factor in the new competitive trend of interconnectivity to the physicians' EMR. Outreach programs need to be fast and efficient at building

PAML Develops Business Strategy Based on Hospital Lab Joint Ventures



MountainStar Clinical Laboratories, LLC of Salt Lake City, Utah is the newest joint venture for Pathology Associates Medical Laboratories (PAML). During the past decade, PAML developed a strategy of opening up new markets by first acquiring a local laboratory company, then developing a laboratory outreach joint venture with one or more hospitals in the community. PAML generally assumes responsibility for pre-analytical and post-analytical functions and services, as well as handling reference testing for the JVs.

PAML's Joint Ventures with Hospital Labs

ALPHA MEDICAL LABORATORY, LLC
Coeur d'Alene, ID—Founded 1995
Kootenai Medical Center

TRI-CITIES LABORATORY, LLC
Kennewick, Pasco, Richland, WA—Founded 1997
Lourdes Health Network
Kennewick General Hospital
Kadlec Medical Center

TREASURE VALLEY LABORATORY
Boise, ID—Founded 1999
Saint Alphonsus Regional Medical Center

MOUNTAINSTAR CLINICAL LABS, LLC
Salt Lake City, UT—Founded 2007
St Marks Hospital
Lakeview Hospital

PACLAB NETWORK LABS, LLC
Olympia, Tacoma, Seattle, Everett, Bellevue, Kirkland, WA—Founded 1996
PAML (Bellevue, Seattle, Olympia)
Providence Health System–Washington
Providence Everett Medical Center
Providence Centralia Medical Center
Franciscan Health System
St Josephs Medical Center
St Francis Hospital
St Clare Hospital
Stevens Healthcare
Evergreen Healthcare
Overlake Hospital & Medical Center

interfaces between the LIS and clients' EMRs. This takes capital and resources that many hospitals are not willing to invest. Next to consider is the added cost of sales and marketing, along with the financial expertise to evaluate the profitability of individual accounts. Another consideration is accurate billing and collections and an effective customer service department. These all take staff resources and investment capital that may not be available.

EDITOR: Those are useful recommendations. Thank you for helping us understand PAML's business strategy.

MARING: You're welcome.

TIFFANY: Yes, we appreciate the opportunity to explain why we believe in laboratory joint ventures, and how they can help hospitals develop more effective outreach programs. TDR

Contact Thomas Tiffany, Ph.D., and Noel Maring at 509-755-8900 or nmaring@PAML.com.