

*From the Desk of R. Lewis Dark...*

# THE DARK REPORT

RELIABLE BUSINESS INTELLIGENCE, EXCLUSIVELY  
FOR MEDICAL LAB CEOs/COOs/CFOs/PATHOLOGISTS

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**R. Lewis Dark**

**Founder & Publisher**



## *Being the Biggest Doesn't Guarantee Success*

NEWS THAT ANOTHER HEALTHCARE GIANT is in financial trouble and the object of an unwanted acquisition offer should not be surprising. Even if **Aetna, Inc.** is purchased by **WellPoint Health Insurance Networks Inc.** and **ING Group NV**, the new buyers must fix the same problems now plaguing the nation's largest health insurer. (*See page 8.*)

Aetna's difficulties bring to mind an important business principle: being the biggest certainly gives a company clout, but it doesn't guarantee success. Aetna provides another example for thoughtful laboratory executives and pathologists of why large size does not automatically mean profits.

I mention this for two reasons. First, **THE DARK REPORT** has always encouraged local laboratories and pathology groups to pursue the business opportunities that exist in their marketplace. Demand always exists for a nimble competitor that can be highly responsive to the needs of its customers. Billion-dollar companies with national reach are much less responsive to the unique needs of individual communities across the country.

Second, size may have its benefits, but it also has its disadvantages. Regional laboratory organizations can compete quite effectively against national companies, but only if they are willing to get close to their customers and offer unique services which meet the needs of these customers.

These two points are validated by the experience of a few healthcare companies that used acquisitions and consolidation to become the biggest. **Columbia/HCA Healthcare** took only nine years to grow from two hospitals in El Paso into a \$20 billion corporation with more than 400 hospitals. Its nine years of increasing profits ceased in 1997. **MedPartners** had a similar story. Founded in the early 1990s, it quickly grew into a multi-billion PPM (physician practice management company). But huge losses in 1998 proved its downfall, and MedPartners exited the PPM business.

In the lab industry, there are comparable stories of a spectacular rise, followed by an equally spectacular financial decline. As a new class of "biggest" companies emerges in lab and pathology, smaller competitors should watch closely and seize the competitive opportunities unaddressed in our industry's "biggest" market leader.

# NH Rural Hospital Labs Connecting Via Internet

*New Hampshire Rural Health Coalition ready to deliver added-value to lab users*

**CEO SUMMARY:** *Expect the Internet to be a tool for leveling the competitive playing field. Ten rural hospital labs in New Hampshire are now connecting their labs and their outreach physician office clients with a Web-based lab test ordering and results reporting system. The goal is to increase shared testing of lab work among members, consolidate lab test reporting, and establish electronic links with outreach clients.*

**R**URAL HOSPITAL LABS don't intend to miss the Internet gold rush. In New Hampshire, a ten-hospital lab consortium is preparing to install Web-based lab test ordering and results reporting into its first sites.

Known as the **Clinical Laboratory Alliance (CLA) of the New Hampshire Rural Health Coalition (NHRHC)**, its membership is limited to rural hospitals of less than 100 beds.

"Our group is on the brink of a major breakthrough," stated Robert Ryan, Laboratory Director at **Spear Memorial Hospital** in Plymouth, New Hampshire. "Just a few months ago, we succeeded in getting our hospital administrators to understand the economics of our proposals and decide to support our efforts.

"Once we obtained the commitment of our administrators," he added, "we began making speedy progress on several business objectives, including using the Internet to connect our laboratories."

Ryan says the laboratory alliance has three main goals. "First and foremost, we want to drive down our cost per reportable," he noted. "Since rural hospital labs don't have the specimen volumes found in larger hospital labs, we knew that we had to work together to achieve this goal.

"Second, we are doing test bidding among ourselves," Ryan continued. "It makes sense to maximize the amount of testing which stays in our region.

"Third, we want to link our laboratories electronically," he said. "This allows us to share many resources,

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THE DARK REPORT Intelligence Briefings for Laboratory CEOs, COOs, CFOs, and Pathologists are sent 17 times per year by The Dark Group, Inc., 1731 Woodland Terrace Center, Lake Oswego, Oregon 97034, Voice 1.800.560.6363, Fax 503.699.0969. (ISSN 1097-2919.)

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SUBSCRIPTION TO THE DARK REPORT INTELLIGENCE SERVICE, which includes THE DARK REPORT plus timely briefings and private teleconferences, is \$10.80 per week in the US, \$11.40 per week in Canada, \$12.45 per week elsewhere (billed semi-annually).

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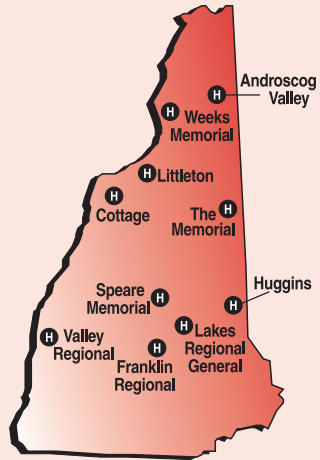
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# New Hampshire's Clinical Lab Alliance Establishing Competitive Presence

*Service area for the New Hampshire Rural Health Alliance's Clinical Laboratory Alliance (CLA) is the northern half of the state. This rural regional lab network covers a remotely-populated area. Listed below are the ten hospital lab members:*

- **Androscoggin Valley Hospital**  
Berlin—92 beds, Thomas Marallo
- **Cottage Hospital**  
Woodsville—48 beds, Elna Ilesley
- **Franklin Regional Hospital**  
Franklin—49 beds, Kevin Bluemel
- **Huggins Hospital**  
Wolfboro—82 beds, Michael Wilkes
- **Lakes Region General Hospital**  
Laconia—143 beds, Michael Wilkes
- **Littleton Hospital**  
Littleton—54 beds, Paul Conner
- **Spears Memorial Hospital**  
Plymouth—47 beds, Robert Ryan
- **The Memorial Hospital**  
North Conway—35 beds, Michael Wilkes
- **Valley Regional Hospital**  
Claremont—71 beds, Judith Putnam
- **Weeks Memorial Hospital**  
Lancaster—49 beds, April Whitehead



## CLA's Business Goals

1. *Drive down member's cost per test.*
2. *Share testing among members.*
3. *Establish information system links between member labs and outreach clients.*
4. *Create a branded lab outreach program, with sales literature and a full-time sales rep.*

develop a consolidated laboratory test report, and provide the information system platform to electronically link our member laboratories with their physician outreach clients.”

### **Ambitious Goals**

Those are ambitious goals for any urban regional laboratory network, but Ryan believes the CLA is up to the challenge. “Over the years, our lab directors have regularly met to explore ways of working together. As the trust between us increased, these meetings led to several shared lab projects,” he explained.

“For example, we organized a shared courier service between our hospitals and labs,” explained Ryan. “We’ve already established the foundation for laboratory standardization by standardizing some of our instruments under a contract with **Beckman Coulter**.

“We showed our hospital administrators how these initiatives saved money,” he said. “We provided them with our business plan projections for the CLA. Once they understood the numbers and realized that enhanced lab services would benefit each hospital

and its patients, the administrators gave us their blessing and support.”

Ryan says having the support of the administrators makes a big difference. “In earlier years, we made proposals to our hospitals in a somewhat piecemeal fashion,” he explained. “This time, we presented them with a comprehensive business plan. It laid out all our objectives, the money and resources required, and the type of benefits that would result.

### **Selection Of Reference Lab**

“Our business plan was helped by the fact that we had already gone through an RFP process for a reference laboratory partner to CLA,” added Ryan. “The reference lab partner we selected is providing a variety of support services to CLA. It also helped us develop a convincing business plan that administrators felt confident in approving.”

One CLA business strategy is to use the business expertise of its reference laboratory partner. “Since our hospitals are all less than 100 beds, we have limited capital and management resources to devote to this lab network,” stated Ryan. “Thus, we needed to tap every available source of management know-how and help available to us.

“In particular, CLA doesn’t have much money available to fund CPU-to-CPU links between our ten hospital labs, let alone establish direct electronic links with each lab’s outreach physician office clients,” continued Ryan. “Most laboratorians know that anything involving LIS software is expensive and time-consuming.

### **New Internet Technology**

“However, new Internet technology changes this economic equation,” he noted. “We recognized that a Web-based connection between our hospitals and doctors’ offices was the most cost-effective and feasible way for us to achieve this goal.

“That was one reason that we decided to select **Specialty Laboratories** of Santa Monica as our reference laboratory partner,” explained Ryan. “We liked their Web-based information system, which is called DataPassportMD™.

“We also liked how Specialty was willing to accommodate our particular business needs as a laboratory network,” he added. “After all, our ten hospitals are pretty far apart and there’s a lot of empty country here in upstate New Hampshire. We estimate a total population in our service area of about 350,000 people. Moreover, population growth is slow, averaging 1% to 3% per year.”

CLA’s first Web-based CPU is being installed at **Lakes Region General Hospital** in Laconia. “We are in the midst of competitive bidding among ourselves,” said Ryan. “Lakes will be one of the facilities taking in testing from CLA. It will act as the server site for CLA’s test dictionary and results.

### **Web-based Links To Labs**

“Once our Web-based system is installed at Lakes, the other CLA sites can implement the Web-based software provided by Specialty and begin connecting it to other CLA hospital labs and their own outreach clients.”

One interesting aspect to CLA’s lab network is that **AmeriNet** will act as the messenger in evaluating the bids and offers for testing done among CLA members. “We were pleasantly surprised that AmeriNet was willing to provide this service for our labs,” mused Ryan. “They have solid experience with this function and we consider it another plus for our business plan.”

CLA will not initially incorporate as a limited liability corporation (LLC). “NHRHC is the umbrella business organization,” explained Ryan.

“For six years, the various hospital members of NHRHC conducted business through this entity. So it will be our parent.

“CLA’s governing body is a steering committee made up of all ten member hospital labs,” he added. “Because we’ve been meeting for such a long time, there is trust and mutual respect among this group of charter members to CLA. But we are feeling our way. The lab network does require us to give up some independence and control, and we certainly don’t know what to expect when we admit new lab members.”

### **Prospective New Members**

Ryan disclosed that news of the rapid progress at CLA has already caught the interest of other rural hospital labs. “Although many aspects of our lab network are in an embryonic stage, once we solidified our business plan and got the support of our hospital administrators, it caused other rural hospital labs to sit up and notice,” he said.

“Since December, we’ve had one hospital lab ask to join the network,” continued Ryan. “There’s another hospital lab that’s expressed interest. As we get our service infrastructure installed, we expect that several other hospital labs in this region will want to become part of CLA.”

One specific goal of CLA is to develop the outreach testing done by its member hospital labs. “Each of our ten members has an existing outreach program,” stated Ryan. “CLA intends to create a uniform laboratory ‘brand’ for our members.

### **Sales And Marketing**

“CLA will provide literature and a common test catalog. We also intend to hire a sales and marketing rep, a first for this rural area, who will travel throughout our service region and develop outreach business for our CLA hospital labs,” he explained. “Building

outreach business for our members is a major goal for CLA.”

Clinical Laboratory Alliance represents a good example of how rural hospitals laboratories can use the regional laboratory network business model to pursue aggressive goals.

Despite their somewhat remote location in the northern part of New Hampshire, these ten hospital laboratories have built the trust, and the business foundation, to pursue the market opportunities.

CLA’s first initiative is to create the information system linkages. These will give it the capability to provide more sophisticated information services between its member labs, as well as its outreach clients. CLA accurately perceives that lab information will be its added-value competitive advantage in the marketplace.

***CLA’s business priorities demonstrate how the Internet makes it economical for all sizes of laboratories to offer competitive services...***

The relatively inexpensive costs associated with installing and operating thin client/Web-browser based lab links make it affordable for CLA, as a regional lab network, to actually implement this as a first priority.

THE DARK REPORT observes that CLA’s business priorities demonstrate how the Internet makes it economical for all sizes of laboratories to offer competitive services in the healthcare marketplace.

Of equal importance, CLA also demonstrates that rural hospitals can profit from opportunities in their service area, if they will band together and combine resources.

**TDRR**

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# Academic Hospital Lab Raises Competitive Bar

*UMASS Health System Lab is moving to a new facility and implementing Web-based ordering*

**CEO SUMMARY:** *Few academic center laboratories are as swift-moving as the UMASS Health System Laboratory. In the next 90 days, it will move into a brand new off-site core laboratory. During this same 90 days, it is implementing its first web-based laboratory test ordering and results reporting installations. This flurry of activity is driven by a strategic business goal of raising the competitive bar.*

**F**EW LABORATORIES MAINTAIN the ambitious schedule of management initiatives that is common at **UMASS/Memorial Health System Laboratories (UMMHSL)** in Worcester, Massachusetts.

“It’s a little crazy to build a new clinical lab and occupy the facility at the same time that we are implementing Web-based lab test ordering and results reporting,” declared Michael Snyder, M.D., Chief of Hospital Labs at UMMHSL.

## **Would Rather Set The Pace**

“But our philosophy is that time must not be wasted. If we don’t do it first, our competitors will,” he added. “And we would rather set the pace than find ourselves having to run even harder just to catch up.”

The new core laboratory facility came about as a result of the merger two years ago of the **UMASS Medical Center/University Hospital** with cross-town rival **Worcester Memorial Hospital**. The combined healthcare system involves more than 700 beds,

plus a large number of affiliated physicians. The new lab should be completed in April, with move-in scheduled for May 2000.

“Because of the proximity of the two hospitals and the great success of our laboratory outreach sales program, a new off-site clinical laboratory made economic sense,” observed Dr. Snyder. “It gave us the opportunity to build the laboratory infrastructure needed to support our current rate of growth.

“Economics was also the reason behind our decision to roll out Web-based lab test ordering and results reporting,” noted Dr. Snyder. “We’ve been using **Metricom, Inc.’s** test ordering/reporting product on our health system’s intranet for several years. It was already a client/server-type of product.

“Advances to Internet technology now make it cost-effective for us to go to our outreach clients and replace expensive T-1 and ISDN phone lines with less expensive connections,” he explained. “Clients will use a Web-browser to con-



nect to our Metricom system to order lab tests and retrieve results.

"In addition to lowering our costs, the Web-based version includes medical necessity features, ABNs, and compliance checkers. It also can handle scheduling for nursing homes and supplies ordering," he continued. "Our first lab users to get the Web-based version will be using most of these features.

"We've worked for three years to enhance the capabilities of our lab information system. We recognized early-on that the Internet would change, for the better, many aspects of laboratory medicine and outreach testing services. We intend to use our Internet-based information system capabilities to roll out a variety of sophisticated laboratory services," explained Dr. Snyder.

### Academic Center Edge

Dr. Snyder is referring to the competitive edge that his academic center gives him in the healthcare marketplace. "Wave one in our business plan is to get our lab clients to use the Web-based system for lab test ordering and results reporting," he said. "Wave two involves delivering educational and clinical added-value services to our lab users.

"Specifically, we think our laboratory can be the delivery vehicle to provide relevant continuing education to our physician-clients," continued Dr. Snyder. "We expect that increased familiarity with the Internet will lead to increased email exchanges between our laboratory directors and the clinicians.

"Best of all, the cost to provide these services will be minimal. The Internet really levels the playing field and allows my academic laboratory to use its full resources to compete in the marketplace against the commercial laboratories," enthused Dr. Snyder.

Metricom, located in Weymouth, Massachusetts, is the vendor support-

ing UMMHSL. "Although we've been working with the UMASS Health System for a number of years, what makes this laboratory project different is that it's the lab which is driving these enhancements," stated Anne Wood, Vice President at Metricom.

### First Operational Sites

"The first operational sites will use our thin client product, accessed by a Web browser," continued Wood. "These will be mostly affiliated hospitals and network physicians.

"One interesting application of the ASP-Web browser model is with Dr. Snyder's prison accounts," she noted. "With existing traditional client lab information systems, traveling to the prisons to do upgrades and service to the system is time-consuming and expensive, partly due to prison security requirements. Using the thin client with a Web browser cuts the cost of servicing these accounts substantially, while at the same time greatly reducing the number of support calls needed by that prison client."

In helping the UMASS Health System laboratory to simultaneously build and occupy a new core laboratory while implementing Web-based lab test ordering and results reporting, Dr. Snyder's leadership demonstrates that even academic center laboratories can be fast-reacting to market developments.

### Stronger Lab Competitor

As Dr. Snyder's comments indicate, he and his lab manager, Paul Defilippi, view these developments as opportunities to be exploited in the marketplace. With this attitude, and equipped with a new, state-of-the-art, front-end automated core lab, UMASS Health System Laboratory will certainly become a stronger competitor for lab business in central Massachusetts.

**TDR**

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## Managed Care Update

# WellPoint Health Networks Offers To Buy Aetna For \$10.5 Billion

*Unsolicited tender includes Dutch insurer, catches Aetna in the midst of a CEO transition*

**T**AKING ADVANTAGE of a weak share price for **Aetna, Inc.**, two major corporations sent an unsolicited tender offer to the Aetna board.

The joint bid was submitted by **WellPoint Health Insurance Networks Inc.** of Thousand Oaks, California, and **ING Group NV**, a Dutch insurance company. The bid was proffered to Aetna on March 1.

The two companies offered a price of about \$70 per share, worth almost \$10.5 billion. Aetna shares, trading around \$40, immediately jumped 34% to \$53 when traders learned of the bid.

### **Aetna Under Siege**

Aetna is a company under siege. Its stock price declined 60% during 1999, a time when the stock market boomed. Poor financial performance by its health insurance division, **Aetna/U.S. Healthcare** was enough to cause the sudden resignation of Chairman and CEO Richard L. Huber just two weeks ago, on February 25, 2000.

For the clinical laboratory industry, Huber's resignation should be read as a sign of difficult times for the HMO industry. **Humana, Inc.**'s CEO, Gregory H. Wolf, resigned last summer after Humana posted two consecutive quarters of losses.

At **Pacificare Health Systems Inc.**, long-time CEO Alan R. Hoops has announced that he will retire as soon as

a replacement CEO can be found. Pacificare, with a business plan that pushes 100% of the risk upon providers by the use of capitated contracts, is finding ever-growing numbers of hospitals and physicians rejecting capitation. (*See TDR, September 20, 1999.*)

### **Ongoing Integration**

The bid for Aetna by WellPoint and ING Group probably now puts Aetna into play. WellPoint, a national health insurer, has 7.3 million beneficiaries. With Aetna/U.S. Healthcare's 21 million beneficiaries, it would become the nation's largest health insurance company.

WellPoint has very different strategies than Aetna. It provides customers with many plan choices and uses a high co-pay, such as \$20 per visit, to discourage overuse. Financial analysts say WellPoint has prospered during the past years as a result of doing small and medium-size acquisitions in selected markets outside California.

### **Change In Contract Policies**

If WellPoint successfully acquires Aetna, its different operating philosophy would certainly change the way Aetna/U.S. Healthcare currently contracts for clinical services, including laboratory testing. From that perspective, an eventual acquisition of Aetna might be beneficial to regional laboratory providers throughout the United States.

**Acquired \$49.0 Million of Path Practices in 1999**

# ***AmeriPath Pursues Ambitious Strategy Of Rapid Expansion***

**CEO SUMMARY:** *As the pathology profession's only publicly-traded physician practice management company, AmeriPath is the spearpoint of far-reaching changes now transforming pathology. With an annual revenue run rate of \$270 million and an ample war chest of growth capital, AmeriPath intends to continue its steady expansion. In the 28 months since its initial public offering (IPO), the company has generated an unbroken stream of revenue gains and profit increases. AmeriPath's business goals provide insight into how the entire profession of pathology may evolve in coming years.*

**M**ANY NAYSAYERS WITHIN THE pathology profession predicted doom and gloom for the various forms of national anatomic pathology companies that emerged during the last years of the 1990s.

However, without exception, these pioneering anatomic pathology firms have remained in business. Several are flourishing and enjoy revenue growth and profit margins that are the envy of other healthcare business sectors.

The market leader in anatomic pathology is most likely **AmeriPath, Inc.** of Riviera Beach, Florida. It finished 1999 with revenues of \$232.8 mil-

lion and net income of \$23.0 million, or \$1.05 per share. No other anatomic pathology company approaches its size.

## **Next Market Phase**

AmeriPath is an example of the next market phase for the PPM business concept: the single-specialty PPM. In the last issue of *THE DARK REPORT*, we covered the evolution of the physician practice management industry. Currently there are at least six companies organized as single-specialty pathology PPMs. Of this group, only AmeriPath has become a public company. (*See TDR, February 14, 2000.*)

AmeriPath is one of those companies which is actively shaping the future look of the anatomic pathology profession. Transformational forces of pathology regionalization, centers of excellence, national branding, and centralized management are playing out within AmeriPath.

Long-time clients and readers of *THE DARK REPORT* know that, since the late 1980s, the American healthcare system has been in transition from a cottage industry of small, independent provider groups, to a consolidated industry comprised of large provider organizations under professional corporate management.

This consolidation is most visible in two sectors of healthcare: concentration of hospital ownership and consolidation of health insurers. AmeriPath represents the strongest example of consolidation within the anatomic pathology profession. It now employs 297 board-certified pathologists, practicing in 30 states. It operates 30 outpatient laboratories, and services 164 hospital locations and 43 outpatient surgery centers.

## **Acquiring Pathology Groups**

AmeriPath reached its size and geographical reach through an ongoing program of pathology group practice acquisitions. In so doing, it demonstrates that there are anatomic pathology groups within the United States willing to join a consolidated management organization.

To grow, AmeriPath had to overcome two large negatives. One, anatomic pathologists are widely recognized as one of the most stubbornly independent of all physician specialties. By nature, pathologists are not "joiners." Thus, they are highly skeptical of the concept of joining a pathology PPM.

Second, since AmeriPath's initial public offering (IPO) in October 1997, the PPM industry has endured difficult times. Billion-dollar PPM leaders like **MedPartners**, **PhyCor**, and **FPA Medical Management** literally disappeared from the business marketplace. AmeriPath had to convince both pathologists and investors that it had a viable business plan as a pathology PPM.

## **Influential Force In Pathology**

By overcoming these two negatives and growing rapidly, AmeriPath demonstrates its ability to influence the pathology marketplace. And if AmeriPath is destined to be an influential force in shaping the evolution of anatomic pathology as we know it today, then it should be closely watched by pathologists interested in staying ahead of the curve.

Historically, AmeriPath has kept a low public profile within the pathology profession. Alone among the single-specialty

## AmeriPath Pays Good \$'s To Buy Pathology Groups

*One reason that pathology practices agree to sell to a PPM is to convert their equity capital into liquid assets. Here's a look at how some recent AmeriPath acquisitions were structured.*

On July 26, 1999, **Consulting Pathologists, PA** of Philadelphia, Pennsylvania (annual revenues: \$4.4 million) was acquired by AmeriPath. Its five pathologists received approximately \$6.7 million for the practice. Payment was in the form of \$3.3 million in cash, AmeriPath shares worth \$570,000, and contingent notes totaling \$2.3 million.

Closed on September 13, 1999 was the acquisition of **Pathology Associates of Texas**, located in Dallas (annual revenues: \$4.4 million). These nine pathologists received approximately \$15.8 million for the practice. Payment was in the form of \$8.7 million in cash and contingent notes totaling \$7.1 million.

*The actual value for each practice will be calculated upon its actual cash flow, such as EBITDA (earnings before interest, taxes, depreciation, amortization), not annual net revenue. These numbers were published in AmeriPath financial filings. The per-pathologist sales price was \$1.34 million in the first example and \$1.75 million in the second example. It is not known how many pathologists in each example were full partners at the time of each sale.*

pathology PPM companies, it is one company that has not permitted THE DARK REPORT to visit its corporate headquarters and meet with its executive team.

However, the company does actively promote itself to the investment community. During the month of January, AmeriPath participated in a couple of Wall Street events, including **Hambrecht & Quist's** 18th Annual

Healthcare Conference in New York City on January 12, 2000 and the *Wall Street Transcript*.

To an audience of financial analysts and investors, AmeriPath Chairman and CEO James C. New openly discussed many of the company's accomplishments and future plans. He described AmeriPath's view for the future of anatomic pathology and how it intends to exploit new opportunities.

### Strategic Growth Markets

First, AmeriPath will pursue strategic growth in a limited number of healthcare markets in the United States. "The initial market research we did indicated that, of the top ten markets, nine were east of the Rockies," stated New.

California is largest, "which is only marginally bigger than Florida, the second largest market, or Texas, the third largest market," New stated. "The remaining seven key markets are in the Northeast and Midwest.

"We developed a regional approach to our business which we implemented and successfully completed in Florida," he continued. "We now provide [pathology] services throughout the state of Florida. We are finishing that same model in Texas, with our last operation under development in Houston."

James New is describing AmeriPath's plans to regionalize its pathology services, market-by-market, state-by-state. Next comes similar expansion "in the states of New York and Pennsylvania and key markets in the Midwest," he explained. "So we will continue to grow, mostly for the next two years, in the Northeast, the Midwest, and a bit in the Southeast."

### Regionalization Strategy

This strategy of regionalization will be supported by creating anatomic pathology centers of excellence and branding them nationally. This will emphasize esoteric work and higher-

end cancer testing. "We have established what we call the Center for Advanced Diagnostics," said New, "allowing us to participate in that esoteric market. Through our hospital contracts, we currently outsource that work to our competition.

"This totals about \$10 million per year," he continued, "and is a great opportunity for us to bring this work in-house. We will expand product offerings to the urology and gastroenterology marketplaces. These are two new markets for AmeriPath."

The national branding effort was launched during the summer of 1999. As reported in THE DARK REPORT, AmeriPath has built a national center of excellence in dermatopathology, in conjunction with A. Bernard Ackerman, M.D., located in New York City. It's called the **Ackerman Academy of Dermatopathology**. (See TDR, January 3, 2000.)

### Value Of Lab Information

AmeriPath is not overlooking the added-value of lab information to the healthcare system. Dermatopathology is an AmeriPath trump card which it intends to play. "Being the largest processor of skin tissue in the country, at over 2.5 million biopsies per year, we have an enormous amount of data that we collect," commented New.

"We are now putting together a master database that will allow us to mine that information and begin to provide better diagnostic information to our referral sources and to their patients, as well as to the payers, including HMOs."

AmeriPath is particularly strong in dermatopathology. During its pre-IPO period, it selectively concentrated on acquiring dermpath groups. There were several reasons for this business strategy.

First, dermpaths work outside the hospital, giving AmeriPath more control over business operations. Second, dermpaths primarily serve office-based physicians. This makes it easier

## Demographics Portend Bright Future For Pathology

*Population demographics will work in favor of anatomic pathology during the coming years. AmeriPath, Inc. believes it is well-positioned to profit from the coming boom.*

*"Over the next 20 years, the population base [of the United States] of 55-74 years old will grow over 70%," observed James C. New, Chairman and CEO of AmeriPath. "whereas the base population will grow about 20%. An older individual uses our services three to five times more often than a younger person. So again, for us, that's a very positive trend."*

for AmeriPath to target sales and marketing efforts.

Third, dermatopathologists tend to generate higher billings per year than hospital-based anatomic pathologists. For 1999, AmeriPath's annualized net revenues per pathologist full-time equivalent equaled approximately \$1 million.

THE DARK REPORT expects to see AmeriPath's basic "revenue per pathologist" increase in future years. If AmeriPath succeeds as a practice consolidator, its business management team should develop additional added-value products and services which supplement the revenue generated from basic anatomic pathology procedures.

### Diversified Revenues

AmeriPath is not alone in pursuing this business strategy. **IMPATh, Inc.**, is a New York-based national pathology company focused on providing community hospital-based pathologists with services targeted at hard-to-diagnose cancers. IMPATh is putting biopsy information into a sophisticated database, then selling this information to clinical trials companies, pharmaceutical companies, and other entities. (See TDR, February 1, 1999.)



As a company with national ambitions, AmeriPath must deal with the challenges of contracting for pathology services. In Florida, it parleyed an early regional relationship with **SmithKline Beecham Clinical Laboratories** (SBCL—now **Quest Diagnostics**) into a state-wide contract. AmeriPath discloses that about 9%, or \$21.3 million, of its total revenues comes from contracts with national laboratories.

### Hospital Path Contracts

It has more revenue exposure from some of its hospital contracts. Of AmeriPath's 164 hospital contracts, at least 27 involve hospitals owned by **Columbia/HCA Healthcare**. AmeriPath states that approximately 16.8%, or \$39.8 million, of its total revenues come from contracts with Columbia/HCA.

THE DARK REPORT believes that AmeriPath is now large enough to influence the market evolution of anatomic pathology. Its size, its interstate reach, and its well-funded acquisition war chest will enable AmeriPath to increase its influence during the next few years.

That does not mean that AmeriPath's future financial success is guaranteed. As it grows, it must competently handle the same management challenges which torpedoed so many other well-funded, fast-growing, and profitable PPMs.

### 18 Months To Disappear

Remember that MedPartners, during the first four years of its existence, was highly profitable. It rapidly became a multibillion-dollar company, but then took only 18 months to completely disappear from the PPM marketplace. The financial decline started with a \$646.7 million restructuring charge at the end of 1997.

Many challenges facing AmeriPath relate to the difficulties of acquiring

independent physician practices and integrating their different operational details into the AmeriPath business model. That is one downside to a reliance on acquisitions as the major engine for revenue growth.

Another challenge is "same store" growth. "Same store" growth in the pathology profession is a difficult proposition. For a local AP practice, growth means either getting more hospital contracts, which involves taking business away from nearby pathology practices, or capturing more specimens from physicians' offices.

During the last two years, AmeriPath's same store growth has been 8% (for 1998) and 4% for 1999. During 1999, this growth came from same practice hospital net revenue (+2%) and same practice outpatient net revenue (+3%). Declines in Medicare reimbursement for the year offset these gains by -1%.

### Management Challenges

It must be noted that Wall Street remains cautious about AmeriPath's ability to solve the management challenges facing any fast-growing PPM. AmeriPath's stock trades at a low price/earnings multiple and is currently valued at under \$10 per share.

Being biggest, however, does have some advantages. Within the anatomic pathology profession, AmeriPath is now the company to catch. Unlike other national pathology providers like **DIANON Systems, Inc.**, **IMPATh**, and **UroCor, Inc.**, AmeriPath is strongly-rooted in a local presence. Its anchors are the hospital-based groups and dermatopathology practices providing local AP services.

Because it is consolidating local practices into regional pathology systems, it provides a real-world experiment in the dynamics of pathology regionalization. None of the private pathology PPMs, such as **Pathology**

## AMERIPATH BECOMES A MAJOR PLAYER IN PATHOLOGY

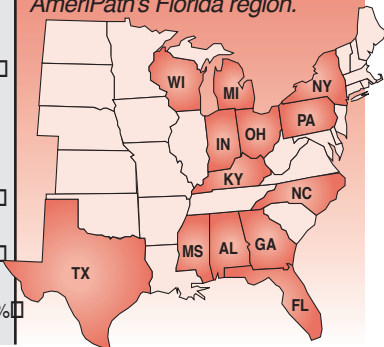
### AmeriPath Delivers Steady Growth

	1996	1997	1998	1999
Pathologists	81	133	226	297
Hosp Contracts	47	75	125	164
Employees	599	994	1,346	1,500
Outpatient labs	12	16	21	30

### AmeriPath's Florida Regional Business Model

(\$s in 000s)	1996	1997	1998
Number of practices	7	8	11
Pathologists	62	72	82
Hospital contracts	29	30	31
Net revenues	\$35.4	\$70.8	\$85.1
Operating margin before amortization	\$9.0	\$20.2	\$25.6
Operating margin as % of net revenues	25.4%	28.5%	30.1%

AmeriPath grew swiftly through the end of 1999. It now operates in 13 states. AmeriPath is organizing itself around what it calls the "regional business model." The table at left shows the year-to-year build-up of AmeriPath's Florida region.



Consultants of America, PathSource, PathGroup, USLABs, or Pathology Partners have created a multi-state presence comparable to AmeriPath. That leaves AmeriPath as the main pioneer to watch.

Attitudes within the pathology profession toward consolidation and regionalization may also be changing more significantly than publicly acknowledged. AmeriPath, in acquiring \$49.0 million worth of pathology practices during 1999, demonstrates there are a number of thoughtful pathologists who see a future in affiliating with its company.

### Modest Physician Turnover

Further, AmeriPath, as an employee-model PPM, has certainly not experienced the doctor-rebellion predicted by many pathologist naysayers. James New reported last month that the company's turnover among physicians is currently 8%. That would represent about 24 of its 297 pathologists, an average of two departures per month over the course of a year.

Since going public in October 1997, the experience of AmeriPath validates THE DARK REPORT's predictions about the pace of consolidation and regionalization within the pathology profession.

Moreover, when combined with the market successes of the national AP companies, private pathology PPMs, and the Pathology Service Associates (PSA) state networks, there is ample demonstration that the pathology marketplace is undergoing several other key trends.

These include aggressive sales and marketing of anatomic pathology services, the emergence of pathology centers of excellence, the branding of anatomic pathology skills, and the attempt to use information, not clinical services, as the added-value profit booster.

Its existing pathology empire gives AmeriPath the clear lead over the anatomic pathology industry. Time will tell whether AmeriPath's executive team capitalizes on this lead or ends up in the PPM dustbin which has claimed so many other companies.

**TDR**

Contact James C. New at 561-845-1850.



## Lab Industry Briefs

### **PARK CITY SOLUTIONS AND AMERICAN MEDICAL LABS CREATE STRATEGIC PACT**

TWO COMPANIES FINANCED by **GTCR Golder Rauner, LLC**, the private equity firm based in Chicago, announced a strategic relationship.

**Park City Solutions, Inc.** of Park City, Utah and **American Medical Laboratories, Inc.** (AML) of Chantilly, Virginia will work together to develop e-business services for healthcare, with a particular emphasis on clinical laboratory applications.

Park City Solutions recently acquired **Chi Laboratory Systems, Inc.** of Ann Arbor, Michigan, as well as a number of other healthcare-focused companies. (See *TDR, January 24, 2000.*)

American Medical Laboratories (AML) has been furiously working on several informatics products and services. These projects are directed by an IS guru that AML hired away from **Federal Express Corporation**.

FedEx is justifiably famous for its sophisticated and useful information systems. AML wanted that expertise to help it develop information services for the clinical laboratory which would give it an added-value edge over competing laboratories.

### **CYTIC CORPORATION REPORTS DOUBLING OF MARKET SHARE**

IN THE BATTLE BETWEEN enhanced Pap smear technologies, **Cytc Corporation** claimed an interesting milestone. During 1999, Cytc says its market share doubled, from 9% to 19%.

In its year-end financial release, Cytc also claimed that it had a 70% market share of the New England

region. With approximately 55 million Pap smears performed annually in the United States, a national market share of 19% would equal about 10.5 million ThinPrep® preparation kits.

With Cytc's 1999 revenues at \$81.1 million and ThinPrep kits retailing at \$10.75 apiece, the arithmetic comes fairly close. Cytc's 1999 revenues almost doubled over 1998's sales of \$44.3 million.

Revenues at Cytc climbed steadily over the year. This is evidence that the company is increasing the frequency with which ThinPrep kits are used. Total revenues were \$81.1 million for 1999.

Cytc also announced three promotions to Senior Vice President. These were Daniel J. Levangie, Director of Sales and Marketing; Joseph W. Kelly, Chief Financial Officer; and Ted S. Geiselman, Director of Technical Operations.

### **TRIPATH IMAGING GAINS SEVERAL NEW CUSTOMERS**

Over in Burlington, North Carolina, **TriPath Imaging, Inc.** has been busy. It announced contracts to place AutoPap® Primary Screening Systems into three of the largest clinical laboratories in Japan.

They are **BioMedical Laboratories** (BML), **BioClinical Laboratories** (BCL), and **Special Reference Laboratory** (SRL). These labs decided to adopt the AutoPap system after performing their own extensive clinical trials.

TriPath Imaging has worked hard to establish itself in Japan. Predecessor company **NeoPath** had a co-marketing agreement with **Nikon** as one initiative. Pap smear screening in Japan is handled very differently than in the

United States. It is common for Japanese cytotechnologists to diagnose 200 Pap smears per day.

TriPath Imaging also inked a new agreement with **Quest Diagnostics Incorporated** that updates the former contract it had with **SmithKline Beecham Clinical Laboratories**. (See *TDR*, November 9, 1998.) Of note is the companies' intent "to collaborate on advanced, next-generation screening technology, as well as on Internet-based software products for the digital storage and transmission of patient data and images."

This demonstrates the potential of TriPath's digital imaging technology to find application in other areas of laboratory medicine, including anatomic pathology. It also demonstrates Quest's interest in having early access to any useful Internet-based applications.

TriPath Imaging also announced two new sales positions. Roger W. Martin will be Vice President of Sales and Marketing. He's a veteran of **Roche Diagnostic Systems** and **Becton Dickinson & Co.** TriPath's new Director of National Accounts is John D. "Jay" Xanthos, Jr., formerly with **Quest Diagnostics Incorporated** and **Laboratory Corporation of America**.

## **HOSPITAL SUPPLY CHAIN READY TO GO INTERNET**

THERE'S ANOTHER SEGMENT of the healthcare industry that is about to feel the full brunt of healthcare e-commerce. That segment is hospital purchasing and supply.

A host of well-funded dot-com start-ups is targeting the \$83 billion that hospitals spend each year on supplies and equipment. Some experts believe that savings of as much as \$11 billion could result from shifting current purchasing practices over to Internet-based technology.

Everyone is in the hunt. They include GPOs like **Premier, Inc.**; distributors such as **Owens & Minor, Inc.**; for-profit hospital companies like **Columbia/HCA Healthcare Corp.** and **Tenet Healthcare Corp.**; and an array of Internet start-ups, such as **MediBuy.com**, **Medsite.com**, and **Medpool.com**.

THE DARK REPORT expects this area of healthcare to undergo just as swift a transformation as that of lab test ordering and results reporting.

## **ANATOMIC PATHOLOGY FIRMS ENJOY ROBUST SALES GROWTH FOR 1999**

WHO SAYS YOU CAN'T MAKE MONEY in anatomic pathology? Both **IMPATh Inc.** and **DIANON Systems** enjoyed record sales and profits for 1999.

DIANON closed the year with \$76.1 million in revenue. This was a 22% increase over 1998 revenues of \$62.2 million. Net income was up 40%, from 1998's \$2.9 million to \$4.1 million.

IMPATh posted even stronger growth numbers. 1999 revenues of \$85.4 million increased by 52% over the \$56.3 million it booked in 1998. Net income was \$9.1 million for 1999, a 31% increase from 1998's \$6.9 million.

These are impressive numbers. When viewed together with the financial performance of **AmeriPath, Inc.** (see pages 9-14), it provides strong evidence that the marketplace for anatomic pathology services is profitable and possibly underserved.

Local pathology groups should reconsider their reluctance to invest in the business support infrastructure and sales resources needed to capitalize on opportunities in their regional market. If not, it's a certain bet the national anatomic pathology firms will move in and capture that business. **TDR**

## The Dark Index

# Quest Diagnostics Announces Plans for St. Louis, Chicago Labs

*Company outlines specific objectives for integrating lab facilities in St. Louis*

**S**t. Louis will continue to be a major regional laboratory testing center for **Quest Diagnostics Incorporated**.

As disclosed in the last issue of THE DARK REPORT, rumors from sources deemed credible indicated that all testing now done in St. Louis was to be consolidated at the Chicago laboratory operated by Quest Diagnostics.

“This story is not true,” stated Surya N. Mohapatra, Ph.D., President and Chief Operating Officer at Quest Diagnostics. “We plan to accomplish three basic objectives with our existing resources in St. Louis.

“One, the former **SmithKline Beecham Clinical Laboratories (SBCL)** St. Louis lab will continue to service its geography,” he explained. “Two, the former SBCL laboratory and the St. Louis joint venture (involving Quest Diagnostics and the **Unity Health System**) will continue to develop integration plans to consolidate the business units.

### **SAMHSA Tests To Move**

“Three, SAMHSA specimens at the St. Louis joint venture will be moved to the Schaumburg laboratory in Chicago,” noted Dr. Mohapatra. “The SAMHSA license at the St. Louis facility will be allowed to lapse. Currently only about 40 SAMHSA specimens per night are processed by the St. Louis facility.

“St. Louis will continue to be an important market for us,” added Dr. Mohapatra. “We will continue to maintain a strong presence there with a full service laboratory. We are currently finalizing our integration plans to consolidate the two business units we now have there.”

### **Ongoing Integration**

The St. Louis objectives that Quest Diagnostics wants to implement are consistent with the overall integration plans that Quest Diagnostics established after its acquisition of SBCL last summer. Quest Diagnostics must meld two separate national laboratory systems into one organization, with a common corporate culture and a uniform level of client service. **TDR**

*For more information, contact Gary Samuels, Quest Diagnostics Incorporated, at 201-393-5000.*

### **Editor's Correction**

The above information, provided by Dr. Mohapatra, corrects rumors that were included in *Intelligence Late and Latent* in the February 14, 2000 issue of THE DARK REPORT. We are committed to a high standard of accuracy in the information presented to our clients. As the lab industry's leading and most respected source for accurate and useful business intelligence, we believe it is important to correct any information we may believe to be true, but is later demonstrated to be inaccurate or misleading—*Editor*.

# INTELLIGENCE

**LATE & LATENT**  
 Items too late to print,  
 too early to report



Interesting things are afoot at **Esoterix, Inc.**, the Austin, Texas-based parent company for six specialty laboratories. President and CEO Charles L Dufesche, M.D. recently left. The new CEO is James McClintic. Esoterix has plans to become a public company and has been shopping its IPO (initial public offering) among brokerage houses. Calls to Esoterix went unanswered as of press time.

There's been lots of interest in the lab industry concerning **Premier, Inc.**'s attempts to enforce compliance with its national laboratory reference testing contract. For the latest developments in this ongoing story, lab executives should read a story in the February issue of *CAP TODAY*. It's a well-balanced story about the pros and cons of Premier's compliance efforts and how hospital laboratories are reacting to the situation.

## FORMER SMS CHIEF NOW WANTS TO BUY THE COMPANY

**Aetna, Inc.** is not the only big healthcare company with an unwanted takeover offer. **Eclipsys Corporation** of Del Ray Beach, Florida made an unsolicited offer to purchase **Shared Medical Systems, Inc.** (SMS) last week. Although SMS shares were trading at \$38.25, Eclipsys offered \$67 per share, a premium of 75%. For the 12 months ended December 31, 1999, SMS reported revenues of \$1.217 billion and diluted earnings per share of \$2.80. This contrasts with Eclipsys' reported revenues of \$249 million and a fully diluted loss per share of \$0.27. Eclipsys's offer is a case of the fish wanting to swallow the whale.

### MORE ON: ECLIPSYS

The Chairman and CEO of Eclipsys, Harvey J. Wilson, was formerly CEO at SMS. He left SMS in 1995 to form

### INFO WANTED

Insider news and tips about labs are always welcome. Call or email in confidence: 503-699-0616 or [labletter@aol.com](mailto:labletter@aol.com).

Eclipsys. In a public statement, SMS said "the proposal represents the most recent in a series of efforts by Harvey Wilson, the Chairman of Eclipsys, to cause SMS, in effect, to acquire his company, under circumstances in which he assumes management control."

### SUMMERTIME BLUES?

Diagnostics manufacturers are unhappy with the significant expense and lackluster results from supporting two lab association exhibit halls and national conventions every summer. Meetings between the diagnostics companies and **CLMA** and **AACC** have brought no resolution to the diagnostics companies' plight. For obvious reasons, the two lab associations want to avoid a combined exhibit hall and national convention. **THE DARK REPORT** has learned that one of the first-rank diagnostic companies recently decided not to exhibit one of the two annual meetings this summer. If true, this may establish a precedent that other diagnostics companies will follow.

*That's all the insider intelligence for this report.  
 Look for the next briefing on Monday, March 27, 2000.*

## *PREVIEW #3*

### **EXECUTIVE WAR COLLEGE**

May 16-17, 2000 • Fairmont Hotel • New Orleans

#### **Topic: Routine Chemistry & Hematology Testing at the Point-Of-Care**

Here's the first appearance by the CARESIDE executive team at a major lab industry gathering. Learn first-hand about this new tool for decentralizing routine testing and hear the experience of early laboratory adopters. This is transformational technology. It's market-ready and now showing up in clinical laboratories around the country.

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## ***UPCOMING...***

- ***THE DARK REPORT Picks Lab Industry Movers & Shakers for 2000.***
- ***Independent Commercial Laboratories Holding Their Own in Today's Marketplace.***
- ***Capitated Rates for Lab Testing Move Show Surprising National Trend.***
- ***Hospital Laboratory Hits Home Run by Adding to Its Outreach Testing Program.***