Volume X, Number 15 Monday, November 10, 2003

From the Desk of R. Lewis Dark...

THE DARK REPORT

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

Restricted information, see page 2

Commentary & Opinion by...

R Lewis Dark

Founder & Publisher

Supply and Demand for Lab Services and Pathologists

IT SEEMS THE LABORATORY INDUSTRY HAS MANAGED to beat back the proposed 20% patient co-payment for Medicare Part B laboratory testing services. Kudos to the hard-working laboratorians and their lobbyists who devoted money and time to oppose this proposal.

But the news remains glum. Word is that lawmakers are considering a ten-year freeze on cost-of-living adjustments to laboratory services. That's certainly not a welcome development. It seems that Part B lab testing is considered a ripe target for budget-shifting efforts to enrich other parts of the Medicare reimbursement structure. I believe the laboratory industry will see worse in the next few years than the current budget-cutting proposals in the Medicare program. Because government health programs represent a major part of our healthcare system, it is now a fact of life that bureaucrats, no matter how well meaning, make important decisions that affect all patients served by laboratories as well as those who work in laboratories.

Supply and demand for laboratory services is affected by these decisions. As our exclusive intelligence briefing about the demand for pathologists *(pages 9-14)* indicates, factors which affect the working environment for pathologists can increase or decrease the supply of new medical graduates over a fairly short period of time, say five to seven years. From the poor employment market for pathologists in the second half of the 1990s, we now see strong demand, particularly for those with subspecialist skills. The same is true of the supply of medical technologists (MT). In earlier issues, THE DARK REPORT has analyzed how liberal Medicare funding sparked a "tidal wave" in annual MT certifications, beginning in the early 1970s. This tidal wave crested in 1983 (after implementation of Medicare DRGs) and has stayed at relatively low levels ever since.

It is important for lab directors and pathologists to recognize that market forces do have significant impact on all aspects of laboratory operations. How many laboratories exist to compete, what salaries are paid to technical staff, whether adequate numbers of technical staff can be hired; all of these factors are greatly influenced by supply and demand forces in today's healthcare marketplace. That is why I think one consequence of continued cutbacks in Medicare funding for Part B laboratory services will be to negatively affect the overall supply of laboratory testing services in coming years. TDR

HPV Test Volume Grows With Payer Acceptance

HPV testing is taking an increasing role in the cervical cancer screening process

CEO SUMMARY: Because cervical cancer screening involves more than 55 million Pap tests per year in the United States, it is a high-profile segment of the lab testing industry. HPV testing is making steady inroads into the cervical cancer screening process. Digene Corporation is the direct beneficiary of this, but Cytyc Corporation and TriPath Imaging are also able to capitalize on emerging opportunities.

IT MAY BE THE MOST OVERLOOKED success story in the diagnostic industry during 2002. HPV testing is gaining rapid acceptance within the clinical community and growing numbers of payers are agreeing to reimburse for these tests.

Evidence of this success can easily be seen at **Digene Corporation**, based in Gaithersburg, Maryland. Digene's fiscal 2004 first quarter revenues climbed to $19.6 million. This is a 55% increase over the $12.6 million Digene posted in fiscal 2003 first quarter. The company turned a modest profit for the quarter of $700,000. It is also the second quarter in a row where Digene has realized a 50% increase in revenues. Much of Digene's revenue growth has come from its introduction of the hc2 High-Risk HPV DNA test™ earlier this year.

In April, the **Food and Drug Administration** (FDA) approved Digene's Pre-Market Application (PMA) supplement for this test, which the company also calls "Digene's DNAwithPAP™ test." It is approved "for use with a Pap test to adjunctively screen women aged 30 and older to assess the presence of high risk HPV types."

This fall, at least three major health insurers announced that they would cover this test. On September 23, Digene publicly confirmed that **Aetna, Inc.** would cover the DNAwithPap test. Last week Digene disclosed that both **Cigna Corporation** and **Anthem Inc.** will cover this test. These two health plans insure 24 million people.

THIS PRIVATE PUBLICATION contains restricted and confidential information subject to the TERMS OF USAGE on envelope seal, breakage of which signifies the reader's acceptance thereof.

THE DARK REPORT Intelligence Briefings for Laboratory CEOs, COOs, CFOs, and Pathologists are sent 17 times per year by The Dark Group, Inc., 21806 Briarcliff Drive, Spicewood, Texas, 78669, Voice 1.800.560.6363, Fax 512.264.0969. **(ISSN 1097-2919.)**

R. Lewis Dark, Founder & Publisher. Robert L. Michel, Editor.

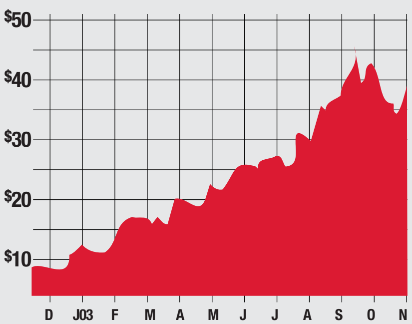
SUBSCRIPTION TO THE DARK REPORT INTELLIGENCE SERVICE, which includes THE DARK REPORT plus timely briefings and private teleconferences, is $11.90 per week in the US, $12.50 per week in Canada, $13.55 per week elsewhere (billed semi-annually).

Digene Stock Zoomed Up Over the Past Year

AS THE CHART BELOW DEMONSTRATES, Digene Corporation's share price has increased dramatically during the past 12 months.

The price of Digene shares has climbed from under $10 last December to as high as $50 in the past 30 days. The substantial gains in its share price are due to the surging revenue growth Digene is enjoying from sales of its HPV tests.

Digene Corporation
(share price–past 12 months)



As laboratory directors and pathologists know, payer reimbursement is a key factor in encouraging laboratories to pick up and offer new diagnostic test technology. Digene's success in gaining reimbursement acceptance by Aetna, Anthem, and Cigna is a sign that other payers are likely to make favorable coverage decisions for this HPV test.

To encourage acceptance of this test among clinicians and the laboratory industry, Digene has mounted a substantial sales and marketing campaign. In conjunction with **PDI, Inc.**, a company which provides "physician-detailing services," Digene has a team of sales reps in the field visiting physicians' offices to provide information and education about this test and the clinical studies which support its use.

"Based on more than 7,500 visits with physicians to date, about 30% indicate their intention to use the test," stated Evan Jones, Digene's Chairman and CEO. "Our efforts are to focus on these early adopters." Lab directors and pathologists should take note of this fact. In tandem with growing payer acceptance, it indicates that a significant percentage of OB/Gyns and other physicians are willing to incorporate Digene's HPV test into their medical practice.

Early Pricing Indications

To date, laboratories have seen a reasonable pricing/reimbursement relationship for Digene's DNAwithPap test. "This test is sold to laboratories in the United States for around $23 to $24 each," noted Charles M. Fleischman, Digene's President. "We have done surveys of the reimbursement authorities that are reimbursing for the test. The weighted average price is approximately the CMS-reimbursement level of about $49. The payers for whom we have information have not discounted from that level in excess of 10% or 15%."

To help encourage laboratories to set up and offer Digene's HPV tests, the company is developing an automated instrument system it calls the Rapid Capture™ System. This system will allow one med tech to perform 350 DNAwithPap tests in an eight-hour shift. Digene filed its PMA with the FDA on November 6.

With two of the nation's largest payers making favorable reimbursement decisions for these HPV assays, there is growing momentum for HPV testing in the clinical marketplace. TDR

Contact Evan Jones and Charles Fleischman at 301-944-7000.

Cytyc and TriPath Imaging Continue Battling For Market Share in the Liquid Prep Wars

WITH THE LABORATORY INDUSTRY continuing to accept and implement liquid prep Pap smear testing, there's plenty of revenue growth at both **Cytyc Corporation** and **TriPath Imaging, Inc.**

Cytyc continues to dominate this testing segment. It reported third quarter revenues of $75.5 million. In comparison, TriPath Imaging reported first quarter revenues of $14.1 million. However, for both companies, revenue growth was substantial. Cytyc's revenues increased 29%, while TriPath's increased 44%.

Because of Cytyc's earlier start in bringing its liquid prep product to market, it commands greater market share and is profitable (net income of $18.6 million). TriPath's market share is much smaller and the company still posts red ink (net income of minus $1.6 million).

In today's laboratory marketplace, both companies are intense competitors. Each has a different strategy for expanding market share and building a more diverse revenue base by offering additional products.

Additional Products

At Cytyc, the company is working to market its ductal lavage test for breast cancer detection. It has also introduced the ThinPrep® Imaging System, which offers location-guided screening assistance to cytotechnologists. Cytyc says that it shipped ten of these systems during the past four months and has orders for seven more.

Relative to earlier years, TriPath has enjoyed a greater degree of sales success during the past 12 months. As a result, much of its revenue growth is attributable to improved sales of reagents and disposables. It announced that, during third quarter, it added 29 new customers in the United States.

Because of Cytyc's dominance in the liquid prep market, one of TriPath's marketing strategies has been to position itself as "Avis" ("We're number two. We try harder.") to Cytyc's "Hertz." Earlier this year it signed an agreement with **Quest Diagnostics Incorporated**, which had formerly offered Cytyc's liquid prep Pap test on an exclusive basis. On October 29, TriPath signed a new three-year agreement with **Laboratory Corporation of America**. LabCorp has offered TriPath's liquid prep Pap test since 1999.

United Kingdom Is Next

The new battleground for these two companies is the United Kingdom. Last month the **National Health Service** (NHS) issued guidance which recommends liquid-based cytology (LBC) for cervical cancer screening in both England and Wales. In March 2002, the Scottish Executive announced a major investment in the Scottish Cervical Screening Program to implement LBC. Cytyc won that round and became the exclusive LBC test technology. TriPath's foothold in England is **The Doctor's Laboratory**, which, in August 2003, announced it would offer TriPath's liquid prep Pap smear.

Within the United States, a high proportion of physicians have converted to liquid prep Pap smear testing. That means both Cytyc and TriPath will increasingly be competing for a larger slice of the same size pie. For laboratory customers, this may lead to better pricing and terms over time as these two companies compete to take customers away from each other.

Tamtron Plans Comeback After IMPATH's Chapt. 11

As part of IMPATH Information Services (IIS), Tamtron hopes to attract a strategic buyer

CEO SUMMARY: It was only 21 months ago that IMPATH acquired Tamtron. Both companies had high expectations for the relationship. But with IMPATH now in Chapter 11 bankruptcy and facing an unclear future, Tamtron is now an attractive asset for potential buyers who want to enter the anatomic pathology marketplace with an established product like Tamtron's PowerPath software system.

IT'S THE PROVERBIAL STORY of bad news and good news at **Tamtron**, the business unit of **IMPATH, Inc.** which sells one of the anatomic pathology profession's leading information management systems.

This bad news/good news story has ramifications throughout the pathology profession. As many as 400 laboratory sites currently use Tamtron's system, called PowerPath®, so anything that might disrupt service is a concern.

Financial Woes At IMPATH

The bad news was IMPATH's financial woes, which caused it to file a Chapter 11 bankruptcy action in New York on September 29. 2003. As a business division of IMPATH, the bankruptcy action and IMPATH's lack of cash significantly constrains Tamtron's ability to conduct expansive business activities and invest funds into product development.

The good news involves the potential for Tamtron to be purchased by a strategic buyer. A careful reading of documents filed in the bankruptcy action reveals that both IMPATH and the creditors have cleared the way for Tamtron to be sold as an asset that creditors and the court categorize as unrelated to IMPATH's core business.

Tamtron customers should welcome this development. IMPATH's bankruptcy filing six weeks ago created concern among many of the anatomic pathology groups using PowerPath. They viewed IMPATH's bankruptcy filing as something that could negatively affect Tamtron's business operations and ability to service its PowerPath customers.

"At Tamtron, we'd like all our customers to know that our business organization is intact and continues to serve all our customers, including new clients," stated Steve Tablak, President of Tamtron. "There have been no service issues caused by IMPATH's difficulties that have impeded our business activities."

Tablak also noted that Tamtron's employee team remains intact. "Since IMPATH's first announcement of financial problems on July 30th, we have not lost any employees," he observed. "This fact reflects well on both the quality of our organization and the commitment our people have to this product and our customers."

In selling to IMPATH last year, Tamtron's board and stockholders had hoped that IMPATH would provide it with capital needed to fund further product development and to expand sales and marketing activities. That has obviously not gone as planned.

Within IMPATH, the IIS division and its two business units have operated in a relatively autonomous manner from IMPATH's physician services and IPO divisions.

But IMPATH's bankruptcy may prove to be a lucky break for Tamtron because the bankruptcy court is positioning the business unit for a potentially speedy sale. A rapid sale to the right buyer would be good for both Tamtron and its pathology practice clients, for at least two reasons.

First, if a buyer is quickly identified and allowed to purchase Tamtron on a fast timeline, this minimizes the time that Tamtron's customers find themselves inconvenienced by the circumstances of IMPATH's bankruptcy. Second, likely buyers should have the capital necessary to invest in Tamtron post-acquisition to beef up product development.

IMPATH's Current Situation

Customers of Tamtron should understand several aspects of its current situation. Since its acquisition by Tamtron early last year *(See TDR, January 28, 2002)*, the anatomic pathology informatics company has operated as part of IMPATH's Information Services Division (IIS). The other business unit in this division is IMPATH Cancer Registry™ (ICR).

Within IMPATH, the IIS division and its two business units have operated in a relatively autonomous manner from IMPATH's Physician Services and IMPATH Predictive Oncology (IPO) divisions. This autonomy has encouraged the bankruptcy court and creditors to see the IIS division as an asset that can be sold quickly.

To that end, investment bankers are working with IMPATH to identify companies interested in buying Tamtron and ICR. Indications are that several strategic buyers are expressing interest in buying both business units and operating them together. ICR's national dataset consists of more than 2.3 million cancer cases nationwide. IMPATH has sold this information to pharmaceutical companies and biotech research firms in recent years.

Unexpected Bidders

The laboratory industry may be surprised at which companies bid for Tamtron and ICR. Just four months ago, **General Electric Medical Systems** acquired **Triple G Systems Group**, the Canadian-based LIS firm. The importance of laboratory test data in diagnosis, prognosis, therapy, and patient-monitoring is recognized by a growing number of companies.

Further, there is widespread recognition that oncology will be a major disease of aging baby boomers. This makes a pathology informatics company like Tamtron more interesting to those companies looking to establish a greater presence in the oncology marketplace. It means Tamtron's eventual buyer may be a new player in the laboratory testing services market. **TDR**

Contact Steve Tablak at 408-972-9600.

Lab Industry Briefs

SPECIALTY LABORATORIES REPORTS THIRD QUARTER FINANCIAL PERFORMANCE

THIRD QUARTER FINANCIAL REPORTS for **Specialty Laboratories, Inc.** show that the company is returning to a more normal routine, following the two unusual and unrelated events which hit it during 2002.

Specialty Labs reported net revenue of $29.9 million for third quarter 2003. This is a decline of 9.7% from third quarter 2002's net revenue of $32.5 million. For third quarter 2003, it posted a net loss of $2.3 million.

A more significant measure is specimen volume, as measured by accessions. For third quarter, accessions were 630,000. This number was down 7.4% from third quarter 2002's 685,000 accessions. But it was a 3% increase from second quarter accessions of 612,000.

Following its licensure problems with federal and state regulators last year, a number of hospital laboratory clients began using alternate sources for send-out testing. Switching from one reference laboratory to another can take a hospital lab client as long as six months to accomplish. That is why it is only now, 14 months after resolution of its licensure problems, that a clearer picture of Specialty Laboratory's long-term relationship with its hospital lab customers is evident.

Another factor in this analysis is Specialty Lab's changed relationship with what was its single largest customer, **Unilab Corporation**. In 2002, **Quest Diagnostics Incorporation** acquired Unilab, completing the purchase early this year. Specimens from Unilab represented 10% of Specialty's total business through 2002. Since February 2003, Specialty Labs has watched the volume of Unilab specimens it tested decline as Quest Diagnostics began performing those tests inside its own laboratory network.

Seen from this perspective, the fact that Specialty was able to increase accessions by a modest amount between second quarter and third quarter indicates that the company is bringing on new business to replace volumes lost during the past 18 months.

Another sign that Specialty Laboratories is focusing on building testing volume through its sales and marketing program is the announcement that it has delivered a next-generation of "Outreach Express®" to the marketplace. This is a browser-based lab test ordering and reporting software product designed to allow hospital laboratory outreach programs to connect with their office-based physician-clients.

Outreach Express was redesigned with assistance from **Microsoft Corporation**. This is the second example known to THE DARK REPORT of Microsoft Corporation working with laboratories to develop informatics products that handle laboratory test data. The other example is in Washington State, where the **PacLab** regional laboratory network collaborated with Microsoft to develop a similar product that links hospital laboratories with office-based physicians.

MEDICARE TO COVER COLORECTAL CANCER SCREENING ASSAY

IT WAS ANNOUNCED LAST WEEK by **Enterix Inc.** that the **Centers for Medicare and Medicaid Services** (CMS) had issued a "National Coverage Decision Memorandum for the use of immunochemical fecal occult blood tests, including its InSure™ Fecal Immunochemical Test (FIT), as a method to screen for colorectal cancer."

As noted in earlier issues of THE DARK REPORT, colorectal cancer screening is the target for a major marketing push by the two blood brothers. The test developed by Enterix, based in Falmouth, Maine, has been licensed by Quest Diagnostics Incorporated.

Having achieved coverage approval from Medicare, the next big step for Enterix and its InSure test is the level of reimbursement which CMS establishes for this test. Without adequate reimbursement, there will be less incentive for laboratories like Quest Diagnostics to offer this type of test.

Lab directors and pathologists should watch how the marketplace responds to the efforts by the two blood brothers to introduce colorectal screening assays. Following the last big wave of lab acquisitions in 2002, this represents the first major effort by the two national laboratories to capitalize on their size and market clout to license new diagnostic technology and bring it to market on an exclusive basis.

CONGRESS CONSIDERS MEDICARE PROPOSAL ON PROVIDER QUALITY

PROVIDER QUALITY is now on the Congressional radar screen. Last week house-senate conferees discussed linking hospital Medicare reimbursement to hospitals' participation in a quality initiative.

In simplest terms, hospitals that voluntarily participated in a recently-launched quality initiative in partnership with the Centers for Medicare and Medicaid Services (CMS) would receive a full inflation update from Medicare in 2004 and the following three years. Hospitals that did not participate would receive a partial inflation update in the three years 2005, 2006, and 2007. The inflation update would be 0.4% below the inflation rate for those three years.

Reported earlier in THE DARK REPORT, the existing quality initiative is run in conjunction with the three major national hospital associations. This is the first year of the program and 1,790 hospitals are participating. They are reporting data to CMS on ten measures of quality relating to heart failure, heart attacks, and pneumonia.

For the laboratory industry, this CMS quality initiative demonstrates that increased visibility for healthcare quality is already a reality. From these early steps, more comprehensive quality programs and public reporting will be forthcoming. The CDC's lab Quality Institute is one such effort directed toward establishing national standards and measures for quality in clinical laboratories. *(See TDR, August 18, 2003.)*

CHANGEOVER TO ICD-10-CM MAY BE OVERLY COSTLY, SAYS BC/BS ASSOCIATION

MANY LABORATORY DIRECTORS and pathologists are probably unaware that preparations to have the healthcare system shift to ICD-10-CM are under way, with a vote scheduled this month by the working task force of the federal **Health and Human Services** Department (HHS).

Now comes a study by the **Blue Cross and Blue Shield Association** (BCBSA). It says that the healthcare industry would incur costs of up to $14 billion to implement ICD-10. This covers spending over a three-year period. BCBSA also predicts the implementation effort would be more disruptive than the Y2K conversion. TDR

CEO SUMMARY: Unlike the slack employment market for pathologists seen during the 1990s, there is strong demand for pathologists in this decade. Private pathology group practices now face competition for the best pathology talent. That's because public lab companies are regularly in the marketplace looking to hire pathologists with the right subspecialty skills and expertise. THE DARK REPORT offers this exclusive look at the employment situation for the pathology profession.

INSIGHTS FOR LABS LOOKING TO ADD PATHOLOGISTS

Market Demand for Pathologists Shifts Toward Specialization

EDITOR'S NOTE: This is the first of a two-part assessment of supply and demand for pathologists. Part One looks at the shift in hiring practices for pathology positions in the United States. Part Two will address efforts to define and measure the productivity of individual pathologists.

Part One of Two Parts

DURING THE 1990S, MANAGED CARE and closed-panel, gatekeeper-model HMOs directly caused a decline in demand for pathologists. That pattern has been reversed in the early years of this decade.

Pathologists are the heart and soul of every laboratory. That is why shifts in the demand for pathologists, as well as changes in high-demand clinical skills, affect the strategic planning for both clinical labs and anatomic pathology groups.

To help clinical laboratory directors, pathologist leaders, and group practice administrators gain an accurate understanding of the supply/demand dynamics for pathologists, THE DARK REPORT is providing this exclusive two-part intelligence briefing. Subjects to be covered are: 1) how and why demand for pathologists is stronger in this decade than the last decade; 2) changes to the candidate pool of pathologists, particularly those individuals who recently finished their formal medical training; 3) pathology subspecialties emerging as the "hot" clinical areas—with salaries to match; 4) what types of laboratories are hiring; 5) typical compensation terms offered to employee-pathologists; and, 6) productivity expectations for employee pathologists.

"What people consider to be the popular wisdom about the professional opportunities for pathologists lags behind the reality of today's healthcare marketplace," stated Rich Cornell, Principal at **Integro Medical, LLC**, a physician recruiting firm based in St. Louis, Missouri. "For pathologists with the right skills and experience, today's professional environment is probably the best I've seen during the 15 years that I've worked to recruit and hire pathologists."

Cornell speaks with unique authority on this topic. He has recruited and placed pathologists in a variety of laboratory environments. One high profile client was **DIANON Systems, Inc.**, which for a period of more than ten years used Cornell's services exclusively to recruit and hire pathologists. Cornell's active client list includes pathology settings that range from public lab companies to academia and private group practices.

"Let me explain the differences between the last decade and this one," declared Cornell. "In the 1990s, the emphasis of managed care was to make primary care physicians the central decision-maker in the healthcare system. Reimbursement declined steadily throughout the decade. Capitation and utilization risk made providers, including pathology groups, hesitant to bring additional physicians into their practice.

Obvious Consequences

"The consequences were obvious. Within the pathology profession, there were too many pathologists being trained," continued Cornell. "It was tough for pathologists to find jobs. A larger number of pathologists deferred plans to retire. Pathology groups became gun-shy about bringing new pathologists into the group.

"One obvious reaction to this situation was seen in the academic sector," added Cornell. "During the 1990s, the number of residency slots in pathology declined. Some medical schools and community-based programs closed down their pathology residency programs. Also, a five-year requirement was put into effect for board certification. By the end of the decade, the cumulative effect of these actions had shrunk the number of new pathologists entering the marketplace each year.

Pathology Responds To Market Forces

GROWING DEMAND FOR PATHOLOGISTS in recent years is a reminder that the forces of supply and demand are constantly at work.

It was just five years ago when positions for pathologists completing their medical training were in short supply. As physician-recruiter Rich Cornell of Integro Medical LLC pointed out in his exclusive interview with THE DARK REPORT, today's healthcare marketplace is hungry for specialist physicians, including pathologists with subspecialty skills.

THE DARK REPORT sees two primary drivers in the renewed demand for pathologists. First, clinicians and their patients increasingly want to refer cases to pathologists with recognized expertise in specific diseases. The trend toward specialization can be seen in every aspect of the economy, and medicine is no exception.

Second, public laboratory companies need more pathologists. These pages have regularly chronicled the strategic plans of the nation's biggest laboratory companies to expand their market share of anatomic pathology specimens. As their case loads increase, these companies go into the pathology marketplace to recruit and hire the pathologists they need. In fact, hiring practices of public laboratory companies may be creating more profound changes within the pathology profession than is currently recognized. Part two of this series will look at this situation.

"The overall situation in healthcare changed during the past couple of years," observed Cornell. "Primary care physicians no longer drive the healthcare marketplace. Some experts believe we now have too many primary care physicians. At the same time, specialists are back in demand. In fact, demand is particularly strong for subspecialists."

As evidence of this change, Cornell points out that residency programs for hospital-based physicians are again full. "Soboyna & Weinstein published an article in the July 2001 issue of *Human Pathology*. They noted that 2001 was a turnaround year, because "pathology filled 82% of its matched slots, whereas anesthesiology filled 89% and the present commodity among residencies, radiology, filled 100%.' These numbers were sustained in 2002," said Cornell.

Supply of New Pathologists

"For 2001, 552 residents or fellows completed training in clinical pathology (CP) or anatomic pathology (AP)," he continued. "On average, each candidate received 1.9 job offers. About 19% of these physicians entered practice, while 19% opted for academics and 58% decided to pursue additional training in specialized fellowships."

This was good news for new pathologists. But on the demand side, there have been noticeable shifts. "Demand for specialized pathology skills is rapidly increasing," observed Cornell. This year Richard Horowitz, M.D., a pathologist affiliated with the **USC** and **UCLA** Medical Schools, conducted a study of new pathologists hired by 481 groups during the years 2000-2002. The results were fascinating. Only 38% of hiring groups were willing to take on a generalist-pathologist! Almost two-thirds, 62%, of hiring pathology groups wanted a new pathologist with sub-specialty training. The top three sub-specialties desired were: cytopathology, dermatopathology, and hematopathology."

Movement Among Groups

The number of pathologists moving annually between practices is significant. Data from the **American Board of Medical Specialties** (ABMS) indicates that there are 21,510 board-certified pathologists in the United States today. Of this total, 13,730 are boarded in both AP and CP, with 5,545 boarded only in AP and 2,235 boarded only in CP. "The **Medical Group Management Association** (MGMA) estimates that at least 8% of the nation's physicians move annually. That means as many as 1,700 practicing pathologists are changing positions each year," noted Cornell.

"About two-thirds of all pathologists work in private practices," continued Cornell. "Ten per cent work in university medical schools or hospitals and an almost equal number, 9%, work in independent laboratories. The balance work in multi-specialty groups or as coroners and medical examiners."

Cornell can identify five significant subspecialities that are currently in demand within the pathology profession. They are dermatopathology, (about 45 fellows per year), gastrointestinal/hepatic pathology (about 51 surgical path fellowships), genitourinary pathology (about ten "true" fellowship programs), hematopathology (about 57 fellows), and cytopathology (about 88 fellows). These numbers are representative and taken from the *Directory of Pathology Training Programs in the U.S and Canada, 2004-2005*.

Public Lab Demand

"Probably the most visible shift in pathologist work environments during recent years has occurred within the public laboratory companies," observed Cornell. "These companies are pushing to expand their revenues from anatomic pathology services. As case volume increases, they need to hire additional pathologists to handle the work. This was certainly true of DIANON Systems during the 1990s. By the end of 2002, they had approximately 40 employee pathologists working on staff.

"Another example is **AmeriPath**, which employs about 450 pathologists, of which 60 are dermatopathologists," added Cornell. "**Both Laboratory Corporation of America** and **Quest Diagnostics Incorporated** are regularly looking to hire additional pathologists.

"Public laboratory companies are constantly in the marketplace to recruit and hire pathologists. As a result, the financial compensation, benefits, and working environment they offer is already establishing a different type of baseline that private pathology groups must understand and meet if private groups are to successfully recruit top pathology talent," he commented.

Compensation & Benefits

"Public laboratory companies know they must offer an attractive package to attract pathologists," noted Cornell. "In terms of working environment, there are probably two significant features a public lab company offers. First is 'quality of life.' Pathologists working for these companies usually have a standard work week that runs Monday through Friday from 8 a.m. to 5 p.m., with no weekends required. They are neither required to be on call nor to perform autopsies.

"Second is case mix. Public lab companies have substantial specimen volume and can allow the pathology subspecialist to look at cases specific to their field of interest," noted Cornell. "This is exactly what today's subspecialists want. They want to concentrate on cases for which they have trained.

Competitive Salaries

"Of course, the compensation packages are competitive," he continued. "Included are stock plans, incentive pay, corporate benefits, and the opportunity to work in a prime location. The public lab companies' regional facilities are typically located in larger metropolitan areas around the country.

This is attractive to pathologists seeking to work in different regions who want to be in or near a major city."

Salaries paid to pathologists by public lab companies are based upon experience, certification, and training. The range is from $190,000 to $300,000 per year. "In today's market, I would expect to see a board-certified dermatopathologist with three years of experience be offered a salary base of around $250,000 per year," stated Cornell. "Annual salary increases average between 2% and 10% per year, depending on individual company policy, employee performance, and several other factors.

Incentive Pay Included

"Incentive pay is part of the overall compensation package," he continued. "Each company requires pathologists to sign out a minimum daily volume. There is a 'per case' incentive of some type for any work signed out that exceeds the daily minimum." *(Editor's note—Specifics of pathologist productivity will be covered in Part Two of this series.)*

"These compensation packages also take into consideration other company objectives," added Cornell. "There can be an annual bonus of between 1% and 20% of base salary. This bonus can be linked to a number of factors, including employee performance, quality assurance/quality control, sign-out volume, the company's financial performance against targets, the regional laboratory's performance in achieving corporate budget targets, and customer satisfaction, to name a few."

Advice For Path Groups

"Any pathology group looking to recruit top subspecialty talent should understand the basic types of employment, compensation, and benefit packages found at public laboratory companies," Cornell stated. "Private group practice settings offer many professional challenges and opportunities that are not commonly found within most public laboratory companies.

"For example, pathologists working in hospital-based pathology groups have a different interaction with referring clinicians and the surrounding medical campus than a pathologist working with a public lab company's regional facility. In hospital-based practice settings, there is the opportunity to be involved in clinical laboratory operations as well as anatomic pathology. The hospitals' patient mix affects the types of cases seen daily by the group. Many pathologists like this type of varied practice setting," said Cornell.

"Demand for pathology subspecialty skills is high in today's healthcare marketplace," noted Cornell. "I see it every day in the recruitment market. There is ample evidence that the demand for pathologist subspecialists will continue to grow."

Standardized Lab Data

THE DARK REPORT notes that Cornell's conclusions about the growing primacy of subspecialty pathology mirrors similar trends which have been regularly reported on these pages. The pathology profession is undergoing a steady evolution in parallel with the healthcare system that it serves.

The key themes in this trend are consolidation of small provider units into strong regional practices, more types of clinical applications that involve molecular pathology, and increased interest by both clinicians and patients to have "disease state experts" as consultants in the case.

This latter point is not only a response to consumer activism, but is influenced by subtle shifts in medical malpractice claims. During THE DARK REPORT'S *Pathologist Income Symposium* in Atlanta on October 23-24, both Cornell and faculty attorneys

Typical Pathologist Pay & Benefits

Listed below are some common benefits and compensation levels from both single specialty groups (SSG) and commercial laboratory companies. These were provided by Rich Cornell, an experienced physician recruiter and Principal at Integro Medical, LLC of St. Louis, Missouri.

SINGLE SPECIALTY GROUPS

Standard Benefits*

- 98% Relocation (avg: ~$9,000)
- 94% Malpractice
- 93% Health Insurance
- 92% CME (avg: ~$3,000)
- 74% Retirement
- 75% Disability
- 35% Signing Bonus (avg: ~$14,000)

SSG Physician Income Averages**

- All physicians: $123,483
- Starting: $190,347
- Eastern: $395,150
- Western: $413,379
- Southern: $511,177
- Midwestern: $472,000

**MHA 2002 Review of Physician Recruitment Incentives.*

***MGMA Physician Compensation and Production Survey, 2003. Figures reflect total compensation, including all benefits.*

COMMERCIAL LABORATORIES

Typical Benefits

- 4-6 weeks vacation or paid-time-off
- 1 week CME, $3-5K CME allowance
- Health & dental insurance for employee. Employee-paid family coverage
- Medical malpractice insurance
- Scheduled holidays off
- Short-term & long-term disability
- Pre-tax savings plan (401K), with some company dollar-for-dollar match.
- Life insurance, typically a factor of 3x the base salary
- Employee assistance program (EAP)
- Moving allowance, $10,000-$20,000

Typical Salary Package

- Salary range of $190K-$300K, based on experience, certification
- Performance incentive, based on 70-100 cases signed out daily, up to $220,000

noted that malpractice trends involving different areas of pathology services are filing claims that may shift the standard of care, at least as it applies to certain pathology subspecialities. This may be another force that helps shift the profession's emphasis away from generalist skills toward subspecialty expertise.

One key insight to be gleaned from Cornell's experience is that the recruiting environment for pathologists is now significantly influenced by public laboratory companies. The break-neck growth of Ameripath, **IMPATH,** and DIANON Systems during the period 1995-2002 placed a significant number of pathologists into employment settings. Add to this the growing numbers of employee-pathologists at LabCorp and Quest Diagnostics. Collectively, these entities may employ as many as 10% of all the pathologists currently in full-time practice in the United States. One result of this shift in pathologist employment is that private group practices now have greater competition when recruiting top pathology talent. **TDR**

Contact Rich Cornell at 877-490-0090.

Dark Index

Bio-Reference Labs An Example Of How Regional Labs Can Grow

In New York City's tough managed care market, BRLI finds both revenue growth and profits

IT'S QUARTERLY EARNINGS TIME, which makes it possible to evaluate trends in the laboratory services marketplace by looking at the performance of public laboratory companies.

Because of their large size and market dominance, the two national laboratory companies are closely watched to see how they have reacted to marketplace issues during the previous quarter. However, one public laboratory company which doesn't attract nearly as much attention is **Bio-Reference Laboratories, Inc.** (BRLI) of Elmwood Park, New Jersey.

BRLI is the third largest public lab company serving the market segment of physicians' offices. At about $215 million in annual revenues, it is a far distant third to the multi-billion revenues of its two larger competitors. But it has enjoyed substantial success in the past two years.

Different Reporting Period

With a fiscal year ending October 31, BRLI's earnings releases come at a different time than most those public companies. For its third quarter 2003 earnings statement (period ending July 31, 2003), Bio-Reference Labs posted revenue gains of 14.8%. Its revenue was $28.9 million, compared to $24.9 million in the same quarter last year.

With this growth has come substantial increases in net profit, due to the unique economics of clinical laboratories. BRLI's net income nearly doubled, climbing to $3 million, compared to $1.5 million for same quarter last year. This performance is reflected in its stock price. During the past 12 months, it has climbed from the $5.00 range to over $17.00.

Doing Well In NY Area

BRLI competes primarily in the New York City metro and nearby areas in New Jersey and Connecticut. Thus, its success at generating profitable new revenues indicates that regional laboratories can compete effectively against the national laboratories—even in difficult managed care markets like the Northeast.

Bio-Reference Laboratories has emphasized sales and marketing. It is following a niche strategy, offering specialized services in areas such as oncology, hematology, and an expanded coagulation laboratory. It also offers enriched laboratory information services to both physicians and payers with its Carevolve.com and PsiMedica divisions.

There is plenty of optimism and energy at Bio-Reference Laboratories. Its ability to sustain growth, confirmed by the similar experiences at private lab companies like **CPL** in Austin Texas and **PAML** in Spokane, Washington, indicate that there are still good business opportunities for regional laboratories. TDR

Managed Care Update

Mergers Create Two Huge National Health Insurers

Consolidation among payers continues, does not bode well for local laboratories

ANOTHER ROUND OF CONSOLIDATION among health insurers has created a new "biggest in the nation" company and boosted the size of the second largest health insurance company.

On October 28, in separate announcements that were just 30 minutes apart, **Anthem Inc.** disclosed it would pay $14.2 billion to acquire **WellPoint Health Networks Inc.** and **United Health Group** stated it was paying $2.9 billion to purchase **Mid Atlantic Medical Services, Inc.**

After completing the acquisition, Anthem will become the nation's largest managed care company, with 26 million members. United Health Group, formerly the nation's largest, drops to second place with 19 million beneficiaries, despite adding two million more people with the Mid Atlantic Medical Services acquisition.

Consequences For Labs

This latest round of consolidation among major managed care companies will have long-term consequences for the laboratory industry. Regional laboratories, some with existing contracts to serve patients in the WellPoint and Mid Atlantic networks, will find it more difficult to retain access to those patients.

In contrast, the two national lab companies are comfortably positioned to gradually gain near-exclusive contract access to these same patients. It is common for large national health insurers to sign exclusive or near-exclusive contracts with either or both **Laboratory Corporation of America** or **Quest Diagnostics Incorporated**.

There are other dimensions to this round of consolidation among payers that are relevant for laboratory directors and pathologists. First, these two big acquisitions further increase the control and market share held by the nation's largest managed care companies. Just five companies now provide health insurance to more than 76 million people. That's one-third of the Americans who have health insurance. *(See sidebar on next page.)*

Second, the acquisitions by Anthem and United Health indicate that further consolidation can be expected within the managed care industry. For regional laboratories, this will not be a positive development. That's because larger health insurers tend to exclude local laboratories from contracts in favor of the nation's biggest lab companies.

Third, the need to boost information technology (IT) capabilities within the managed care industry is one reason why these types of acquisitions are taking place. Smaller health insurers don't have the financial resources necessary to make these investments. Lab directors and pathologists should heed this cue and take proactive steps to beef up the IT capabilities of their labs—in advance of health insurer's needs and requirements.

The pending merger between Anthem and WellPoint has some particularly interesting features. Both companies operate as Blue Cross/Blue Shield licensees. The combined company will have operations in 13 states. Under the license terms of the **Blue Cross & Shield Association**, each state plan operates under the same guidelines and each state plan has its own CEO.

Well-Managed Insurers

Both Anthem and WellPoint are considered well-managed companies. Since 1990, WellPoint has posted double or triple digit growth in all but two years. It has consistently been ranked as one of the country's best-performing companies. Anthem has only been publicly-traded since 1996, but has enjoyed three years of similar double and triple digit growth.

For United Health, the Mid Atlantic acquisition strengthens its presence in that region. Mid Atlantic provides health insurance services for two million people in Delaware, Maryland, northern North Carolina, southeastern Pennsylvania, Virginia, Washington, D.C., and West Virginia. With a total of 19 million members, United Health is considerably larger than **Aetna, Inc.**, the nation's third largest managed care company with 13.2 million beneficiaries.

Expect further consolidation among managed care companies. The economies of scale and the need for considerable investments in information technologies are two reasons which support such acquisitions. However, the flush coffers of managed care companies should not be overlooked as a factor.

As these pages have reported, stiff premium increases in recent years have boosted the profits of almost all health insurers. For example, on October 30, Aetna reported third quarter net income had doubled over that of the previous year. Its net income had climbed to $182.3 million, compared to $81.9 million in third quarter 2002. It is easier to do acquisitions when ample profits are available to fund the deal and support higher share prices.

Consequences For Labs

As consolidation among the health insurance industry continues, local laboratories and pathology group practices will find it increasingly difficult to retain access to patients covered by the acquired insurance plans. However, because local lab testing remains an important part of healthcare, new strategies for preserving patient access are likely to be developed. TDR

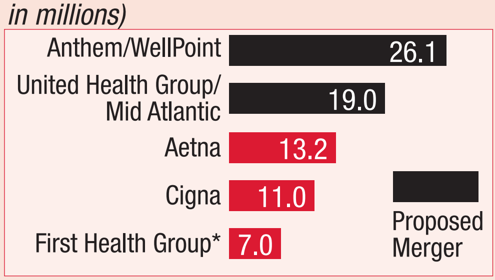
How Big Are the Biggest?

More Consolidation Among Health Insurers

As the bar graph at right demonstrates, the latest round of consolidation has further concentrated market share in the hands of the five largest managed care companies. Collectively, these five firms now provide health coverage to 76.4 million Americans, which represents more than one-third of all the people who have health insurance in the United States.

Nation's Largest Health Insurers

(Ranked by number of enrolled members, in millions)



** Data from company filings.*

Sources: company reports, Citigroup/Smith Barney Managed Care Report, October 2003.

INTELLIGENCE

LATE & LATENT

Items too late to print, too early to report

Has the disappearance of much-despised closed-panel HMOs eased the financial woes of physicians? Apparently not, according to a recent study. Medical groups are losing money. Nationwide, the average loss-per-physician by medical groups was $3,977. In the 2003 survey, 25,784 physicians responded, a 26% increase from 2002. The study was conducted jointly by the **American Group Medical Association** and the National Healthcare Consulting Group of **RSM McGladrey Inc.** This study demonstrates why physicians are motivated to use cost-effective laboratories, particularly in states that permit physician mark-ups on lab testing services.

GROWTH AT VENTANA

Ventana Medical Systems, Inc. saw revenues climb 18% for third quarter, to $32 million. Reagent revenues grew 25%. These strong growth rates reflect the increase in anatomic pathology procedures, which fuel a demand for both instrument systems and reagents used in the histology laboratory.

OSTEOPOROSIS GENE DISCOVERED, MAY LEAD TO LAB TEST

Here's a discovery which could lead to a genetic screening test for osteoporosis. **DeCode Genetics** announced last week that it had discovered a new genetic risk factor for osteoporosis. Based on a study of 1,000 Iceland residents with osteoporosis, DeCode Genetics determined that individuals with bad versions of the BMP-2 gene were three times more likely to develop the bone-thinning disease. The disease findings have already been confirmed in a large group of Danish patients who have osteoporosis. Incidence of the bad version of this gene may be found in as much as 10% of the population. It seems the bad version limits production of the BMP-2 protein, which stimulates bone growth. This limits a person's peak bone mass, setting up osteoporosis later in life.

ADD TO: BMP-2 Gene

DeCode Genetics is working to have a predictive genetic test for osteoporosis available for use by reference laboratories as early as next year. DeCode Genetics has collaborative agreements with **Roche Holdings**. If a useful genetic test is developed, it has the potential, if the cost is low enough, to be used for widespread screening of the population considered most at risk for osteoporosis. Kari Stefansson, M.D., CEO of DeCode Genetics, says such a test would allow younger people to be tested. If they had potential for the disease, it would allow them time to alter diet and lifestyle to prevent or minimize the disease.

TRANSITIONS

- In Wayne, Pennsylvania, the **Clinical Laboratory Management Association (CLMA)** is looking for a new executive director following the departure of Robert Neri. Neri, an experience laboratory administrator, had been CLMA's Executive Vice President in recent years. He is expected to return to a position in a clinical laboratory.

That's all the insider intelligence for this report. Look for the next briefing on Monday, December 1, 2003