

2019-2020 Key Laboratory Services Trends

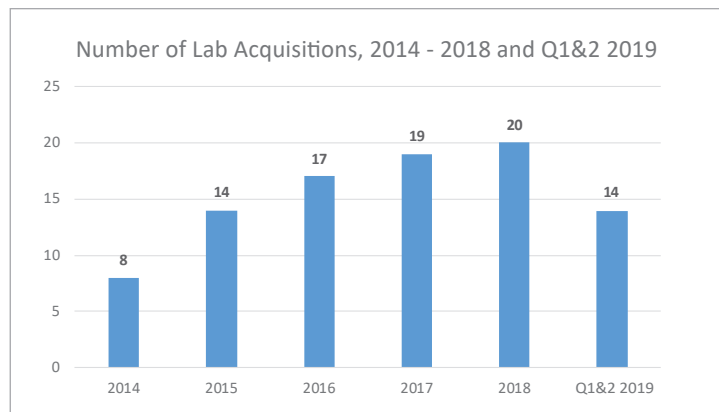
- Protecting Access to Medicare Act (PAMA) payment cuts spur increased M&A activity and drive management to pursue new strategies.** The laboratory services industry will face continued downward payment pressures throughout the remainder of 2019. PAMA reduced payments by approximately 7 percent in 2018 and is scheduled to reduce payments by approximately 10 percent each year in 2019 and 2020. Hospital outreach and regional specialty labs remain vulnerable to rate pressure, which has led several health systems to divest their outreach labs to national providers. Other health systems are forming joint ventures, which allow them to maintain control of their laboratory services while leveraging and expanding lab testing to support integrated clinical care. A higher run rate of acquisition transactions in the first two quarters of 2019 demonstrates increased activity (see Figure 1 below).
- Facing lower margins, hospitals outsource laboratory management to mitigate payment pressures and reduce costs.** According to a survey conducted by UBS, a growing number of hospitals plan to increase laboratory services outsourcing in response to PAMA.¹ This trend is also driven by health systems' general need to execute on performance improvement plans and realize cost savings. As of July 2019, UBS survey data show 23 percent of hospitals expect to increase outsourcing, up from 4 percent in an earlier survey. Of those respondents planning to outsource, 42 percent are considering LabCorp, followed by Quest (33 percent), and other service providers (17 percent).
- Health systems prepare for a shortage of pathologists needed to meet future demand.** As the healthcare industry continues to evolve, independent pathologists have seen payment compression at both the government and commercial levels, coupled with an increased emphasis on efficiency and quality. These changes are having a direct effect on pathology groups. The number of pathologists in the U.S. declined approximately 17 percent from 2007 to 2017, even as the number of physicians and the population overall continued to increase.² As a result, many health systems are concerned about their ability to staff laboratories with well-trained pathologists to handle future demand.
- An intensifying push for price transparency may drive increased scrutiny of hospital lab rates.** The Center for Medicare & Medicaid Services' (CMS) Hospital Outpatient Prospective Payment System recently proposed a new rule that would require hospitals to publicize both gross charges and negotiated prices by specific payers and plans. The proposed rule is intended to increase competition and lower overall costs for patients and payers by enabling patients to shop for services based on actual costs of care. In order to remain competitive, many medical laboratories are streamlining operations and improving efficiencies through strategic partnerships.

1. Taylor, N.: "Hospitals May Boost Outsourcing of Lab Services: UBS Poll." *MedTech Dive*, July 17, 2019. <https://www.medtechdive.com/news/hospitals-may-boost-outsourcing-of-lab-services-ubs-exec-poll/558918/>
 2. Lundberg, G.D.: "How Many Pathologists Does the United States Need?" *JAMA Network Open*, 2(5) e194308, May 31, 2019. <https://jamanetwork.com/journals/jamanetworkopen/fullarticle/2734794>

Acquisition Activity, 2014 Through Q2 2019

Lab merger and acquisition activity is continuing to increase as market leaders aim to diversify and enhance scale.

Figure 1. Acquisition Activity, 2014 Through Q2 2019



Source: Irving Levin

Update on Major Publicly Traded Lab Companies

- The two largest publicly traded independent labs continue to participate in a range of transactions. Quest completed six transactions in 2018, including four acquisitions, a management services agreement (MSA), and a collaboration with an academic medical center. It has announced three transactions in 2019 (through July 31), including an acquisition, an MSA, and a partnership to provide reference testing. LabCorp announced three collaborative partnerships in 2018. In 2019 (through July 31), it has announced an acquisition, a collaborative partnership, and an exclusive preferred lab agreement.
- Consolidation in the industry will continue as the focus remains on cost efficiencies afforded by large-scale automated testing, strategic partnerships, and large integrated service networks.
- PAMA rate reductions are a catalyst for consolidation as smaller labs are disproportionately affected by Medicare payment cuts.

Source: CapIQ

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Notable Health System Transactions (Jan. 1, 2018 – July 31, 2019)

Health System	Date	Lab Partner	Structure	Value Proposition to Partners
Catholic Health Services Partners (CHS) of Long Island	July 2019	Quest	Quest partnered with CHS through a management services agreement.	<ul style="list-style-type: none"> Manages laboratory equipment, supplies, and procurement processes for six hospitals, a core lab, a cancer center, and an infusion center within the CHS system
South Bend Medical Foundation	July 2019	LabCorp	LabCorp is acquiring South Bend Medical Foundation's diagnostic laboratory testing (scheduled to close Q3 2019).	<ul style="list-style-type: none"> Ensures clients and patients in the area continue to receive high quality care
Houston Healthcare	Feb. 2019	Quest	Quest partnered with Houston Healthcare through a management services agreement.	<ul style="list-style-type: none"> Provides management expertise, laboratory equipment, supplies, procurement processes, and reference testing
Marin General Hospital (MGH)	Oct. 2018	Quest	Quest acquired MGH's outreach laboratory services operation.	<ul style="list-style-type: none"> Enhances the delivery of innovative diagnostic information services to communities in Marin County Benefits patients and physicians with an expanded test menu as well as an expanded network of conveniently located patient service centers Monetizes MGH's lab services
Hurley Medical Center, Inc. (HMC)	Oct. 2018	Quest	Quest acquired HMC's outreach laboratory services	<ul style="list-style-type: none"> Grants patients and providers in Michigan access to a broader range of diagnostic services, patient service centers, and Quest's suite of healthcare information technologies and data analytics Monetizes HMC's lab services
RMC Health System	Sep. 2018	Quest	Quest partnered with RMC Health System through a management services agreement.	<ul style="list-style-type: none"> Manages laboratory equipment, supplies, and procurement processes for RMC and Stringfellow Memorial Hospital in Anniston, Ala., in addition to providing reference testing for both hospitals Benefits from Quest's innovative technologies, scale, and diagnostic capabilities
ProMedica	Aug. 2018	Sonic	ProMedica and Sonic formed a joint venture.	<ul style="list-style-type: none"> Provides inpatient reference testing services for ProMedica's hospital-based rapid response laboratories, as well as a comprehensive menu of outreach testing services for physicians based in Ohio, Michigan, and parts of Indiana
Mount Sinai Health System	Apr. 2018	LabCorp	LabCorp and Mount Sinai entered into a new contract as LabCorp is now the primary reference laboratory for Mount Sinai.	<ul style="list-style-type: none"> Improves the quality of laboratory services through standardization of test menus, equipment, supplies, logistics, and processes across Mount Sinai's laboratories

Outlook for Hospital-Based Laboratories: Reevaluate and Restructure Strategy to Adapt to PAMA

PAMA will continue to have a substantial impact and will require hospital leaders to adapt to avoid long-term consequences. PAMA has created a significant financial burden, as the Medicare Clinical Laboratory Fee Schedule includes a payment cut for approximately 75 percent of lab tests that can be billed to CMS. For hospital labs with commercial rates tied to CMS rates, the impact can be even more dramatic. As a result, hospital and health system executives will need to reevaluate and restructure their organizations' lab strategies.

While some hospital labs are exploring diversification into specialty testing, this strategy will require capital investment at a time when the industry is experiencing extreme headwinds. Many health systems are unwilling or unable to invest in this testing, and are instead pursuing other strategies. These include collaborating with commercial laboratories such as Quest and LabCorp in joint ventures, outsourcing inpatient and outpatient lab operations, or selling outreach labs entirely.

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