Laboratory Joint Ventures
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Today’s Agenda

- Clinical Lab Market Opportunity
- Outreach As A Capital Asset
- Outreach Benefits & Mission
- The PAML JV Business Models
- Laboratory Joint Ventures
- Critical Success Factors
- JV benefits to the Hospitals
- Questions & Answers
US Clinical Laboratory Market $55 B in 2008–

Clinical Lab Testing Market

- Hospital Clinical Testing reached $28.4 B in 2007
- Hospitals 55%
- Quest 13%
- LabCorp 8%
- Other CL 11%
- Pols 8%
- Other 5%

Independent clinical lab revenues were $16.5 B in 2007, LabCorp $4.5 B & Quest at $7.2 B in 2008

Washington G-2 Reports Lab Industry Strategic Outlook - 2008

US Competitive Landscape

- Significant industry consolidation has occurred in recent years,

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company</th>
<th>Estimated Net Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Quest Diagnostics – US (Ameripath 2007)</td>
<td>$7200 M</td>
</tr>
<tr>
<td>2</td>
<td>LabCorp – US (acquired 7 labs in 2008)</td>
<td>$4500 M</td>
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<tr>
<td>3</td>
<td>CPL – Sonic Labs – International (acquired 7 labs in the US)</td>
<td>$2000 M</td>
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<td>4</td>
<td>ARUP</td>
<td>$325 M</td>
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<tr>
<td>5</td>
<td>Mayo Medical Labs</td>
<td>$300 M</td>
</tr>
<tr>
<td>6</td>
<td>Bio Reference Labs</td>
<td>$375 M</td>
</tr>
<tr>
<td>7</td>
<td>PAML (and partners) (IDN LAB)</td>
<td>$220 M</td>
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<tr>
<td>8</td>
<td>Spectrum Labs</td>
<td>$165M</td>
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<tr>
<td>9</td>
<td>Carillion Labs (estimate)</td>
<td>$125M</td>
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Lab. Industry Report (LIR) with annual updates and contacts
Carillion Looking for Capital partner for lab to further Hospital Clinical Strategy
Stanford Hospital and Clinics sold outreach lab to LabCorp 2007
Moses Cone Health System, High Point Regional Health System and Novant Health Triad sold major portion of outreach business to Apax Partners to form Triad Lab Alliance dba Spectrum Labs. MCHS retains 20% ownership and seat on the Board of Directors of Spectrum.
NCH Health Care (Naples Fl) sold DSI labs (outreach lab) to LabCorp for $75M

Hospitals Using Labs for Capital Value

Reasons for Considering Sale 2005 Survey

Cash Infusion – 42%
Does not fit mission – 20%
Management Difficulties – 13%
Regulatory Impact – 7%
Other – 20%
Clinical Laboratories provide > 60% of the actionable information for physicians.

Clinical labs are less that 3-5% of hospital cost and can provide significant revenue.

Diagnostics: Clinical pathology, anatomic pathology and Imaging are key hospital system strategies for physicians and should be part of growth strategy for the hospital system.

Integrated Diagnostic information is critical for patient safety, better patient decisions and ultimately best practices.

The current lab testing market Model is comprised of hospital testing, Independent laboratories and POLs ($55B) with hospitals having 55% and Independents 23%.

The Market focus should be on the bringing together of hospital testing (55%) with outreach testing (23 %) to provide integrated Clinical Laboratory testing.

This will provide the best outcomes for the patient, patient safety and the facilitation of evidenced based medicine. It is a critical element for physician practice.

The Integrated Clinical Lab is a mission critical strategy for hospital systems and not to be readily sold for short term capital gains.
Hospital Integrated Delivery Network Systems (IDN) consists of a system of multiple hospital facilities, long term care facilities, and other services providing a continuum of care to patients in a region. Examples are PH&S, Sutter Health, North Shore Jewish, IHC, Trinity, CHI, HCA, and many others.

Hospital Integrated Delivery Networks Systems (IDNS) are consolidating laboratory services through “Lean” processes to reduce cost, increase services and achieve economy of scale.

IDNS are expanding Lab outreach services to reduce cost, standardize on best practices, enhance diagnostic services to physicians and patients and increase Net Operating Income (NOI).

Summary View of PAML’s Org Chart Placement & Governance

PH&S

WA/MT

Oregon
California
Alaska

NW WA
SW WA

PHC EWSA

Montana
SE WA

PAML is an important part of Providence Health Care’s mission and ministry
PAML – Driver of Integrated Clinical Laboratories
Pre-Analytical, Analytical and Post Analytical

PAML Cliff Avenue Technical Center & Part of PHC integrated labs

PAML Iron Bridge Business and Administration

PAML PHC Integrated Labs

- PAML Cliff Ave Technical Center – High-volume rapid-TAT esoteric laboratory
- SHMC provides highly esoteric testing for PAML Outreach – 60% - 70% of the work by volume comes from the Outreach Division
- PAML & SHMC Labs Perform 9.0M tests per year (15% of Enterprise testing)

The integrated laboratories perform about 1100 different types of tests.
About PAML

- A history of successful laboratory Joint Ventures with Hospitals.
- Internationally recognized staff of Ph.D and M.D. scientists.
- Provides billing for 22 partnership entities with average DSO at 40 days.
- Provides reference testing services to over 100 hospitals throughout the West.
- Community-focused by working with local hospitals to maintain local testing, reducing lab cost per test and increasing testing acumen.

PAML and Its Ventures’ Growth 1991 - 2005
All PAML Partnerships are with Hospitals or regional hospital systems.

Most Partnerships are profitable and successful.

All Partnerships push testing into the partner hospitals.

All partnerships involve integration of information systems; reference laboratory, hospital and physician EMRs.

All partnerships bring value to the partners and providers.
# PAML’s Joint Venture Operational Model

10 -15% of tests sent to PAML

85 -90% of Tests Remain in the community

**Physicians, Clinics, etc.**

**Processing Center**

**PAML (esoterics)**

**Hospital Laboratory**

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## Outreach Partnership Business Model – Service and Revenue Flow

- **Specimen drawn**
- **Prepared for testing**
- **Lab result sent to Dr.**
- **Info sent to Billing**

All billing to payers occurs from billing site, using LLC’s or provider’s ID.

Payments are received for timely distribution, precisely according to contract.

Accounting agent prepares monthly statements, contracts auditors/tax experts.

1-To the service provider for pre-analytical costs
2-To the lab provider for testing costs
3-To all owners for profit distribution
4-To the mkt, billing, admin agent for costs
Joint Venture Experience

- Before our joint venture hospital partners experienced:
  - High fixed costs, limited investment capital for lab outreach
  - Lack technology tools – interfacing is problematic
  - Billing of small ambulatory claims is problematic
  - Sales, marketing and client service of ambulatory doctors is immature or non-existent
  - Failure to leverage inpatient data
  - Strong community brand, physician and payer relationships

As Managing Partner, PAML has developed a set of products and services to ensure the success of our Partnerships

1. **JVA MOBILE**: Automated logistics and tracking systems for specimen integrity and logistics services. (These are industry-leading products)
2. **JVA LAB CONNECT**: Connectivity solutions including EMR integration and EMPI.
3. **JVA CRM**: Client Services support through client relationship management software (CRM).
4. **Financial, operational systems, and management services**: including business plans, venture structure, billing system, finance/accounting, & inter-entity billing. (3rd generation billing system with over 20 years of operation)
5. **Billing and collections** that optimize receivable performance and cash flow: provides billing services for 22 clients. (DSO at 40 days)
6. **Sales, marketing**, and client retention systems and Patient Service Centers. (Marketing/Sales have national lab expertise)
7. **Consultative services** compliance, business models, testing, education and hospital labs.
Joint Venture Models

1. PACLAB Agency Model
2. Alpha Medical Labs – JV with KMC – Agency Model
3. Tri-Cities Labs Integrated Lab-Outreach model with hospital lab management
4. Southern Idaho Reference Lab dba TVL – Cotenant model
5. Mountain Star Clinical Labs – JV with regional HCA hospital labs - Agency Model

Legal Structure – Agency Model

- Limited Liability Corporation (LLC)
- “Agency Model”
  - Owners of the LLC act as “agents” to perform specific functions on behalf of the LLC.
    - eg. testing, billing, management, couriers, etc.
- Key LLC agreements:
  - Operating Agreement: Outlines functions of the LLC.
  - Member Provider Agreement: Outlines duties & responsibilities of each member.
  - Management Services Agreement: Outlines Duties & responsibilities of the Manager.
PAML’s Joint Ventures Bring Value To their Owners

- Integrated Outreach and Hospital testing
- Provides physicians with integrated diagnostic information in their EMR
- Provides Net Operating Income & Cash Contributions to joint venture partners
- Provides better patient care and physician service by providing patient focused, physician centered lab services

PAML Consolidated Operations (including venture gains)

- PAML is Wholly owned by Providence Health Care a region of Providence Health & Services Washington/ Montana.
- PAML has grown from a $7M net revenue operation in 1986 and is billing >$200M.
- PAML has five joint ventures one just starting in SLC.
- PAML has also helped start a very profitable technical venture using DNA arrays for cytogenetics testing.
- PAML has sold its Outreach Advantage IP to Sunquest and retains a license for JVs.
- Most PAML ventures are profitable giving good return to their owners
Venture A

- Venture A is an LLC agency model with seven members and 11 hospitals.
- The Venture has over $75M in revenue and returns more than $14M in cash contributions to the members in 2008.
- More than 85% of the testing stays in the region and is performed by the member hospitals.
- Each member hospital is reimbursed for the testing performed as well as indirect expenses.

**JV Member Revenue and Profit Growth**

- Revenue growth
  - $3.3M to $19.3M
- Profit growth
  - $87K to $4.7M
Outreach lab Benefits to the Hospital System:

1. Growth of revenues by a targeted amount based upon market studies and business plan.
2. Improved profitability by expanding market in ancillaries.
3. Improved laboratory testing acumen benefiting hospitals physicians and patients.
4. Significant reduction of inpatient testing costs through economies of scale.
5. More full use of capital investments in lab testing facilities by using excess testing capacity.
6. Enhance hospital revenues through test reimbursement and outreach testing cash contributions.
7. Improved patient care and physician service through integrated laboratory information and knowledge.

How Health Systems Can Achieve Improved NOI

- Hospitals have a high fixed cost investment in laboratory infrastructure... Establish an Outreach testing program.
- Growth and opportunity exists in ancillary outreach... Proven across the US.
- The challenges to growth are systems, experience and expansion capital... Develop the expertise
- Several Large IDN’s have a successful track record of financial and operational results... PACLAB has provided returns of more than $50M to hospital partners over ten years.
- Hospitals have a tremendous opportunity to leverage this capability to benefit the mission with limited capital investment... Integrated Hospital System Labs are fundamental to improved patient care and hospital physician strategy and need to be part of hospital growth strategy.
Questions and Answers

Thank you