



Emerging Business Models in the Clinical Laboratory Industry

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Topics to be Addressed Today

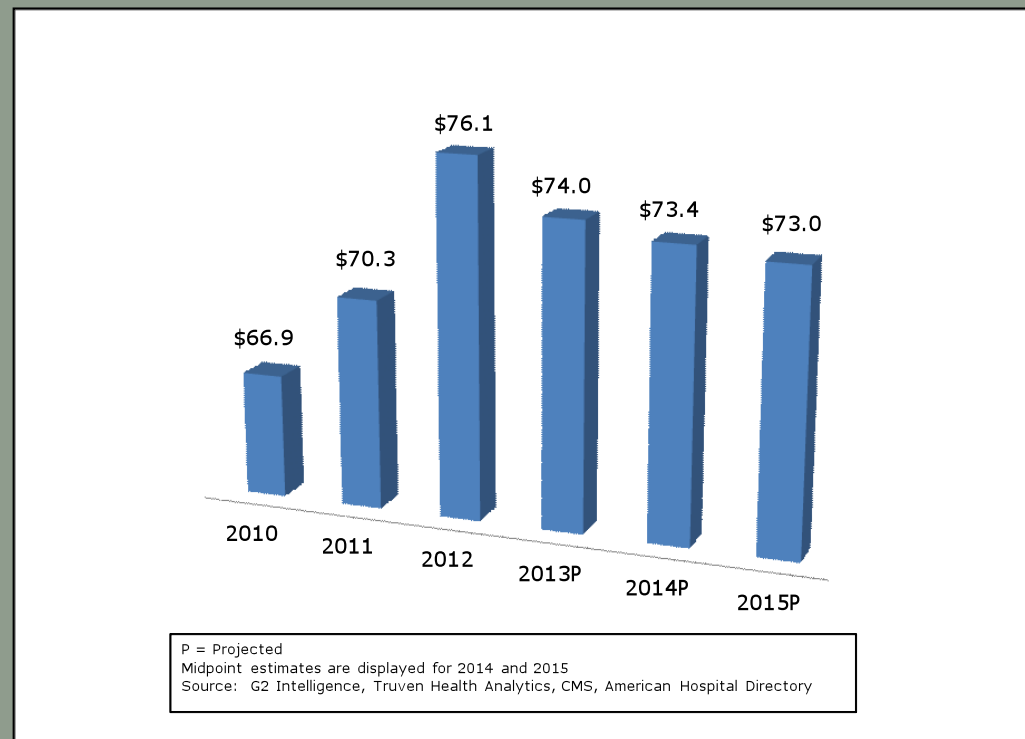
- Laboratory Industry Overview
- Macro Trends Impacting Clinical Labs
- Growing Dominance of Hospital-Owned Outreach Labs
- Commercial Lab / Hospital Lab Business Models
- Emerging Models: Non-Lab Providers

Laboratory Industry Overview

The lab industry is a \$74 billion industry facing dynamic changes under health care reform.

- After many years of consistent growth, lab industry revenue is projected to decline in 2013 for the first time.
- Rate cuts and anemic volume growth are contributing to the decline in lab revenue.

Lab Industry Revenue 2010-2015P (\$ Bil)

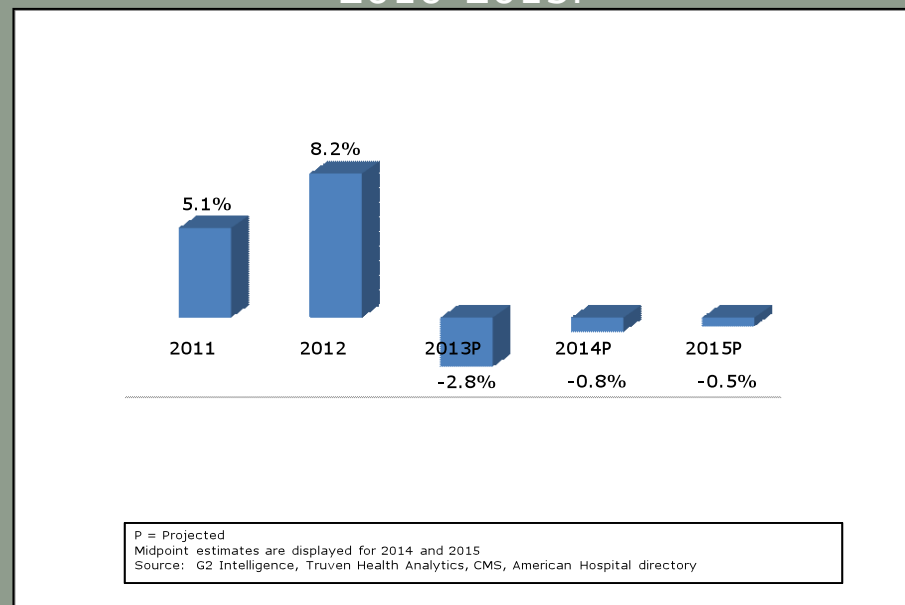


Laboratory Industry Overview

Despite the fact that more individuals are expected to enter the health insurance system in 2014, lab industry revenue is projected to decline due to substantial reimbursement cuts.

- Rates displayed represent changes in total lab industry revenue.
- Reimbursement cuts represent the largest component of revenue decline in 2013.

Lab Industry Revenue Growth Rates
2010-2015P

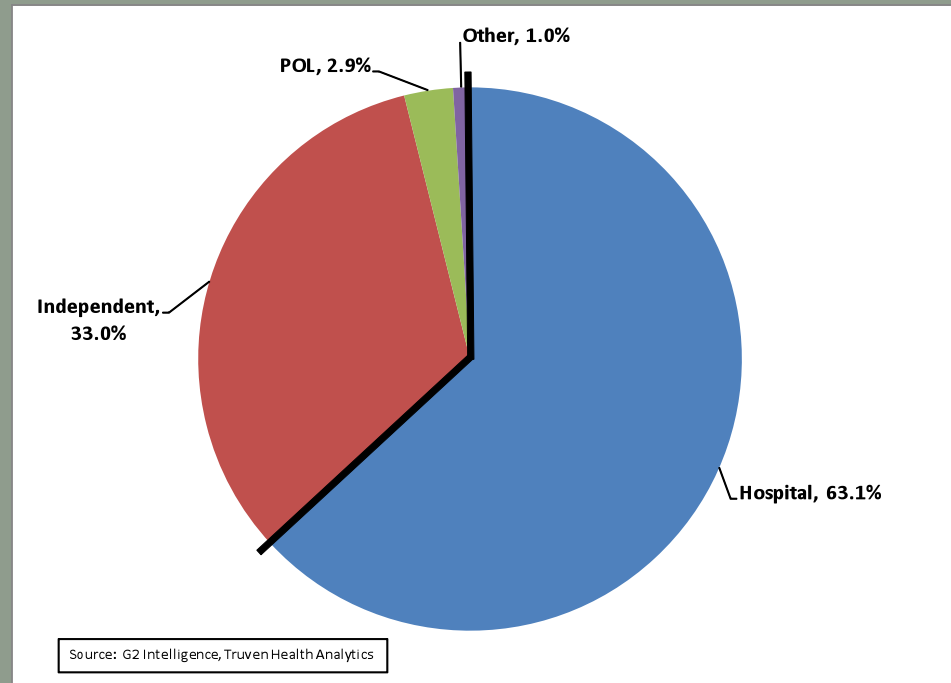


Laboratory Industry Overview

Hospital labs are commanding an increasing share (63.1%) of total lab industry revenue at the expense of independent labs.

- Hospitals accounted for roughly 50% of the market 5 years ago.
- Quest and LabCorp combined account for about 48% of the independent segment.
- While still fragmented, the independent lab segment continues to consolidate.

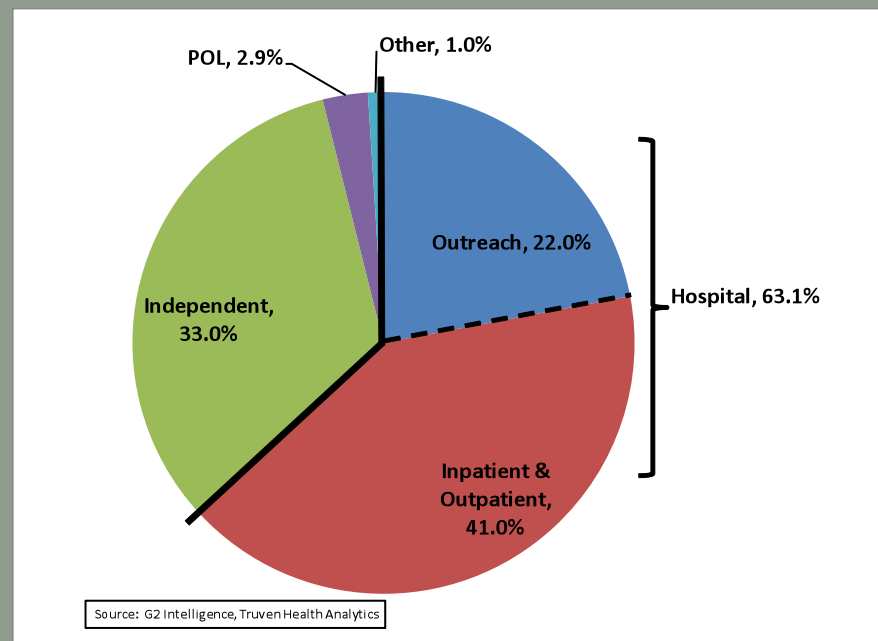
Lab Revenue by Facility Type - 2012



Laboratory Industry Overview

In their 2012 10-K, Quest estimated that the Hospital Outreach segment represented approximately 22% of the entire industry, or approximately 35% of the Hospital segment.

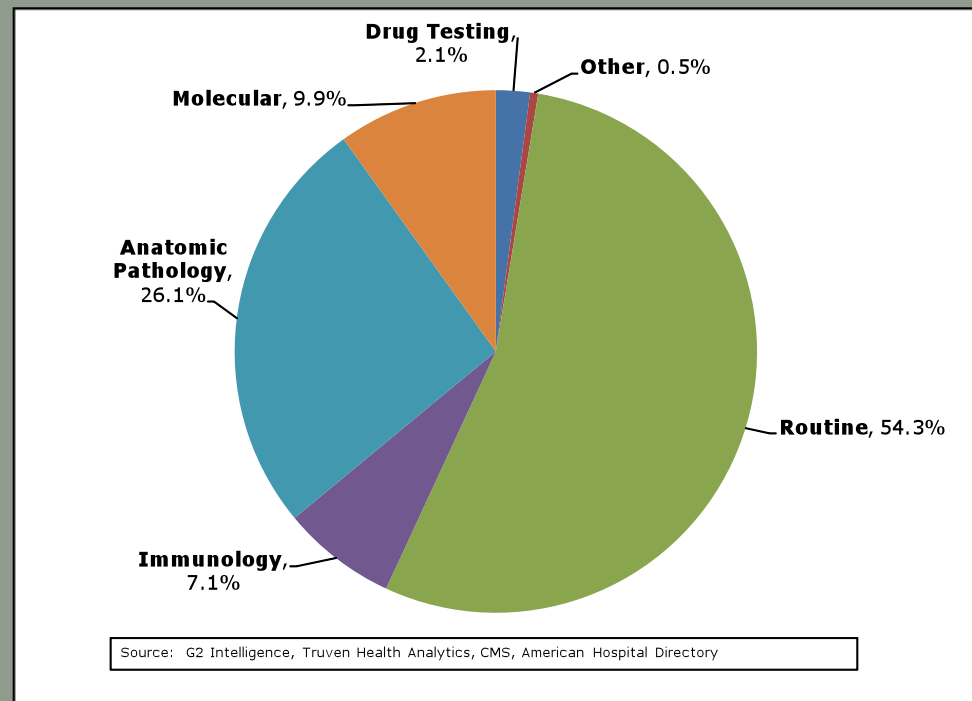
Lab Revenue by Facility Type - 2012



Laboratory Industry Overview

Laboratory Industry Revenue by Testing Segment - 2012

- Anatomic Pathology is projected to shrink by 10.1% in 2013 due to reimbursement cuts.
- The Drug Testing segment is projected to grow by 20% in 2013 (after growing over 23% in 2012) due to increased testing relating to prescription drug abuse.



Macro Trends Impacting Clinical Labs

Several major healthcare industry trends are impacting independent clinical laboratories in significant ways.

- **Lower reimbursement**
- **Physician-as-employee model**
- **Expansion of hospital outreach laboratories**
- Molecular diagnostics, gene sequencing and personalized medicine
- New payment and care delivery models
- Provider-payer convergence
- Consumer health care

Macro Trends Impacting Clinical Labs

Lower Reimbursement – 4.95% overall reduction in 2013

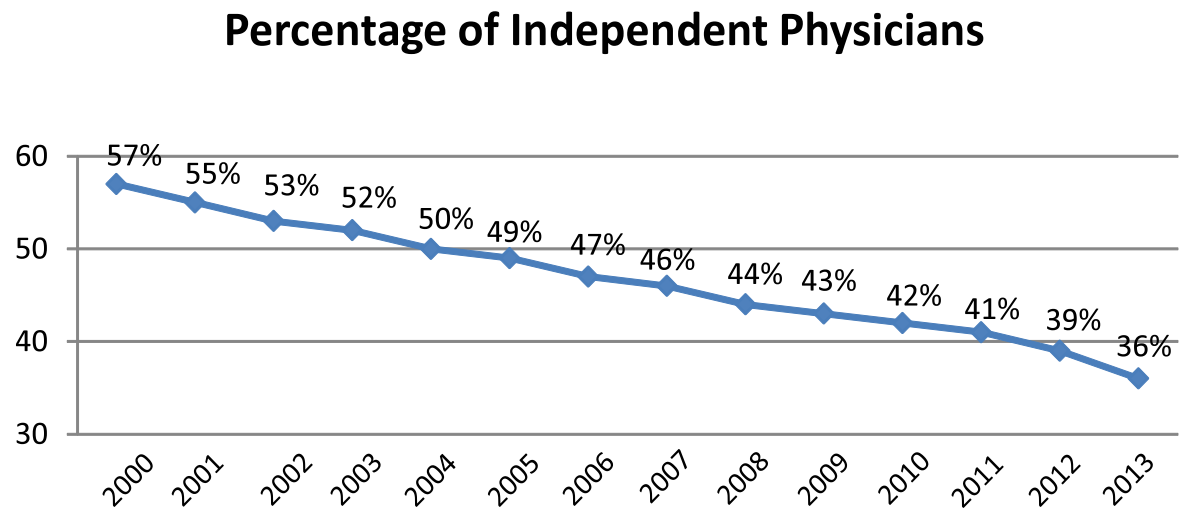
- 1.75% cut in Medicare clinical lab fee schedule under Obamacare
- 2.00% budget sequestration cut
- 2.00% cut for the Sustainable Growth Rate (“SGR”) formula fix
- 1.70% Consumer Price Index (CPI) adjustment
- -0.90% productivity adjustment

Pathology Labs and Molecular Diagnostic Labs experienced particularly severe reimbursement cuts in 2013 and in 2014.

Macro Trends Impacting Clinical Labs

Physician-as-Employee Model

- In 2011, 60% of independent lab services were provided to physician offices according to a George Washington University study.



Source: "Clinical Transformation: New Business Models for a New Era in Healthcare," Accenture, 10/31/12

■ Growing Dominance of Hospital-Owned Outreach Labs

Hospitals control over 63% of the \$74 billion lab market and are providing stiff competition to the national commercial laboratories.

- After reimbursement cuts, the single biggest headwind facing the large commercial labs today is the erosion of their physician client base due to physician practice acquisitions by hospitals.
- Hospitals are benefiting from the higher reimbursement on acquired physicians' lab testing due to the hospital laboratory fee schedule.
- Most industry observers expect that this reimbursement differential that hospitals now enjoy will erode over the medium term.
- In the meantime, however, volume growth at the big commercial labs continues to suffer. Quest just announced that its Q1-2014 volume grew only 0.7% versus Q1-2013. LabCorp had not yet issued its Q1-2014 results at the time of the completion of this presentation.

Growing Dominance of Hospital-Owned Outreach Labs

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	Public Companies				Observed Range Hospital Outreach Labs	
	LH	DGX	BRLI	Average		
Net Revenue/Accession	\$44.28	\$44.34	\$81.17	\$56.60	\$95.00	- \$165.00

Sources: Company Reports, Laboratory Economics, Haverford Healthcare Advisors' Research.

Commercial Lab / Hospital Lab Business Models



Commercial Lab / Hospital Lab Business Models

Continuum of strategic partnership options between labs and hospitals.

Less Collaborative



More Collaborative



Commercial lab and hospital lab share facilities, test volume and logistical services within a defined geography.

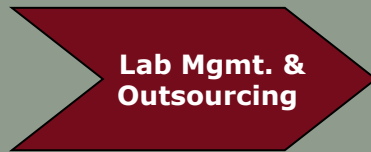
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Outsourcing of laboratory services by hospital in exchange for long-term laboratory services agreement with commercial laboratory.

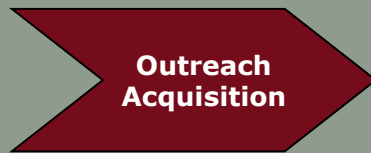
Commercial Lab / Hospital Lab Business Models

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Less Collaborative



More Collaborative



Acquisition of the outreach client list with or without a lab management or lab outsourcing arrangement.



Involves shared equity ownership or profit sharing by the hospital and commercial laboratory.

Commercial Lab / Hospital Lab Business Models

Hospital Outreach Laboratory Acquisitions

Typical Reasons hospitals wish to exit the outreach business:

- To monetize a non-core asset and utilize the capital for other key investment: physician practice acquisitions, GI suite, etc.
- Inability to be competitive due to use of hospital fee schedule in the outreach market
- Space constraints / hospital wants space for other, more core use or ancillary revenue opportunity

Commercial Lab / Hospital Lab Business Models

More hospital systems are choosing to monetize their outreach laboratory businesses.

HOSPITAL LABORATORY TRANSACTIONS - 2012 - YTD 2014						
Date	Acquirer	Target	Purchase Price	Target Revenue	Target EBITDA	Price to Revenue
1 Jan-12	Quest Diagnostics	S.E.D. Labs	NA	\$75,000,000	NA	
2 Dec-12	Quest Diagnostics	UMass Memorial Medical Center clinical outreach lab	NA	NA	NA	
3 Apr-13	Laboratory Corporation of America	Dignity Health's Outreach Clinical Lab Operations (AZ)	NA	NA	NA	
4 May-13	Quest Diagnostics	Dignity Health's Outreach Clinical Lab Operations (CA, NV)	NA	NA	NA	
5 Aug-13	Laboratory Corporation of America	Genesis Clinical Laboratory Outreach Business	NA	NA	NA	
6 Sep-13	Laboratory Corporation of America	John Muir Health Clinical Laboratory Outreach Services	NA	NA	NA	
7 Mar-14	Laboratory Corporation of America	Terre Haute Medical Lab	\$10,500,000	NA	NA	
8 Mar-14	Quest Diagnostics	Solstas Lab Partners Group	\$570,000,000	\$355,000,000	NA	1.61

Emerging Models: Non-Lab Providers

United WestLabs, Santa Ana, CA –

- Enters into management agreements with hospitals to build outreach programs.
- In exchange for a management fee and reimbursement of its actual costs, UWL provides all of the pre- and post-analytic services necessary to build and grow the program.
- UWL employs outreach staff, leases PSCs, provides courier service, IT connectivity, etc.
- Testing is done at the hospital lab.
- UWL bills on behalf of the hospital under the hospital's payer contracts.
- Hospitals leverage underutilized lab capacity and realize a new revenue stream.

Emerging Models: Non-Lab Providers

Private Company A –

- Similar to UWL model except the operator bills for lab testing on behalf of itself under its own, newly garnered payer contracts.
- Hospitals realize a revenue stream without the risks and hassles of running an outreach business.

Private Company B –

- Enters into a laboratory management agreement with hospitals; compensation is based on a share of the hospital's lab cost savings or a percentage increase in the lab's contribution margin.

Haverford Healthcare Advisors

- Provides business valuation and transaction advisory services to healthcare service companies
- Specific focus on clinical laboratories and pathology practices
- Facilitates the process of selling, merging or partnering, or growing through acquisition
- Provides lab valuation services, frequently in connection with a contemplated transaction or with the formation/dissolution of joint ventures

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