CREDO WEALTH

Testing Times

Galen, the philosopher-physician of late antiquity, is reputed to have remarked of a certain cure that “all who drink of this treatment recover in a short time, except those whom it does not help, who all die.” Thankfully, with the advent of laboratory testing and peer reviewed research, such quackery has long since been expunged from modern medicine. In the US alone, the laboratory testing market is worth $75bn, accounting for approximately 3% of total healthcare expenditure. Of this, Quest Diagnostics dominates as one half of an effective duopoly.

As the major player in an industry enjoying secular tailwinds such as population growth, an ageing population, and increasing healthcare coverage, Quest’s performance in recent years has hardly been what one might expect. The company has struggled to grow, ceding market share to hospital-owned labs, and last year’s revenue and earnings figures are broadly comparable with 2009 levels. Yet in spite of this, the changes initiated in 2012 by then new-CEO Stephen Rusckowski – brought in to restore growth – have begun to bear fruit, with five consecutive quarters of positive organic growth. Though some uncertainty remains, particularly surrounding the rate at which Medicare (US national insurance for the elderly and infirmed) reimburses companies for running tests, there is reason to believe that the future will be a significant improvement over the recent past.

The rate at which Quest is reimbursed for tests covered by Medicare is a complex issue, and is laden with uncertainty. Under new legislation, laboratories will provide their costs for conducting tests and a composite rate will determine the amount Medicare will reimburse. However, hospital laboratories, which are typically higher-cost, are excluded from this calculation and so independent firms will be reimbursed at a lower rate than they otherwise would. At first glance, one might think Quest’s revenues may suffer under such a regime, yet there is little incentive to do business with hospital laboratories at a potential loss. Rather, as the lowest-cost player, Quest may suffer from lower prices in the short-term, but will likely enjoy gains in volume as competitors opt to consolidate or outsource their testing.

However one looks at it, measures aimed at reducing the cost of healthcare should in time prove beneficial to the lowest-cost and largest-scale provider. Though lower reimbursement rates may hurt, for Quest the secondary impacts of this pain on the broader market should be positive over the long-term. In this sense, Galen’s prognosis is perhaps a fitting truism: the benefits of the competition induced by the legislation shall accrue to those it can help – the low-cost firms such as Quest – whereas those whom cannot compete, it cannot help, and they shall surely perish.

Important Notice