Silver Lining for Agile Freestanding Imaging Centers

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Since the passage of the Deficit Reduction Act of 2005 (“DRA”), freestanding imaging providers have overcome a series of volume and reimbursement pressures in an effort to sustain profitability. The DRA (effective in 2007) set reimbursement per procedure at the lesser of the hospital technical component or the Medicare physician fee schedule rate. Prior to the passage of the law, freestanding centers were reimbursed more than hospital outpatient departments (“HOPD”) for most modalities including MRI & CT. As a result of the DRA and other Centers for Medicare & Medicaid (“CMS”) payment rulings, reimbursement to freestanding centers has been cut by almost 60.0% for some procedures since 2005.

In addition to reimbursement woes, utilization in the imaging industry has declined. A recent report published by the Medical Imaging & Technology Alliance indicates that imaging utilization among Medicare beneficiaries fell 1.0% in 2011, extending a two-year slide in utilization. Furthermore, the Healthcare Cost Institute in a recent report indicated that radiology utilization among privately insured Americans dropped 5.4% in 2010. The increased popularity of high deductible plans, stringent authorization requirements for advanced imaging services, and patient sensitivity towards high-cost imaging services have helped to explain the decline in imaging utilization. Despite these challenges, many within the imaging industry remain positive regarding the industry’s outlook, particularly towards freestanding imaging centers. CEO of AGI Healthcare Group Richard Townley said in a recent radiology business journal that freestanding centers may be in a good position to effectively serve patients.

“Freestanding centers are increasingly well positioned to leverage their lower prices, better service, and often superior quality, generally at the expense of local hospitals and weak operators.”

- Richard Townley, CEO AGI Healthcare Group

A company that appears to be demonstrating these qualities is RadNet which has recorded six straight quarters of positive year over year (“YOY”) same store volume growth, as illustrated by the chart below.
The trends observed in the RadNet volume statistics and the volume trends observed in our valuations highlight the two key themes of the freestanding imaging industry.

**Only the Strong Survive**

When asked about his company’s volume growth, RadNet CEO Howard Berger, MD said, “We think we can maintain those volumes... at the expense of other operators... that either we consolidate or that go out of business.”

Creighton Cook, director of business development for Outpatient Imaging Affiliates (OIA), recently stated “There are imaging centers in this country going out of business every day, most of which were not developed under a strong business plan.” These complacent centers have been unable to adapt their cost structure to maintain profitability in a challenging operating environment, thus creating a development opportunity for larger, more profitable imaging managers. Furthermore, independent from any development opportunity, the bankruptcies of smaller imaging centers have created volume opportunities for larger, more developed players in the market. Cook describes the current environment as a market correction, one in which the survivors are going to be hospitals and quality independent owners.

**Importance of the Low Cost Provider**

Another factor helping to brighten the outlook for freestanding imaging centers is the increased pricing transparency within the imaging market. In spite of the DRA, HOPD rates for imaging procedures have remained significantly above freestanding rates due to commercial contracts. In some markets we have observed HOPD rates at almost 10 times the amount charged by freestanding centers. Insurance companies have begun to steer imaging volume to the lower cost freestanding centers by actively marketing to patients the reduced out-of-pocket cost to the patient at the freestanding center. Patients have also become more price sensitive as they have increased awareness of healthcare pricing resulting from improved information and increased responsibility for healthcare cost due to the increased popularity of high deductible healthcare plans.

With more reimbursement cuts on the horizon, consolidation and bankruptcies among freestanding imaging providers are expected to continue. As pricing transparency for healthcare services continues to improve, the shift in volume from high cost HOPD providers to more cost effective freestanding providers is expected to continue. Each of these trends will actually favor well-positioned freestanding providers.