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DRUG TESTING
AN INDUSTRY STUDY

Things you will learn from this whitepaper:

1. What are the current challenges facing the drug testing industry?
2. How do government regulations affect drug testing costs?
3. How has consolidation affected the industry's landscape?
4. What are the advantages of the testing industry compared to other drug related industries?

This whitepaper will have special interest to:

1. Attorneys consulting with drug testing laboratories considering mergers or acquisitions.
2. Judges presiding over business disputes & corporate litigation cases.
3. Business mediators & arbitrators.
4. Financial & income tax advisors.
5. Those concerned with the valuation of drug testing laboratories.

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Notice & Disclaimer

In a forensic accounting setting, the purpose of an industry analysis is to allow a comparison of the subject company to its industry. This comparison is vital to assess the strengths and weaknesses of the subject company, as well as its industry and company specific risks.

The following study contains a brief, selected analysis of the specified industry. It is based upon a review of current economic statistics, articles in the financial press, reviews found in current business periodicals and information posted on numerous internet sites. It does not purport to be all-inclusive or to contain all of the information which a prospective investor or lender may require. Projections and opinions are based upon information provided by third parties. We make no representations or assurances that this information is complete or accurate. Neither Mark S. Gottlieb, CPA, PC nor any of its officers, employees, or representatives make any representation as to the accuracy of completeness of this report or its contents, nor shall any of the foregoing have any liability resulting from the use of the information contained herein or otherwise supplied.

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Industry Overview

Drug testing, a relatively young component of the medical and diagnostic testing industry, has grown rapidly over the past 20 years. As of 2001, drug-testing laboratories had become a $5.9 billion annual business, and had spawned a strong secondary market of guerrilla counter-labs and websites peddling products intended to sabotage tests. This, in turn, has fueled research and galvanized the industry.

The Drug & Alcohol Testing Industry Association (DATIA), based in Washington D.C., has 1,100 members, including drug labs, collection facilities and equipment makers. Major companies in the industry include PharmChem, a giant urine-testing lab, and Psychemedics, the nation's leading hair-testing facility. These companies alone do over $60 million in annual business. GlaxoSmithKline, another industry leader, did 24 million drug tests in a decade, from 1988 to 1998.

Currently, 67 percent of the nation's largest companies test their employees or applicants for drugs, according to a 2001 survey by the American Management Association. And though the percentage of companies that test is down from its peak—81 percent in 1996—the industry seems poised for moderate growth. Most state and federal jobs require regular drug screening, and with the consolidation of commercial labs moving along steadily, profits have risen.

Competitive Landscape

Drug testing laboratories typically receive samples from a broad geographical base, and there are pronounced economies of scale in the industry. Small labs can compete effectively by providing specialized analyses or services, or by serving geographical regions with few screening facilities.

Because most testing is requested by large corporations and government agencies, drug testing laboratories do not compete for business from individuals. Contracts are a key component of the industry, and most laboratories seek to establish and maintain themselves via renewable contracts with client companies. Testing may be done at discrete or random intervals, but contracts ensure that drug-testing companies retain a base clientele.

Over the past 30 years, the drug-testing industry has gone from a small, boutique enterprise to a heavy player in the medical and diagnostic laboratories industry. Because of a sudden spike in demand in the early 1980s, a great number of laboratories arose to meet market opportunities. As the industry peaked and began to settle out, labs remained competitive through mergers and acquisitions, and by continually developing faster, cheaper, and less invasive testing procedures.

Over this period, the growth of managed care organizations (MCOs) and hospital groups encouraged consolidation in the medical laboratory and diagnostic industry, and this trend carried over into the drug testing industry. Customers with large memberships often prefer to negotiate contracts with companies that can provide services regionally or even nationally, and mergers have seen a streamlining of physical and administrative resources, thereby increasing profitability.

Products, Operations & Technology

At the minimum, each sample is tested for what is known as the Big Five: marijuana, cocaine (including crack), methamphetamines (including its cousins, amphetamines and Ecstasy), PCP (also known as angel dust), and opiates (like heroin and morphine). Employers typically do not ask that a sample to be tested for prescription drugs. Laboratories seldom screen for alcohol or cigarette use, since these are legal.

Drug-testing technology has become increasingly precise over the past few decades, and even industry opponents admit that false positive readings are now extremely rare. A positive test for heroin, for example, can no longer be blamed with any degree of credibility on consumption of poppy seed bagels. Tests function by screening for metabolites in a subject's urine, certain of which remain up to three weeks after a subject has used drugs. In the case of marijuana use, the chemical THC is present.

Urine tests, the standard screening protocol, are billed at an average of $25 per sample. Hair analysis, becoming more common, can track a longer history of drug use, and is billed around $50. With this type of analysis, laboratories claim that the hair shafts of a 60-strand, 1.5 inch sample can trace drug use going back three months, making it the most rigorous test commonly available to clients.

Procedures at medical clinics and other collection facilities are required to follow strict guidelines set up by the Federal Department of Transportation. "Chain of Custody" is an important protocol ensuring that the sample attributed to an individual is in fact the same sample collected from the designated party. Drug testing firms must work closely with collection centers to ensure that Chain of Custody is implemented, as this is vital to successful testing. Human monitors, extensive paperwork and specialized collection and transport equipment all contribute to overall testing cost.

Though dismissive of saboteurs' claims that tests can be easily defeated, drug-testing firms are nonetheless involved in a constant cat-and-mouse game with companies and services attempting to foil accurate testing. Kits containing adulterants such as nitrites and bleach, diuretics, synthetic urine, chemically treated shampoos, herbal concoctions, and a slew of other products are commonly advertised in print and online venues. Drug-testing firms continuously research and examine these kits in order to ensure accuracy of service in testing.

Finance & Regulation

Following President Ronald Regan's Executive Order 12564, drug abstinence became an absolute condition of federal employment. This order created guidelines for the drug-testing industry, and despite opposition from the ACLU and other lobbying groups, Congress passed the Drug-Free Workplace Act in 1988. In the decade following Regan's decree, drug testing in the U.S. increased 277 percent, and became common throughout the private sector in all lines of work. Courts have consistently upheld the drug testing of both federal and private sector employees as Constitutional.

With new testing technologies continuously coming into use, regulations governing waste disposal have become a key procedural concern for laboratories, as well. The increasing scope and vigilance of EPA rulings has raised both administrative and base overhead costs. Continuing education with regard to EPA protocol is an important facet of laboratory administration.

Workforce

Employment in the industry has grown steadily over the past 30 years. Clinical laboratory technologists have a bachelor's degree in medical technology or in another life science, and can perform a variety of tests. Technicians have associate degrees or a diploma from a vocational or technical school, and perform a narrower selection of tests. Some states require lab personnel to obtain licenses. Also, professional certification aids individuals in proving their competence and marketability.

Because technicians are less costly to employ than better-educated technologists, and because of the routine nature of testing, many laboratories have begun using more technicians. At some companies, technicians constitute up to 75 percent of the staff. Technologists in particular tend to remain employed in the industry for long periods, due to the high level of education and training required for the occupation. In the year 2001, technologists had a mean annual salary of $42,790; technicians, $28,360.

As with the health care industry at large, qualified workers are in short supply. Workers in health care tend to be older than workers in other industries, and in the next decade thousands of workers will reach retirement age. This fact, coupled with a steady demand for drug testing services, presents one of the industry’s most formidable challenges.

Industry Advantages

No Dependence on Third Party Payers - Unlike the rest of the medical and diagnostic laboratory industry, drug-testing companies are not reliant on third-party payers such as Medicare, Medicaid, MCOs, or other health insurers. Legislative reform, which places ever-changing compliance demands on general medical laboratories, has no bearing on the industry.

Contract Management Services - Due to their acumen in managing for-profit facilities, some companies serve as consultants or contract managers for labs owned by hospitals. This niche is expected to shrink, however, as hospitals continue to outsource diagnostic and laboratory testing to commercial labs.

Scientific Advances - Rapid advances in understanding human physiology and pathology are creating sleeker, less expensive screening protocols. The drug-testing industry has proven adept in co-opting advances in medical testing fields; these are often implemented with minimal research investment.

Legislative Support - Over the past three decades, most legislative actions and virtually all judicial decisions have supported the Constitutionality of compulsory drug testing in both the private and public sectors. Therefore, the drug-testing industry should experience steady demand for services into the foreseeable future.

Critical Issues

Workforce - Shortages in qualified personnel is the key issue facing drug-testing laboratories in coming years. With demand for services constant and the pool of available technicians shrinking, companies must find new solutions in order to meet market demand, and to remain fiscally viable.

Lobbying Unions - Though protected and even sponsored by legislation and judicial precedent, the drug-testing industry provides a controversial service. Organizations such as the ACLU staunchly opposed compulsory drug testing, as do many commercial guilds and unions. While these groups have had minimal effect on the industry to date, reports detailing the inefficacy of drug testing as a business strategy has caused some disquiet among industry figureheads.

Industry Outlook

Of all divisions in the medical and diagnostic testing industry, drug testing is arguably the most static. Demand has remained relatively constant over the past decade, and unlike its parent industries, drug testing does not benefit from rising health care costs. As the industry follows general commercial trends, commercial consolidation should continue to increase total revenues. The development of new testing technologies will provide opportunities for greater profitability, as well. If the issue of employment resources can be dealt with, the industry should be profitable into the foreseeable future.

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