

# M&A in Healthcare IT

*The deals are smaller but the pace is accelerating.*

by Ben Rooks

**W**hile still considerably down from its high several years ago, the number of merger and acquisition transactions grew in 2003 and by all appearances is likely to continue to do so going forward. Between March 2002 and March 2003, M&A activity was near a nadir level with roughly 30 combinations. Between March 2003 and March 2004, closer to 40 transactions were announced. Unlike in the heady days of the dot-com bubble, almost all deals were relatively small. Only six exceeded \$100 million, and only one—Rochester, N.Y.-based Eastman Kodak's acquisition of dental practice software vendor PracticeWorks—reached \$500 million.



## Tuck-in versus platform acquisitions

Most of 2003's acquisitions were "tuck-ins"—additional technology acquired to enhance an existing product and service set or the addition of a new distribution channel or clients. Libertyville, Ill.-based Allscripts Healthcare Solutions' purchase of Advanced Imaging Concepts and of RxCentric, Engelwood, Colo.-based Quovadx's acquisition of CareScience, and Atlanta-based NDCHealth's purchase of ArcLight Systems all typify tuck-in acquisitions.

"Platform" acquisitions, in contrast, typically add exposure to a new area and often add considerable financial girth. While these moves typically are higher risk, they're more likely to have a meaningful impact on the acquirer's business and future prospects. When I wrote on M&A activity for *Healthcare Informatics* in 2001 (June issue, page 85), I introduced the brief acquisition rule I had formulated during my 10 years as an equity research analyst—sell a company's stock if the CEO cannot explain an M&A rationale in less than 10 minutes of focused conversation. I still sup-

port the skepticism that rule implies and consider it especially important for platform acquisitions.

Kodak's purchase of PracticeWorks for 4.5× revenues (an astounding 32× the last 12 months' earnings before interest, tax, depreciation and amortization) was clearly a platform acquisition. It was particularly noteworthy because Kodak apparently was most interested in the digital radiography systems, which PracticeWorks had acquired the year before for only \$60 million. Interestingly, Kodak stock declined more than 20 percent within eight weeks of the announcement. While the stock

price has recovered, it has significantly underperformed both the Dow and Standard & Poor's 500.

WebMD, Elmwood Park, N.J., continued to expand its claims submission functionality, acquiring MediFax-EDI for the relatively high revenue multiple of 4.9× and Advanced Business Fulfillment for 4.1×. While the strategic fit of these transactions seems obvious, the valuations were on the high end. Continued activity from WebMD can be expected.

## Other transactions of note

On the clinical front, GE Medical, Milwaukee, and QuadraMed, Reston, Va., enhanced their functionality by acquiring small lab information companies. Quovadx's acquisition of Rogue Wave helped lower its average sale price and diversify its revenues away from healthcare.

Total eMed's purchase of EdiX from IDX Systems, Burlington, Vt., to form Spheris Corp., headquartered in Franklin, Tenn., was clearly a sign of continued opportunity in the transcription (and broader outsourcing) space. Transcription is probably one of several areas that will look for more growth through horizontal acquisition and increased service offerings.

Raleigh, N.C.-based Misys Healthcare System's acquisition of Patient1 from Per-Se Technologies, Atlanta, attracted attention for at least three reasons: It went for just a small fraction, at \$30 million, of the price Per-Se's earlier incarnation (Medaphis) paid for Ultricare (Patient1's former name). It marked Misys' expansion in patient care from ancillary to enterprise systems. And, it showed new price discipline by Misys, whose willingness to pay up for both Sunquest and Medic was often remarked upon by industry watchers.

### A quickening tempo

Only two healthcare IT companies (IMPAC Medical Systems, Mountain View, Calif., and CPSI, Mobile, Ala.) have gone public within the past two years. This closing of the equity markets sharply limits investor liquidity to M&A. Furthermore, up until six months ago, the volume of new private equity investments in healthcare IT had contracted significantly. Many private equity investors had to turn to working through their existing portfolio companies rather than seeking new investments.

### SOME OF THE M&A ACTIVITY IN 2003

Expanded company	Merged/acquired company
Capgemini	Transiciel
Cerner Corp.	BeyondNow Technologies
CMHC Systems	Earley Corp.
Cognizant Technology Solutions US Corp.	ACES, Infopulse, Ygyan Consulting
Creative Socio-Medics Corp.	Adia Corp.
First Consulting Group Inc.	Coactive Systems Corp., Paragon Solutions Inc.
HealthScribe Inc.	Max Health India Ltd., Scribes OnLine
Ingenix Inc.	Symmetry Health Data Systems
MED3000 Inc.	Child Health Management Services
Merge-eFilm	RIS Logic
Omnicell Inc.	BCX Technology Inc.
Park City Solutions	Netsteps Inc.
PeopleSoft Inc.	JD Edwards
Perot Systems Corp.	HPS, Vision Healthcare
SAS	Marketmax, OpRisk Analytics
Source Medical	Health Information Systems
TECSYS Inc.	PointForce
VitalWorks	AMICAS

Compiled from information provided by the companies in the online Healthcare Informatics 100 survey.

This trend appears to be abating. More private investors are seeking to put money to work either in new companies or through expanding (primarily through acquisition) existing portfolio companies.

Over the past 12 months, many companies finished integrating their prior acquisitions and rationalizing their internal operations. At the same time, in part as a component of a broader recovery, share prices have recovered, driving a significant increase in M&A dialogue. The sentiment has clearly changed in the past six months and buyers have either re-emerged or are planning their strategy.

Increasingly, size and scale are becoming more important, both to companies and their customers. In reviewing the revenues of the 2003 *Healthcare Informatics* 100 list, it is readily apparent that 20 percent of the companies have approximately 80 percent of the revenues. While the energy, entrepreneurship and innovation of the smaller companies are undisputed, in too many cases these firms lack the scale to be economically viable in the medium to longer term. Customers might value these companies' innovation, but they might also doubt the smaller companies' staying power as the long-term partner that managers and boards require. Good products and services, while necessary, have become insufficient, as both clients and investors also seek national sales organizations, significant marketing budgets and, often most important to clients, strong balance sheets.

To investment bankers, current M&A-oriented requirements are obvious: growth plans should be clear and rational, and pricing must be disciplined. The likelihood of a successful large-scale roll-up (as tried by HBO & Co. or the previous management team at QuadraMed) continues to diminish. Equally clear is today's significantly narrower list of buyer candidates. Accordingly, sellers' valuation expectations must be realistic.

One trend is expected intuitively but absent in reality: private-to-private company mergers. Such transactions have the potential to create a combined company with the necessary scale to compete effectively, establish a broader portfolio of products and technology, diminish duplicate operating expenses and provide the financial runway to compete. Yet often, these benefits do not outweigh the control and economic debates in private-to-private negotiations. If these issues can be overcome, multiple opportunities exist to create competitive businesses.

### Predictions for fiscal 2004

Looking forward, both the pace and size of acquisitions can be expected to increase. At least one public company below \$100 million in market cap will be acquired (75 percent odds), and a larger company (top 10 pure-play) may be acquired (20 percent odds). ■

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