Consolidation Alters the Mix

Several Healthcare Informatics 100 companies see vigorous M&A activity.

by Benjamin M.W. Rooks

Although *Healthcare Informatics* reviewed merger and acquisition activity last year as part of its annual June 100 issue, the accelerated pace and scale of consolidation warrants an update on how the contenders have shifted and what the chess board looks like going forward. A scan of the upper tier of the top 100 list finds mammoth companies acquiring large ones, new market segments entered through technology acquisitions, companies dividing themselves and an industry stalwart hitching its wagon to one of the biggest companies in the world.

Focusing primarily on the top of the list and on only those companies that have more than 25 percent of their revenues in healthcare IT reveals as much activity this year as the space has seen since the e-health days. Interestingly, most of the combinations have centered around radiology, in part, no doubt, because its buyers have been the earliest adopters of IT due to, among other things, its clear return on investment. Taking it from the top ...

■ Let's call the whole thing off

Netherlands-based Philips Medical System (No. 2) leads the pack with its acquisition of Stentor for \$280 million (5.6 x estimated 2005 revenue, 3.7 x estimated 2006 revenue), jilting the public markets since Stentor had an initial public offering (IPO) in registration for eight months. The combination of PACS with Philips makes intuitive sense, because Philips had previously partnered with Swedish company Sectra (No. 50) for its PACS solution. This marriage left Sectra with a questionable dance partner and in serious need of new distribution.

Philips is also noteworthy for its 2003 partnership with Epic Systems (No. 20). Although Epic has been steadfastly independent (and extremely successful), industry watchers have postulated that this partnership could ultimately represent a liquidity path for the company.

■ You've gotta have heart

The purchase by Belgium-based Agfa (No. 3) of Heartlab (No. 58) for \$132 million (3.5 x revenues, 24.5 x EBITDA—earnings before interest, tax, depreciation and amortization) was one of several cardio-PACS acquisitions by players at the top of the list.

Acquisitions by IDX Systems (No. 15) of RealTimeImage for \$15 million and by McKesson (No. 5) of Medcon (No. 98) for \$84 million (4.7 x revenues, 24 x EBITDA) were also noteworthy, as broader systems vendors sought to add functionality for this area of growing importance.

Finally, on Nov. 1, in part to build more growth into its story, Emageon (No. 56) acquired Camtronics Medical Systems, the cardio-PACS subsidiary of OEM manufacturer Analogic Corp., for \$40 million (approximately 1 x trailing revenues—1.2 x once the real estate value was subtracted).

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■ Party like it's 1999

The near-constant hum of the acquisition machine at WebMD (No. 7) diminished over the past few months as the company divided in two. Renaming itself Emdeon, the company executed a successful IPO of WebMD, its portal business. For observers who long for the e-health days, the IPO was as successful as any of late, closing up 26 percent on the first day of trading.

Freed of this distraction and armed with additional cash and stock currency, both WebMD and Emdeon are likely to pick up their acquisition activity again to grow their businesses.

■ Don't stop thinking about tomorrow

Cerner Corp. (No. 9) has often seemed to hold a bit of disdain for its more acquisitive competitors, preferring to develop its own applications. But over the past few years, it quietly and successfully made several small acquisitions of technology applications (e.g., CoPath) and client bases (e.g., Citation) it hoped to migrate to its platform.

This changed with Cerner's $100 million acquisition of the medical division of VitalWorks. (The deal closed just before I joined William Blair & Company, which advised VitalWorks on the sale.) As a long-time Cerner watcher, I was shocked that Cerner, of all companies, would pay up for a consolidator, but early indications are that the acquisition is a success and will help Cerner drive its enterprise solutions to physician desktops.

Cerner's acquisition of French healthcare IT vendor Axya Systèmes points to its continued interest in being a worldwide player in the market. With 75 hospital clients, Axya provides a good entry point.

Cerner's acquisition of Bridge Medical from AmerisourceBergen put Bridge's point-of-care technology in the hands of an entity that could both sell and understand it, but at a price far below what Bridge originally sold for ($11 million plus a potential earn-out versus $27 million paid by AmerisourceBergen). Cerner's challenge, however, is yet to come.

The company has promised its shareholders that it will continue to deliver 25 percent earnings growth over the next few years. As the law of large numbers bears down like a freight train, Cerner might have to use both its market dominance and high-priced currency to become significantly more aggressive. This would clearly represent an even more dramatic shift than its purchase of VitalWorks. But given CEO Neal Patterson's ability to see where the puck is headed, I'm eager to see the company's next move.

■ Take a chance on me

The big deal of the year (at least so far) is the acquisition of IDX by GE Healthcare (No. 12) for $1.2 billion (2.2 x revenues, 17.5 x EBITDA). The fit seems clear at first glance. IDX offers GE the best client base in the business with its unmistakable dominance at the high end of medical practices. Further, CareCast, IDX's hospital product, is a strong solution that will likely fit well within the Centricity offering GE is developing, and the ImageCast radiology information system clearly fits with GE's PACS and modality systems sales.

While IDX's quality of product and install base are both beyond dispute, the valuation was likely a stretch for GE (a company known for its financial discipline), especially given the lack of recent CareCast sales and partial U.K. National Health Service displacement.

Two interesting points on this deal: It does not appear to be accretive to GE this year or next, and IDX was actively seeking to be acquired, having contacted 75 potential buyers (which seems like a very wide net), 20 of which expressed some interest.

■ Where have all the cowboys gone?

With healthcare IT system sales finally growing, the need for skilled implementation staff has grown as well. Therefore, consultancies have followed the example of accounting-firm consolidation of the past few years (remember the term "Big 8"?), with the North American healthcare practice of Capgemini (No. 13) joining up with Accenture for $175 million (1.02 x revenues, 13.5 x operating profit). At roughly the same time, Healthlink (No. 45) was acquired by IBM for an undisclosed (but likely sizable) amount.

This trend will probably continue, given the ongoing need for these types of services. And the need will only accelerate as computerized physician order entry and electronic medical records are more widely adopted (especially in smaller hospitals and physician groups).

■ Fixing a hole

Ingenix (No. 14), the wholly owned subsidiary of managed care giant United Healthcare, also remained active, purchasing privately held coding and compliance vendor HSS (No. 86) for a rumored $100 million. Having shown the appetite and skill for acquisition, and clearly having the funds behind it, Ingenix is likely to continue to be an aggressive (if not always high price paying) purchaser—of both small companies, such as decision-support tool provider IHCIS, acquired in early 2005, and more sizable companies, like HSS.

■ Breaking up is hard to do (or is it?)

After numerous quarters of lackluster, or worse, performance and a literal shareholder rebellion, NDCHealth (No. 17) announced in January 2005 that it was investigating "strategic alternatives." In case that wasn't clear, in late March it announced actively pursuing a sale.

Finally, in late August came the announcement that Per-Se Technologies (No. 18) was buying NDCHealth's hospital and retail pharmacy businesses for $658 million (2.92 x revenue, 10.5 x EBITDA) and that Dutch publisher Wolters Kluwer was acquiring the pharmaceutical information management business for $382.1 million (2.36 x revenues, 15.1 x EBITDA). Just as the NDC deal was closing, Wolters Kluwer opened its checkbook again to acquire ProVation Medical, a procedurally focused software tool vendor for up to $112 million ($40 up front, plus an earn-out that should be easily reached). This was one of the higher multiple transactions disclosed last year. Coincidentally, a month before Wolters Kluwer announced its intent to deepen its pharma presence, another Dutch Company, VNU, announced plans to merge with pharmaceutical market research firm IMS Health for $6.8 billion (4.24 x last-12-months revenue and 12.9 x LTM EBITDA). VNU shareholders subsequently rebelled and scuttled the deal (as well as VNU's CEO's employment.)

■ The sounds of silence

While it raised $75 million in convertible debt last year, bringing its current cash stash to close to $135 million and a strong stock currency, Allscripts (No. 37) has yet to spend any of it on acquisitions. Apparently, the company is exercising strong discipline in waiting for the right (and presumably accretive) target before spending money for non-organic growth.

Ultimately, I expect the money to be used for more than interest income and look forward to seeing where it's deployed. One logical area for expansion would be a path to the small-practice market, but something more strategic could also be under consideration.

■ Money, it's a gas

In October, The TriZetto Group, Newport Beach, Calif. (No. 23), raised its own war chest, bringing its cash on hand to more than $150 million. As with Allscripts, I anticipate a good portion of this money to be used for acquisitions as TriZetto seeks to capture more of its payer clients' wallet share. The burgeoning area of consumer-directed healthcare is a logical target for growth, as are care management and analytic applications. (William Blair was a co-managing underwriter for both the Allscripts and TriZetto offerings.) On Nov. 21, Trizetto announced it has signed a definitive agreement to acquire privately held CareKey, Inc., a break-even care management software provider for an astounding $60-100 million, depending on milestones reached. TriZetto announced that the deal would be accretive to 2006 earnings, even at this level, which suggests major cross-selling opportunities have been identified.

■ Don't stop believing. Or should you?

With seven companies on the *Healthcare Informatics* 100 list acquired in the six months since its publication, and a few more rumored to be on the market as this is written, the current M&A market is one of the most robust seen in years, and I expect that to continue through 2006. In most cases, this shouldn't raise too much concern for customers, because bigger buyers can mean better balance sheets and better-assured longevity for the products.

Customers should, as always, probe on support plans, migration strategies (if applicable), and the new parent's plans for their vendor. But I tend to take the responses with a grain of salt, believing that, "We won't change your culture," ranks with, "This won't hurt a bit," and, "The check is in the mail."

Several years ago as an equity research analyst, I introduced the "Five Minute Rule of M&A": If a CEO can't explain the price or rationale for an acquisition in five minutes of focused conversation, sell the stock. While obviously not totally applicable for system or service buyers, the corollary applies: If a vendor can't understandably explain its reasoning, be cautious going forward. ■

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