

Consolidation: The Year that Wasn't

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A slow acquisition environment got even slower in 2003, but an economic recovery could change everything.

By Joseph Goedert, News Editor

For health care information technology, the "Golden Age" of acquisitions was 1998 through 2000, when blockbuster deals-fueled with overvalued stock prices-fundamentally changed the competitive landscape.

Since those heady days, however, the Internet bubble burst, stock prices went south, and a new era began. Each year since 2000, the number of health care I.T. acquisitions has dwindled, not only in number but in consequence. And in 2003, the merger and acquisition market was downright boring.

Only 41 deals were done by mid-December-compared with a total of 90 deals in 2000-and most were small pickups of niche technology vendors. Only four acquisitions in 2003 topped the \$100 million mark, a far cry from 2000, which saw five blockbuster deals worth more than \$1 billion each.

"It was pretty dull stuff," says Vince Ciotti, president of HIS Professionals Inc., a Santa Fe, N.M.-based consulting firm. "Maybe the other shoe drops this year."

However, 2003 may some day be remembered as a turning point. The stock prices of many vendors rose dramatically during the year, although to levels far below their 1998-2000 highs.

This enabled some vendors to get back into acquisition mode, since stock-as opposed to cash-has become the acquisition currency of choice. As a result, acquisition activity picked up in the second half of 2003, a trend that could carry over into this year, some experts say.

"The beginning of a stock market recovery tends to be a difficult time for acquisitions because potential buyers are sitting there with depressed prices and their acquisition targets believe they are being undervalued," says David Francis, managing director of Jefferies & Co., a Nashville, Tenn.-based investment firm. "But if this market recovery continues, we will see a much more robust acquisition environment in 2004."

Bargain days

During the Internet boom it was common for buyers to pay an acquisition price equal to three or four times the annual revenue of the acquired company. In recent years, however, acquisition prices of one times revenue have become common.

That trend continued in 2003, with some notable exceptions. WebMD Corp., Elmwood Park, N.J. paid nearly five times revenue for Medifax-EDI Inc. of Nashville, Tenn. Eastman Kodak Co., Rochester, N.Y., paid three times revenue for PracticeWorks Inc. of Atlanta.

In general, however, 2003 was again a buyer's year, particularly if a company's stock price was high enough to attract companies looking to sell.

Consolidation: The Year that Wasn't

"The market has never been better for acquisitions," says John Ryan, president of Zix Corp., a Dallas-based vendor that bought two companies in 2003. "We will never again find technology as inexpensive as it was this year."

Acquiring vendors in 2003 focused on doing more with less, says Eugene Mannheimer, senior research analyst at the Newport Beach, Calif.-based investment firm Roth Capital Partners.

"Companies with beaten-down stock prices were less compelled to look for acquisitions," he contends. "The acquisitions tended to be of the 'fill the gap' nature, scooping up niche applications in a move toward becoming 'one-stop' vendors and offering end-to-end solutions."

Consequently, some of the acquisitions in 2003, while by no means blockbusters, were significant strategic moves for the buyers. For instance:

- GE Medical Systems Information Technologies of Milwaukee paid \$55 million to add laboratory information systems to its portfolio with the purchase of TripleG Systems Group of Toronto.
- Misys Healthcare Systems, Raleigh, N.C., now has a hospital/delivery system-oriented computer-based patient records system after paying \$30 million for the Patient1 product line from Per-Se Technologies Inc., Atlanta. Misys could easily have spent that much developing such a system itself but "buying the product gave us a time-to-market advantage," says Thomas Skelton, CEO.
- A total of \$1.5 million in cash and stock gave Zix Corp. of Dallas an inroad into the electronic prescription market with its buy of financially troubled PocketScript LLC, Mason, Ohio. Zix Corp. closed \$2.5 million in e-prescribing business within 90 days of buying PocketScript, says Ryan, the Zix CEO.
- First Consulting Group Inc., Long Beach, Calif., got low-cost, off-shore, outsourced software development capability after paying \$4.25 million in stock for Paragon Solutions Inc., Atlanta.
- Quovadx Inc., Englewood, Colo., expanded into the disease management arena with its \$28 million pick-up of CareScience Inc., Philadelphia.

The big ones

The biggest deal of the year occurred in October when Kodak paid \$486 million-\$468 million in cash and \$18 million of assumed debt-for PracticeWorks. PracticeWorks is a vendor of practice management and electronic medical records software for dental practices. What made the company particularly attractive for Kodak, however, was PracticeWorks' late 2002 acquisition of Trophy Radiologie S.A, a Paris-based vendor of digital radiography systems.

With the emergence of digital radiography, Kodak's Health Imaging Group has seen its traditional X-ray film business diminish. Several observers believe the high price paid for PracticeWorks-which had paid \$60 million for Trophy Radiologie-shows Kodak is desperate to modernize its product line. "Any way you look at it, they overpaid," states Francis, the investment analyst.

Kodak disagrees. The company isn't desperate, contends Daniel Kerpelman, president at Kodak's Health Imaging Group. Rather, it is continuing a multi-year strategy of developing or acquiring digital radiography systems and picture archiving and communication systems for the medical arena, he says.

The PracticeWorks buy enabled Kodak to enhance its dental imaging services, which were primarily film-based, Kerpelman says. And in addition to the PracticeWorks deal, the company made two other acquisitions related to digital radiography technology during 2003, he notes.

Consolidation: The Year that Wasn't

WebMD Corp. made two of the remaining big buys. The company agreed to pay \$280 million in cash for Medifax-EDI Inc., a Nashville, Tenn.-based clearinghouse, and paid \$110 million in cash for Advanced Business Fulfillment Inc., a St. Louis-based vendor of printing and mailing services for checks, remittance advice and explanation of benefit forms.

Both buys complement existing WebMD services through its Envoy clearinghouse, industry experts say, although some believe the company significantly overpaid for Medifax. Still, Medifax will bring new revenue to Envoy, which has seen flat or declining internal growth for several years, Francis says. WebMD officials were not available for comment.

WebMD's announcement that it would buy Medifax came amid a federal investigation into accounting practices at Medical Manager Corp. before it became part of WebMD in 2000.

Medifax executives decline to comment on why the company agreed to sell while the investigation continues. However, investment analysts and consultants note that a holding company-Crescent Capital Investments of Atlanta-owns Medifax and will receive cash when the acquisition closes. Consequently, any reverberations from the investigation would not affect Crescent.

GE Medical Systems, Milwaukee, paid \$2.3 billion for Finland-based Instrumentarium, a vendor of medical devices and health care information technology. Instrumentarium's information technology assets-including an anesthesia information system and clinical data repository-will be folded into GE Medical Systems Information Technologies, GE's health care I.T. unit.

The I.T. assets comprised about 10% of the overall deal, says Dow Wilson, president and CEO of GE Medical Systems Information Technologies. The purchase gives GE Medical a significant foothold in the European medical device market and continues GE's strategy to integrate clinical devices and I.T., he adds.

The 800-pound gorilla?

During the past decade, GE Medical Systems has quietly built a sizable health care I.T. portfolio through a series of relatively small, niche acquisitions. The purchased applications, placed under its GE Medical Systems Information Technologies unit, have grown into the Centricity line of image management and clinical information systems.

Because of GE's deep pockets, industry observers for several years have predicted the company was poised to make a major splash in the health care I.T. industry by acquiring a major vendor of financial and administrative hospital information systems.

That's probably not going to happen, says Wilson of GE Medical Systems Information Technologies.

His unit's strength is in clinical systems and 80% of its new clients already have a hospital information system. Nor is GE likely to buy clinical giant Cerner Corp., a combination that some observers predict year after year. "The economics aren't right, not even close," Wilson says. "It just would cost too much and take too long to recoup. Our unit can grow organically at 25% a year, so that's what we'll do."

While likely to continue niche buys to solidify its image management and clinical offerings, GE has another long-term vision, Wilson says. "Bioinformatics in five to 10 years will be big business."

Consolidation: The Year that Wasn't

Outlook for 2004

Whether the new year will be more exciting on the acquisitions front is debatable. Some observers believe the improving economic climate and increase in acquisition activity in the last half of 2003 indicate a busy time ahead. "Part of the ability to consolidate is to have a stock currency; that's the only way big deals are done," says Lorine Sweeney, president and CEO of Quovadx, which has made eight acquisitions in recent years. "In 2003, stocks began to go back up. At the beginning of a bull stock market, we tend to see two or three years of merger and acquisition activity, and it's already started."

Francis, the analyst, believes a robust acquisition environment could lure big companies. Such multinational firms as Accenture, Toshiba and Siemens could be active, with a "reasonably high likelihood" that a major health care I.T. vendor will be sold. "The large, broad-based I.T. and consulting firms are still very interested in the health care market," he says.

Kodak, already established in general radiology and dental markets, could look at acquiring vendors serving subspecialties such as women's health or orthopedics, says Kerpelman, at its health imaging group. Moving into niche areas often works better through acquisitions, he adds.

Industry experts see several vendors as attractive candidates for acquisition in 2004, including:

- Quality Systems Inc., Irvine, Calif., which sells practice management and electronic medical records software to physician and dental practices. With a good reputation and sitting on a pile of cash, analyst Mannheimer calls the company "a sitting duck for a takeover."
- If Eclipsys Corp. of Boca Raton, Fla., can't quickly fix the workflow problems in its SunriseXA suite, it will have to consider being a buyer or seller, Francis says.
- QuadraMed, after a protracted period of divesting ill-advised acquisitions and then going through a financial scandal, now is a good takeover candidate, some experts say. Misys CEO Skelton, however, says the company now is strong enough to go it alone.
- The SSI Group, NDCHealth Corp. or ProxyMed, which specialize in transactions processing software and services, have a lot to offer a larger company, says John Osberg, president of Informed Partners, a Marietta, Ga.-based consulting firm. "I guarantee one goes in the next couple of years, and at a huge multiple."
- Misys will become disenchanted with Patient1 and be more willing to part with serious money to get deeper into the inpatient clinical market, maybe even buying giant Cerner Corp. of Kansas City, Mo., some observers predict.
- Per-Se Technologies, needing cash, may not be able to refuse a decent offer for its electronic data interchange business, some observers believe. The company in 2003 sold its Patient1 computer-based patient records system and recently announced it will sell the Business1 financial system.
- Mediware Information Systems Inc., Lenexa, Kan., offers blood bank, pharmacy and surgical information systems that several larger hospital-oriented vendors could see as a good fit for their portfolios, Mannheimer says.

Good candidates

In addition to these companies, a whole category of health care I.T. vendors could be in the acquisition radar, says Sweeney of Quovadx. "Any public company with revenue under \$100 million and in decent financial condition is a good candidate for acquisition," she says. It's just not cost effective to be a public company of under \$100 million because the costs of being a public company—including complying with an abundance of regulatory reporting requirements—can be \$2 million a year, she adds.

Consolidation: The Year that Wasn't

Regardless of how active the acquisition market is this year, the industry is unlikely to see inflated price tags, as was the case during the dot-com boom of the late 1990s, Mannheimer says. Most acquisitions, he believes, will remain below two times revenue. "The big companies learned from the dot-com hangover and are being more sophisticated with their acquisition decisions."

This year, however, could see a company with grand visions of becoming a "one-stop shop" start an acquisition binge, Francis says.

But previous consolidation attempts, by QuadraMed, WebMD and the former HBO & Co., now part of San Francisco-based McKesson Corp., provide lessons on the dangers of trying to get too big too fast.

"It's amazing how short memories are in this business," Francis says. "Every few years, another group believes it can consolidate this market and I wouldn't be surprised to see that happen again in 2004 if the equity markets continue to recover."

Grading the Buys of 2003

John Ryan, CEO of Zix Corp. of Dallas, Texas, believes the value of an acquisition cannot be judged until after its first year. Duly noted, but it often is tempting to pronounce judgment long before that time.

So with a note of caution, nine industry observers have identified a number of buys in 2003 they feel were smart moves. They include:

- WebMD Corp.'s acquisitions of Medifax-EDI Inc. of Nashville, Tenn., and Advanced Business Fulfillment of St. Louis, complement its Envoy clearinghouse unit, observers say. Medifax brings established, real-time transactions processing services, especially in the Medicaid environment. The Envoy clearinghouse, on behalf of payers, will be able to transmit remittance advice and explanation of benefit transactions to Advanced Business Fulfillment for printing and mailing. To a person, though, observers interviewed believe WebMD overpaid for both deals.
- Omnicell Inc., a Palo Alto, Calif.-based vendor of automated pharmaceutical dispensing and bedside medication management software, acquiring BCX Technology Inc. of Lebanon, Tenn., an inventory management software vendor. The deal expanded Omnicell's portfolio and gave it access to additional hospitals to cross-sell services.
- Quovadx Inc., Englewood, Colo., purchasing Rogue Wave Software Inc., a Boulder, Colo.-based vendor of C++ development software. The \$71 million sale price included \$33 million in cash that Quovadx will acquire, making the net price \$38 million, a little more than one times revenue. The deal significantly expands Quovadx's existing application development services and complements its strategy of preserving customer investments in legacy systems, while getting the company into the financial services industry, says Eugene Mannheimer, senior research analyst at Roth Capital Partners, a Newport Beach, Calif.-based investment firm.
- Misys Healthcare Systems' acquisition of the Patient1 computer-based patient records system from Per-Se Technologies Inc., Atlanta. If Raleigh, N.C.-based Misys does a better job marketing the software than Per-Se did, the deal will be a great strategic fit as Misys has a large hospital base of installed ancillary information systems, says David Francis, managing director of Jefferies & Co., a Nashville, Tenn.-based investment firm. Others warn that Patient1 is not sufficiently robust for large organizations.

Consolidation: The Year that Wasn't

Amsterdam publisher Wolters Kluwer's purchase of Skolar Inc., of Palo Alto, Calif., which operates an Internet-based medical reference service. The move continues a strategy by Wolters Kluwer to become a dominant player in the medical reference field, says John Osberg, president of Informed Partners, a Marietta, Ga.-based consulting firm.