

Still Waiting for Consolidation Wave

January 2005 Health Data Management

For the fourth straight year, vendors tread lightly in the acquisition arena.

By Joseph Goedert, News Editor

Vendor consolidation in the health care information technology industry moved at a tepid pace in 2004. "It was a cautious year, it was a year of a lot of tire-kicking," says John Osberg, president of Informed Partners LLC, a Marietta, Ga.-based consulting firm.

Vendors used acquisitions to fill holes in their product lines or position themselves for new markets, but took few risks.

The number of acquisitions in the past 12 months was on par with those made in 2003, which had a merger and acquisition climate that Health Data Management termed "downright boring" a year ago.

In addition, the value of the deals in 2004 generally were smaller. Only two publicly announced acquisitions were valued at \$100 million or more, compared with four deals in 2003.

This past year continued a four-year trend of slower vendor consolidation in the health care I.T. industry. The years 1998 through 2000 saw substantial consolidation as companies used overvalued stock prices to make huge acquisitions; 2000 alone saw five deals worth more than \$1 billion each. But the days of blockbuster deals when companies swallowed dot-com firms and established vendors left and right remain a memory. Many vendors paid dearly for those acquisitions and the lessons haven't been lost.

QuadraMed Corp., for instance, had a voracious appetite for other companies in the previous decade, but has struggled-under different leadership-to digest or divest the firms it bought. Still, the company has continued to make acquisitions, albeit at a far slower pace. Further, it believes the climate is right for a new wave of consolidation-and would like to lead the wave, says Larry English, chairman, CEO and COO of the Reston, Va.-based company. However, "we are very disciplined financially and are not going to do dumb deals," English states.

Forces aligning?

The financial discipline seen in 2004 should continue in the coming year, other vendor executives and industry observers predict. However, market forces are converging to bring a new urgency to consolidation.

The Bush administration has made it clear that the health care industry must develop a national health information network, including an electronic medical record for each person.

While the administration presented a framework for a national network and made health care I.T. a campaign issue in 2004, presidential challenger Sen. John Kerry (D-Mass.) said little on the subject and presented no concrete proposal. Consequently, many vendors were hesitant to make acquisitions to support a move toward a national network because Kerry's support for the initiative was not clear, says Gene Mannheimer, senior research analyst at Roth Capital Partners, a Newport Beach, Calif.-based investment firm.

Still Waiting for Consolidation Wave

But now that the Bush team is back for four more years, interest in electronic medical records vendors is growing. "The political climate suggests electronic records activity will increase," says Jason Baker, director of business development for Cerner Corp., a Kansas City, Mo.-based vendor of clinical information systems.

Cerner recently bet \$100 million on that suggestion. The company late in 2004 acquired the medical division of VitalWorks Inc., Ridgefield, Conn. The division primarily sells electronic medical records and practice management software to physician practices, serving about 30,000 physicians.

The acquisition gives Cerner a footprint and institutional knowledge in the independent physician practice marketplace, says John Dragovits, vice president. Further, serving both the hospital and physician communities will help Cerner become a player in regional health information networks, he adds. The White House envisions such networks as the foundation of a national network.

Besides entering the physician arena with the VitalWorks unit, Cerner broke from its tradition of making small, niche acquisitions. "It is a bold move for Cerner, but whether it proves to be successful remains to be seen," contends Benjamin Rooks, a director in the Chicago office of Shattuck Hammond Partners, an investment banking firm.

Rooks sees VitalWorks' medical unit as a "roll-up" of disparate products from multiple acquisitions. "Cerner always avoided a roll-up, now it's bought one," he says. "Managing roll-ups is not something Cerner has done; it was one of the attractive points about the company."

However, VitalWorks stopped making acquisitions in 1999 and has consolidated its product line and integrated it into a single unit, responds Baker of Cerner. "The majority of revenue is recurring from longstanding clients, which lowers the financial risk of the deal."

For VitalWorks, divesting the medical unit, which it projects will have about \$70 million in revenue during 2004, leaves the company as a pure player in the picture archiving and communication systems market, says Stephen Kahane, president and CEO.

"Electronic medical records are hot and clearly that was the promise for the medical division," he says. "VitalWorks was getting its product out, but was not an industry leader and had more work to do with its product. We sold the medical unit so we'd have capital to build the PACS business."

Filling holes

QuadraMed filled two holes in its Affinity hospital information systems product line via acquisitions in 2004. The company spent \$5.8 million and an undisclosed amount of stock for Tempus Software, a vendor of scheduling software.

It also acquired the radiology and laboratory information systems of Australia-based D,tente Systems for \$4 million.

QuadraMed bought D,tente because, "a large part of the market is looking for integrated solutions from fewer vendors," English says.

The company is "Americanizing" the lab and radiology systems to support language and terminologies used in the United States, and expects to release beta versions during 2005.

Still Waiting for Consolidation Wave

QuadraMed previously worked with a handful of Tempus customers and had written interfaces between Affinity and the scheduling software. Now, Tempus' software is part of every Affinity proposal, English says. The company also will sell the software on a standalone basis.

Big deal

Cerner's deal for VitalWorks was the second largest acquisition in 2004, topped only by WebMD Corp.'s \$168 million buy of VIPS Inc., a Baltimore-based vendor of software for health insurers.

The VIPS acquisition enables WebMD to expand the payer-oriented product portfolio of its claims clearinghouse. VIPS sells fraud and abuse detection, HEDIS reporting, provider performance measurement, case/disease management, and predictive modeling software. It also serves the Medicare program with claims and eligibility verification transactions processing software.

After the acquisition closed, VIPS landed a five-year, \$30 million Medicare eligibility integration contract, says Kevin Cameron, CEO of Elmwood Park, N.J.-based WebMD. "VIPS would not have made a bid on its own and WebMD would not have received the request for proposals," he adds. "VIPS gives us a significant presence we did not have before in the government arena."

WebMD made two other acquisitions in 2004, paying \$2 million for the Physicians' Online Web portal and \$40 million for Dakota Imaging Inc., Columbia, Md.

WebMD previously had bought print/mail vendor Advanced Business Fulfillment. Dakota Imaging rounded out its capability to handle paper claims and related transactions, Cameron says. "We can take anything-paper or electronic-from providers and give anything to payers."

The pick-up of VIPS was a smart move on WebMD's part, contends Osberg, the consultant. "WebMD now is managing platforms for many payers. It is a deeper cut of the payer business."

Other smart buys that observers saw in 2004 include:

- Document imaging vendor Captiva Software Corp.'s \$5.2 million acquisition of ADP Context Inc., a vendor of coding software. "ADP was motivated to sell and there is strong synergy between Captiva and Context," Osberg says. "They paid a good price and the logic of the deal is quite good."
- 3M Health Information Systems rounded out its coding and compliance software line by picking up Info-X Inc. for an undisclosed sum. "It meant 3M was in the business to stay and I expect them to be more active," says Rooks, the investment analyst.
- Chart management vendor ChartOne Inc.'s acquisition of coding vendor eWebHealth, terms of which were not disclosed, changed ChartOne from being simply a return on investment-oriented business processing outsourcer to a software vendor, Rooks says.
- Equity firms Warburg Pincus and Soros Private Equity, for an undisclosed price, bought Spheris, the nation's second largest medical transcription vendor. The deal came at a time when the leader-MedQuist Inc.-is in serious trouble after acknowledging it did not follow proper billing procedures.

One reason 2004 was a lackluster year for acquisitions is that many potential acquisition targets believe their companies are worth more than they are, experts say.

QuadraMed may have made just two acquisitions in 2004, but it did a lot of tire kicking. "We looked at practice management, emergency department and materials management information systems, but couldn't find vendors that want to be acquired for reasonable terms," English says.

Still Waiting for Consolidation Wave

"Most young companies with new technology, low sales and no profits are overly optimistic on how quickly they will generate revenue and profit, and thus are overly optimistic on their valuation," adds Thomas Skelton, CEO of Misys Healthcare Systems Inc., Raleigh, N.C.

But the climate may be changing, others say. "Smaller vendors continue to overestimate their worth, but from the spring of 2004 on, have begun to be more reasonable," says Nancy Larson, general manager of Salt Lake City-based 3M Health Information Systems.

If the Bush administration continues its push for health care automation, and acquisition targets are more realistic about their price tags, 2005 could be an active acquisition year, observers say. Companies that are good candidates for acquisition include:

- The new, PACS-focused VitalWorks will get attention, observers say. PACS are hot and CEO Kahane says he's not looking to sell, but believes others will make offers. "I imagine there will be more people interested in VitalWorks because it is a pure-play company," he adds. "The radiology market is hot now. It's not something that might be hot in the future."
- However, buyers might find prices for such vendors too high. QuadraMed, for instance, likely will partner with a PACS vendor rather than buy, English says.
- Hospital information systems vendors Eclipsys Corp. and QuadraMed have struggled in recent years, and they annually make this list of acquisition targets. However, they've shown an ability to evade acquirers and continue to go it alone.
- MedQuist's troubles could prevent it from recovering on its own, Osberg says. "Once you get so tarnished, it's hard to sell product and easy for competitors to take your business. They'll have to sell the property and rebrand it."
- Quality Systems Inc., vendor of the NextGen Healthcare Information Systems physician practice management and electronic medical records software, is a tempting target for many larger vendors. Noting the company is sitting on \$58 million in cash, stock analyst Mannheimer says, "If QSI announced it was selling its dental business, it would be a much more attractive acquisition candidate."
- Allscripts Healthcare Solutions, vendor of a modular-based approach to electronic medical records, is another company that acquirers will find too tempting to pass up, Osberg says. Its applications also support mobile computing devices. "Allscripts will be bought," he predicts.
- Mediware Inc., a vendor of blood bank, pharmacy and surgical information systems, would fill several holes for a hospital information systems vendor. The company is one of the few veteran, niche players still independent, Mannheimer says. "It's inevitable Mediware will be acquired," he adds.
- Companies that offer Medicare eligibility verification services or software to administer health savings accounts can expect telephone calls in 2005, according to Osberg. He believes financial institutions could re-enter the health care I.T. market.

Mixing it up

Companies acquisitive in the past, such as GE Healthcare, Misys Healthcare Systems and McKesson Corp., could get back in the mix in 2005 and make blockbuster buys, observers say. Even if that doesn't happen, there should be more buys in 2005, Rooks believes.

"More of the little players are realizing they can't go on alone," he notes. "Consolidation needs to continue because it's still a field of pygmies. Hospitals want vendors with staying power."