

Vendor Consolidation: Still Riding the Wave

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Plenty of buyers and sellers in 2006 as vendors tried to get footholds in growing niches.

By Joseph Goedert, News Editor

Consolidation in the health care information technology market took a sizable jump in 2005, and many industry insiders predicted 2006 would see even more activity.

They were right. It was a busy year, with Health Data Management tracking 76 acquisitions by Dec. 1, one-third more than the 55 deals in 2005.

While the majority of acquisitions were small, acquirers spent serious money in many instances. More than 20 companies that are household names in the industry changed hands during 2006 (see chart, pages 58-59). At least nine buys were worth more than \$100 million and two, McKesson Corp. buying Per Se Technologies Inc. and General Atlantic LLC acquiring Emdeon Business Services, topped \$1 billion.

The prevalence of smaller deals, however, will continue, observers believe. In part, this is because the acquisition market is favorable enough that many smaller vendors can get better value by selling than if they tried to grow the business on their own, says Victor Kats, director of business development at Misys Healthcare Systems, Raleigh, N.C.

Customer service concerns also are driving some small vendors to look for a buyer. "As niche vendors continue to grow, they will be challenged with keeping service up to par," Kats explains. "A \$10 million company a few years ago that's now a \$50 million company may not have the necessary service infrastructure."

Some smaller companies, however, simply don't want to be bought. Acquisition inquiries for mobile computing software vendor PatientKeeper Inc. increased this year but the discussions never got far, says Stephen Hau, co-founder and vice president of marketing and business development at the Newton, Mass.-based firm. "We prefer to remain independent and control our own destiny."

Going public is a possibility for PatientKeeper, Hau says. But public or private, the company is committed to being independent. "We spend about zero percent of our time thinking about being acquired."

A defining characteristic of acquisition activity in 2006 was that 11 claims clearinghouses-including two of the nation's largest, operated by Elmwood Park, N.J.-based Emdeon Corp. and Alpharetta, Ga.-based Per-Se Technologies Inc.-changed hands. Just as significantly, two of the clearinghouse buyers were banks, evidence of the push by financial institutions to stake out territory in the health care market.

With the industry starting to accept standard transactions beyond claims, electronic data interchange is a growth area in health care, says John Osberg, president at Informed Partners LLC, a Marietta, Ga.-based consulting firm. The acquisition activity during 2006 in the EDI market "is the beginning, not the end," he adds.

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Banks have dabbled in health care EDI before, but soon lost interest. Now that the industry is starting to adopt standard transactions, their interest has been renewed. "We've got standards and banks follow standards," Osberg explains. "Medical banking is here to stay this time. Banks' core competency is processing consumer debt, and we've got standards now to do that."

In April, PNC Financial Services Group Inc. of Pittsburgh acquired Healthcare Administration Technologies Inc., a Tulsa, Okla.-based clearinghouse. Five months later, Charlotte, N.C.-based Bank of America bought HealthLogic Systems of Norcross, Ga. "There are a lot more banks beyond these looking at the health care marketplace," notes Kevin Cameron, CEO at Emdeon Corp.

Banks not going anywhere

For financial institutions, there is value in managing health savings accounts, flexible spending accounts and health reimbursement arrangements as more employers start to offer consumer-driven health plans. "That's a compelling enough opportunity for banks to stick around, and the fact they're making acquisitions leads me to believe their presence will be permanent," says Kats, the business development director at Misys.

Banks also see EDI as a way to offer value-added revenue cycle management services to providers. For instance, they want to reformat the 835 electronic remittance advice transaction that providers receive from payers to enable automated posting to patient accounts and balancing of the remittance against the actual electronic funds transfer-or payment-from insurers.

More than ever, providers need faster and more complete payment as patients increasingly are responsible for a larger part of their medical bills, Cameron says. "Three to five years ago, consumers were paying 25% of the bill," he notes. "Now, they're paying 35% to 40%. That's putting pressure on the provider market. Uncollected copays used to frequently be written off, but now they're a more significant portion of a provider's revenue."

But while some banks have hired health care professionals to add in-house expertise, Cameron isn't yet convinced that many financial institutions fully understand the complexities of the health care industry. "Some people are greedy, and I'm not sure they know what they're getting into."

Banks soon could be joined by another group of powerful companies-health insurers-in their quest to buy clearinghouses.

Eden Prairie, Minn.-based Ingenix, the I.T. division of giant payer UnitedHealth Group, in 2006 paid \$54 million for Electronic Network Systems Inc., a veteran clearinghouse in Colorado Springs, Colo.

Ingenix also acquired Kaysville, Utah-based Claredi Corp., a vendor of transactions compliance testing software. "Because PNC and Bank of America acquired clearinghouses, other banks will buy clearinghouses," Osberg predicts. "Because UnitedHealth Group bought a clearinghouse, other insurers will buy one. These are bellwether transactions that will drive other deals to be done."

While clearinghouses were a hot commodity in 2006, electronic medical records vendors were not.

The EMR highlight was Allscripts LLC of Chicago paying \$304 million in cash and stock for A4 Health Systems Inc. of Cary, N.C.

Allscripts for many years sold its EMR software primarily through IDX Systems Corp., but the partnership is changing now that GE Healthcare of Waukesha, Wis., owns IDX. Allscripts also focused on the large physician practice market. Buying A4 enabled Allscripts to pick up practice management

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software and an accompanying EMR for small and mid-size practices, plus an emergency department information system.

A year ago, several industry experts predicted EMR vendors would be attractive acquisition targets, but the activity was minimal.

Not worth it?

The valuation expectations-what companies believe they're worth-are very high among small health I.T. vendors, says Pamela Pure, executive vice president at McKesson Provider Technologies, the I.T. division of San Francisco-based McKesson Corp. Consequently, some EMR vendors didn't attract the attention they could have because they felt they were worth more than acquirers were willing to pay, she adds.

Other factors contributed to interest being low for EMR companies, says Cameron at Emdeon.

Many smaller EMR vendors have not yet been accredited by the Certification Commission for Healthcare Information Technology as meeting specific criteria for performance, which reduced their chances of being bought.

In addition, many vendors don't want to acquire an EMR product and spend a lot on integrating it with their existing product portfolios, Cameron notes. "Larger vendors are developing their own EMRs and don't want to fit in others." They also don't want to have to support two EMR platforms, he adds.

Acquisitions that, on the surface, seem relatively small can bring real value to the buyer and change the competitive landscape.

For \$49 million, Misys Healthcare acquired a clearinghouse that brought value on three fronts. The clearinghouse of Payerpath Inc. in Richmond, Va., is only a fraction of the size of Misys' clearinghouse that services its physician practice management software clients.

But Misys in late 2005 and early 2006 was sending paper claims to Aetna Inc., angering clients, after the insurance giant sharply limited the number of clearinghouses that could directly submit claims. Through Payerpath, Misys got electronic again with Aetna.

Payerpath also brought to Misys comprehensive claims editing software that enables clients to submit cleaner claims to insurers and get paid faster. Further, the software's workflow module prioritizes the highest value claims that still need work before being submitted or resubmitted.

Misys typically has targeted larger physician practices for practice management and electronic medical records software, and Payerpath also gave it a good footprint in the small practice market.

Now, Misys is offering small practices its software at special pricing to compete with application service provider rivals in the low-end market, Kats says. Payerpath sells its services via a monthly subscription fee, and Misys can bundle clearinghouse services with the software.

Each year, one deal stands out as a sleeper that will deliver big dividends, and another stands out as somewhat puzzling.

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For consultant and vendor researcher Ron Johnson, Microsoft Corp.'s acquisition of the Azyxxi integration software product was the sleeper of the year.

Azyxxi pulls data from disparate information systems, patient monitoring devices and medical imaging systems and stores the information in a central data repository. Developed a decade ago at Washington (D.C.) Hospital Center, it now is used by all seven hospitals of MedStar Health, a Baltimore-based delivery system.

Redmond, Wash.-based Microsoft will form a new division to further develop Azyxxi and commercialize it, with Washington Hospital Center serving as a development laboratory.

Johnson, president of R.L. Johnson & Associates in Tracy, Calif., believes a commercialized Azyxxi will force every vendor of clinical data repositories to re-do their products. That's because Azyxxi enables the storage and retrieval of far more data fields than current-generation clinical repositories.

"Most databases have 200 to 300 fields of data per patient," he explains. "Azyxxi has more than 1,100 fields. It is the finest integration and data mining tool I've seen. The key to any good system is good design, and it's a brilliant system."

On the flip side, some experts see Sage Software's \$565 million acquisition of Emdeon Corp.'s Practice Services division as quite a gamble. The division primarily sells the Medical Manager physician office software, and it boasts more than 100,000 physicians to whom Irvine, Calif.-based Sage can market its business management software.

The company expects to integrate the acquired practice management and electronic medical records software with its business software, and bundle that with credit card processing and outsourced payroll services.

But health I.T. vendors have a tough enough time getting physicians to adopt core technologies for treating patients and getting paid. Consequently, some are skeptical Sage will find doctors in smaller practices interested in its accounting, payroll, human resources and customer relationship management applications.

"Doctors have historically resisted this type of cross selling and it will be more challenging than they anticipated," says consultant Osberg.

Sidebar

Slimmed-Down Emdeon Still A Player

Emdeon Corp. may have sold its two core business units in 2006, but the Elmwood Park, N.J.-based vendor remains a major player in the health care information technology industry.

While the company sold to Greenwich, Conn.-based General Atlantic Partners a majority interest in its Business Services electronic data interchange division for \$1.2 billion, it continues to operate the unit's claims clearinghouse, the largest in the nation. Emdeon also has 50% control on the new board of directors governing the division.

Further, when Irvine, Calif.-based Sage Software Inc. bought Emdeon's Practice Services physician software division, it contracted to retain the clearinghouse's services to its physician clients through

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2013. "All of the companies remain tied together in ways that they can bring advantages to each other," says Emdeon CEO Kevin Cameron.

Emdeon still owns two other established I.T. firms, the ViPS payer-oriented software firm and the WebMD Health medical information content Web portal for consumers and medical professionals.

Divestiture of the EDI and physician software units-the former Envoy Corp. and Medical Manager Corp., respectively-ended an ambitious and expensive attempt to wed the largest clearinghouse with the largest practice management software vendor.

But the companies never meshed, suffered from insufficient investment and brain drain, and until recently struggled to grow their businesses. "You had two different strategies that people were trying to sell under the same umbrella," says Vinson Hudson, president at Jewson Enterprises, an Austin, Texas-based consulting firm.

Cameron sees divestiture as a new business strategy rather than a failed experiment. "The combination of assets was not something current management did in the first place," he notes.

Emdeon may have slimmed down, but it might not stay skinny for long. The sale of Business Services freed up capital-much of which is being used to buy back public stock, and some observers believe the company will soon become privately held.

But new acquisitions could be on the horizon. Cameron declines to give details, but notes the company has never had difficulty raising capital, and he expects the WebMD health unit to continue to be "somewhat acquisitive" after four buys in 2006. Further, Emdeon isn't averse to other acquisitions "that would be strategically complementary to the businesses we currently own," he adds.

Sidebar

McKesson Aims High With Per-Se

The largest vendors in the health care information technology industry generally have avoided the small physician practice market. Conventional wisdom dictates it is not a profitable enough market for them to try to crack.

"It is not easy for a large company whose whole business is larger organizations to move down to the small practices where margins are extremely thin," says Vinson Hudson, president at Jewson Enterprises, an Austin, Texas-based consulting firm. But because of the sheer size of the small physician market, "everyone is trying to figure out how to capture it."

McKesson Corp. is about to test conventional wisdom, armed with a new strategy. The giant San Francisco-based I.T. vendor and medical/surgical/pharmaceutical supplier is buying Per-Se Technologies Inc. for \$1.8 billion, which includes nearly \$600 million in assumed debt.

Alpharetta, Ga.-based Per-Se is a vendor of outsourced billing and business office services to providers. It also operates a large clearinghouse serving physicians, hospitals and more than 50,000 retail pharmacies, and sells scheduling software to hospitals.

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After buying large parts of Atlanta-based NDCHealth Corp. last year, Per-Se also is a major vendor of practice management software for small physician practices, claiming approximately 100,000 customers.

McKesson, perhaps best known for its hospital software, also sells practice management and electronic medical records software, primarily to group practices of 50 or more physicians. Per-Se's presence in the smaller clinic market was a major reason for the acquisition, says Pamela Pure, executive vice president at McKesson's Provider Technologies division in Atlanta. "This will be a very strong market entrance for us."

By March, McKesson expects to offer a suite of professional services and software-standalone or remotely hosted via the application service provider computing model to physician practices of all sizes. The suite will include practice management and electronic records software, clearinghouse services and outsourced billing services.

Physicians will be able to contract for one or more applications and services, or the whole suite. "We understand how price-sensitive this market is and how some physicians will want to buy incrementally," Pure says.

McKesson knows that getting small practices to automate or expand their use of information technology will not be an easy task, Pure adds. But the vendor isn't an unknown to these practices, already serving many as a source of a wide variety of supplies.

McKesson will augment its 600-strong sales force that targets small practices with Per-Se's value-added reseller market.

Dental I.T. vendor and supplier Henry Schein, Melville, N.Y., proved the model of serving practices of all sizes is feasible, says John Osberg, president at Informed Partners LLC, a Marietta, Ga.-based consulting firm.

McKesson's biggest challenge, he believes, will be providing an adequate level of support to small practices. "It's going to be hard."

But McKesson needs to branch out from its core hospital I.T. business, and doing so successfully would bring substantial rewards, says Ronald Johnson, president at R.L. Johnson & Associates, a Tracy, Calif.-based vendor research firm. "You've got a half-million docs out there to sell to."

There's also value in Per-Se's clearinghouse, which coupled with McKesson's existing electronic data interchange business will create one of the largest clearinghouses in the industry. Further, McKesson would have the opportunity to mine Per-Se's pharmacy claims data to analyze physician prescribing patterns and sell the data to pharmaceutical firms, Johnson says.