

# Alaska Healthcare News

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## What's Driving the M&A Frenzy in Health Care IT?

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Information technology is at the core of building the new 21st-century health care system. Yet transforming health care won't be as easy as it's been for many other industries that have experienced change through technology, such as financial services and manufacturing.

This is because health care providers must comply with a host of new government regulations that are pushing them to create a smarter, more efficient care delivery system that advocates stronger connec-

tions, better data, and faster, more detailed analysis. However, along with the new laws and mandates, the government is providing substantial financial stimulus to the medical community to spur the technology transformation.

The reasons are clear: Health care information technology (HIT) is the principal means by which providers can address the new health care laws. Therefore, increasing the adoption of new HIT systems is crucial in the short term in light

of the tight deadlines for demonstrating "meaningful use," which is required in order for providers to receive financial reimbursement for the cost of the IT systems. It's also critical that providers not only implement the new technology but also transform clinical operations to maximize the utility of the new HIT systems.

In particular, the electronic health record (EHR) incentive program, which began in 2011, reimburses physicians and hospitals that install EHR systems to help providers improve communication and documentation and cut down on duplicate screenings and tests. More than 76,000 physicians and over 2,200 hospitals had adopted EHR systems through March 2012, and Medicaid and Medicare paid out more than \$4.5 billion in incentive payments just in the past year to cover the costs and implementation of these new systems. This is out of a total \$23 billion earmarked by the government for HIT financial incentives. Another estimated 140,000 providers, or 46 percent of primary care providers nationwide, are already on track to implement HIT systems during 2012.

## Built-In Demand

With the onslaught of new government mandates that started with meaningful use and continue with the hospital readmissions reduction program, accountable care organizations (ACOs), and ICD-10, health care providers are having a difficult time keeping up. Since each successor HIT stage builds on its predecessor, it's imperative for organizations to realize that success will be defined by effective adoption of EHR systems first. Beyond that, providers need business intelligence systems and data analytics to produce effective clinical workflow and provide

have been major drivers behind the quickened pace of change. As new HIT systems are added, the data necessary to support performance improvement is becoming more available and more clinically robust, giving ACOs the ability to measure and communicate value to their patients and payers.

For example, Advocate Health and Blue Cross Blue Shield of Illinois, the state's largest hospital and health insurer, formed an ACO in 2010 and can now show meaningful results after two years of building the network and infrastructure. With six months of relevant data in hand from newly installed

Not surprisingly, much of the growth—and the most aggressive land grab—is happening in the physician EHR market, which will likely continue to drive HIT growth in the short term, since new entrants can stake a claim without needing the legacy infrastructure and relationships to support the bigger hospital and health system conversions. In the past year, EHR sales to physicians grew at 22 percent, with a total of 57 percent of office-based physicians now using some form of EHRs. In addition, the financial payback to publicly traded hospital management companies has translated into more than \$400 million of ad-

HIT Incentive Payments Available to Eligible Providers

Initial Payment Year*	2011-2012	2013	2014	2015	2016	2017
Medicare	\$44,000	\$39,000	\$24,000	\$0	\$0	\$0
Medicaid	\$63,750	\$63,750	\$63,750	\$63,750	\$63,750	\$0

\*Represents total cumulative amounts that can be paid out over the three remaining years for Medicare and over six total years for Medicaid.

outcomes—otherwise they run the risk of bogging down a very expensive tool with bad processes that won't yield the benefits.

Having the appropriate HIT systems in place is also key to implementing the mandate to form ACOs. To date, more than half of all hospitals and health systems have started down the ACO path. In April 2012 there were 27 new ACOs representing 375,000 Medicare beneficiaries across 18 states that began to receive upfront savings to assist with the costs for building the infrastructure to get their ACO up and running. Another 150 ACOs are slated for start dates in July.

The continued support and financial incentives to help with building the EHR and ACO infrastructure

HIT systems, the organization has shown a drop in admissions of 10.6 percent and a 5.4 percent reduction in emergency room visits.

## Rising Fortunes

With the dramatic increase in demand by health care providers for IT systems to respond to new regulations, HIT companies have seen a jump in sales and profitability over the past year and expect it to continue. Publicly traded HIT companies have seen sales growth expectations for the next 12 months (NTM), which were at a moderate 11 percent in November 2011, rise to a current growth expectation of 17 percent. Profitability expectations have also increased, with expected NTM EBITDA growth of 34 percent in December 2011 more than doubling, to 79 percent, today.

ditional revenue in 2011, with the expectation that full-year numbers for 2012 will be up to three times higher, or \$1.2 billion in additional revenue, as more HIT systems are put in service and government incentives are redeemed.

Overall, the HIT market is estimated at close to \$40 billion and is expected to grow at an average annual rate of 13 percent over the next five years, with select niches growing at rates as high as 18 to 20 percent per year. This level of growth has caused a tremendous surge in the HIT sector, with over 8,000 companies or divisions now calling themselves IT vendors to the health care industry in some way and almost one quarter of those companies having formed in just the past three to five years. Many of these new vendors, such

as Medstreaming, NextGate, Apixio, and Deep Domain, were created to respond directly to health care mandates or to targeted provider issues.

There's also a flood of small to midsize technology companies, such as Agnity, CloudPrime, Aero-Scout, and InfoStretch, that began selling into multiple vertical markets but have found immediate traction within the health care market and are now using it to quickly establish product credibility and a market foothold. Many of these IT players bring fresh technology, use cloud-based systems that bypass the need to create custom connections with legacy systems, and use software-as-a-service (SaaS) pricing structures, which provide a low-cost alternative to licensing and make it an easy return-on-investment proposition for providers.

### **Enter the Whales**

In addition to the influx of new vendors, many large technology companies have taken a closer look at health care as a viable and fast-growing vertical market for expansion, and they've been busy making acquisitions. The simultaneous expansion of the overall market with the addition of new vendors and resulting consolidation through acquisition is dramatically redefining the HIT sector.

For example, the software application company Oracle acquired ClearTrial, a maker of SaaS-based clinical trial tracking systems, while the semiconductor giant NantWorks has jumped into HIT by picking up a number of diagnostic testing, telehealth, and analytical imaging companies over the

past 10 months. Even large medical technology and supply manufacturers that have historically played on the fringes of HIT are now coming in full force, with CareFusion acquiring the enterprise inventory management company Phacts to pick up 200 new health care clients and Alere expanding its health care equipment business into HIT by purchasing eScreen, a Web-based drug screening technology firm.

Along with strategic buyers, greater volumes of capital are coming into the sector from private equity firms, and many are now willing to consider more strategic valuations in order to get into the market. A recent example is Genstar Capital's \$414 million acquisition of eResearchTechnology, a health outcomes research company that was valued in the transaction at a substantial 38 percent premium over its 90-day trading range.

Traditional HIT firms still play a significant role within many hospital systems and provider groups, having an installed base and longstanding relationships, but they're now under pressure to stay ahead of the regulations as well. This has further accelerated consolidation, with traditional players like Cerner acquiring Clairvia for its advanced resource management software and investing in Sotera Wireless, a maker of software that monitors patient vital signs.

AthenaHealth has also been in the market recently to pick up cloud-based order workflow capabilities from Proxsys. Even a midsize legacy vendor to physician groups, Medical Transcription Billing, has been actively acquiring companies to address new mandates,

purchasing GlobalNet for its EHR systems and United Physicians and Better Billing to expand its customer footprint for revenue cycle management.

### **The Bottom Line**

There's no doubt about it: HIT M&A transaction activity has heated up. There were 258 health care-related IT deals in 2010, increasing to 273 in 2011, and we're on track to see an estimated 300 deals this year. The rampant activity has pushed overall valuations of HIT companies up as well, with deals getting done at an average of 2.5x trailing 12-month (TTM) revenue but with a very wide range of 1–8x TTM revenue. Deals have averaged 15.7x TTM EBITDA, with a range spanning 9–94x. This vast spread reflects the different perceived values based on technology, pricing model, installed base, and target market of the company acquired.

The expansion in valuation and the surge of interest in the sector has brought many new parties to the table. HIT companies have numerous alternatives for growth and combination right now. Many have received unsolicited acquisition offers, and others are looking for ways to expand quickly in the current environment without giving up substantial equity.

The result? There are many strategic alternatives to be evaluated right now, including outright sales, strategic partnerships, growth capital, private equity investments, marketing partnerships, and technology sharing. These are all means for fast-growing HIT companies to further boost growth and maximize value

while market timing is ripe.

What's eminently clear is that this isn't the time to do nothing. The IT sector is the hottest real estate in the health care industry, and now is the moment to know your options.

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