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Healthcare Services: Healthcare IT Services Insights

2013 Outlook — Focus on Data Analytics

Background

In 2009 healthcare providers began to make their first healthcare IT investments in anticipation of receiving the incentives and avoiding the penalties for achieving Meaningful Use as prescribed by the American Recovery and Reinvestment Act of 2009 ("ARRA"). According to the CMS, as of November 2012, about $9.3 billion in electronic health record (EHR) incentive payments had been made to 173,168 professionals and 3,393 hospitals. The ARRA may or may not have spurred recovery, but it certainly stimulated reinvestment in healthcare IT, perhaps none too soon for the US healthcare system. Healthcare is a data-intensive endeavor and the wise application of technology to analyze data is among the best tools available to improve efficiencies and manage risk in order to ensure delivery of quality care to an increased population of insured in the face of budget constraints and payment reforms.

While the macro factors driving trends in the sector are well known, they are so profound that they bear repeating: i) a multi-decade trend of healthcare expenditures rising faster than GDP, as a result of an aging population and increases in cost of care; ii) extreme pressure on federal and state budgets, employers' income statements and household income making the cost trend unsupportable; and iii) with the enactment of the Affordable Care Act (the "ACA"), 20 million people poised to enter the market with coverage at the lowest level of reimbursement. A revolution is underway in which payers — governments, employers and consumers — are overthrowing the old regime of fee-for-service and forcing risk-bearing reimbursement models such as bundled payments, value based purchasing, accountable care and readmission penalties onto providers.

Source: Public data and information

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2013 Outlook — Focus on Data Analytics

Market disruption

Disruption is roiling the market. Providers are consolidating, creating heretofore unholy alliances among physicians and hospitals. Hospital censuses are under pressure as patients with lower acuity needs are increasingly treated outside of the four walls of the hospital in lower cost outpatient venues. At the same time, readmission penalties impose financial risk on hospitals for the post-discharge care provided in post-acute care environs such as LTACs, SNFs, occupational medicine facilities and the home.

As providers spend to comply with Stage Two of Meaningful Use, anticipate Stage Three requirements and consider the IT functionality required for success in this new risk bearing environment, many are finding their incumbent IT systems to be of limited use in meeting their future needs. Specifically, the integration of financial and clinical data and electronic health record interoperability are now critical to the management of quality of care and risk. In the most recent quarter both Cerner Corporation (NASD:CERN) and athenahealth, Inc. (NASD:ATHN) reported that a large percentage of their respective bookings came from outside of their installed base, suggesting market share increases at the expense of legacy systems.

Increasing importance of data analytics

A major benefit from the deployment of technology is the exponential increase in the amount of clinical data now collected and stored. However, much of this data is captured within the EHR or in siloed systems. To make full use of this data, it needs to flow from discrete locations and be aggregated and analyzed on a population basis so that trends can be identified and predicted. Ultimately, data analytics are fundamental for improving population health and quality of care. With spending on EHRs, cloud-based storage and mobile technologies well underway, data analytics may be a major area of focus for investment and M&A activity.

Several smaller data analytics companies are focused on niches. It is logical to anticipate that strategic buyers will be on the hunt for M&A targets in the sector to broaden their product and service portfolios. Recent examples include the acquisition of MediConnect Global, Inc. by Verisk Analytics, Inc. (NASD:VRSK) in March 2012 and athenahealth's October 2012 acquisition of Healthcare Data Services ("HDS"). Both of these transactions are instructive.

According to Verisk, it made the MediConnect acquisition to advance its position in healthcare data, analytics and decision support solutions.[1] MediConnect's proprietary technology enables clients to access clinical data from medical records in facilities and provider locations globally. It also offers scheduling, retrieval, review, data validation and analytics. In announcing the transaction MediConnect's Chief Executive Officer Amy Rees Anderson, said: "Combining MediConnect's innovative systems and services with Verisk's extensive data analytics will provide a turnkey solution that will transform the way the healthcare industry manages medical costs and improves the quality of care." While financial information for MediConnect is not publicly available, the purchase price of $324mm (net of $25mm in tax and working capital benefits) has been estimated to be approximately 5.5x MediConnect's revenue and 14.7x its EBITDA.

According to athenahealth, it expects to strengthen its capabilities in the analysis and reporting of population-based cost and quality data in support of healthcare organizations' need to improve care coordination and reimbursement levels.[2] HDS provides analysis of population-based cost and quality data to health systems. Its risk management tool allows health systems to calculate spending by provider and per patient, information that is essential in the era of new reimbursement models that pay for performance and outcomes versus fee for service. In announcing the transaction, Jonathan Porter, co-founder of HDS, said: "Together with athenahealth, we would be able to bridge the gap between providers, payers, and patients by providing ready-to-use population health management capabilities as part of EHR workflows that support restructured payment models and ensure the delivery of appropriate and necessary care to patients." While terms of the transaction were not announced, athenahealth is trading at 6x revenue, 50x EBITDA and 149x LTM EPS, affording it ample cushion to structure an accretive transaction.

> "As providers spend to comply with Stage Two of Meaningful Use, anticipate Stage Three requirements and consider the IT functionality required for success in this new risk bearing environment, many are finding their incumbent IT systems to be of limited use in meeting their future needs."

Conclusion

In 2013 demand drivers and infrastructure may drive growth in investment and M&A activity in data analytics. The ARRA-fueled spending on EHR technology has enabled the collection of vast amounts of patient data that increasingly resides in cloud-based storage that can be aggregated and shared via health information exchange tools. Providers and payers will increasingly apply analytics to this data to measure, analyze and predict care quality and financial risk. Investors and acquirers may seek opportunities to profit from this trend.

Source: Capital IQ and public information
1. Verisk March 2012 press release
2. athenahealth September 2012 press release

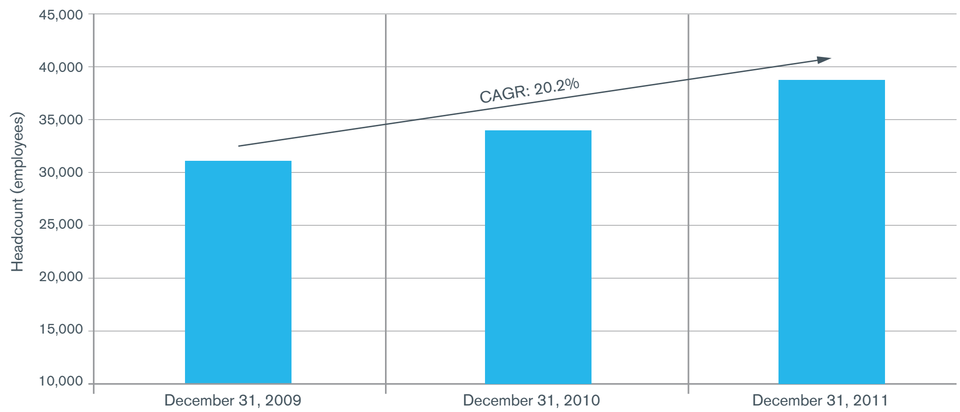
Stimulative Impact of the ARRA on the HCIT Sector

"I'm absolutely convinced, and the vast majority of economists are convinced, that the steps we took in the Recovery Act saved millions of people their jobs or created a whole bunch of jobs,"

– President Obama, July 2011

Economists have debated the direct impact of the ARRA on employment in the US labor market as a whole. There can be no debate of its impact on the HCIT industry. Employment at the 17 HCIT companies in our index that disclosed headcount at year-end 2009 increased by 44% from 2009 to 2011.

Aggregate HCIT Headcount[1]

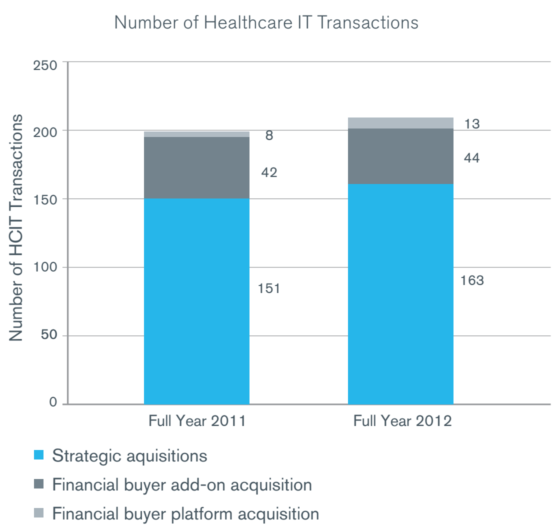


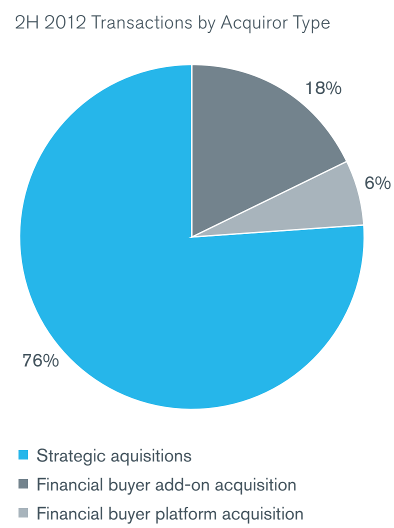
1. Headcount as reported by Accretive Health, Advisory Board Company, Allscripts, athenahealth, MedAssets, Quality Systems, Accelrys, Cerner, CPSI, Healthstream, Healthways, HMS Holdings, Medidata, Merge Healthcare, National Research, Omnicell and WebMD. Figures include transactions that were announced during the period.

2012 M&A Activity

There were 108 HCIT transactions announced during the second half of 2012, slightly fewer than the 112 transactions announced during the first half of the year. As compared to the same period in 2011, HCIT transaction activity increased by 1.9% in the second half of 2012. For the full year, 2012 HCIT M&A activity increased by 9.5% year over year, outpacing overall U.S. M&A activity which grew by 4.6%. Strategic acquirers, including portfolio companies of financial investors, represented 94% of activity with new platform acquisitions by financial investors represented the remaining 6%.

2012 Healthcare IT M&A Activity





Visibilty of ACA implementation post-election.

Merger and acquisitions activity in the HCIT sector was strong throughout the year despite earlier uncertainty as to the ACA's implementation. Many companies made acquisitions during the year to bolster their service offerings in anticipation of the evolution of reimbursement models necessitated by the market, regardless of the fate of the ACA. With the dust from the 2012 Presidential election now settled, there is now more certainty around the scope and timetable for the ACA's implementation, which may spur future M&A activity.

Private equity firms exited investments anticipating tax changes in 2013.

The Riverside Company, Roark Capital Group, Riordan, Lewis & Haden, Francisco Partners and Vista Equity Partners were among the private equity groups that sold HCIT portfolio companies in the second half of 2012. The companies sold operate in multiple HCIT subsegments and were acquired primarily by strategic buyers. Some of the key transactions from the period include:

- In September 2012, QuadraMed, a Franciso Partners portfolio company that provides electronic document management solutions, sold its health information management business, Quantim, to Nuance Communications (NASD:NUAN). According to Nuance, it expects Quantim's computer-assisted coding solution to bolster its coding and compliance platform ahead of the federally mandated ICD-10 conversion in 2014.[1] Francisco Partners acquired the entire QuadraMed business in 2009 for $125.5 million and sold the Quantim division to Nuance for $230.0 million.
- The Riverside Company sold HEALTHCAREfirst ("HCF") to Pamlico Capital and HCF's management team in September 2012. HCF provides web-based software that helps home health agencies and hospices manage their clinical and business operations. Riverside acquired HCF in 2008 and during its investment period, HCF completed two add-on acquisitions which, together with organic growth, resulted in a four-fold increase in revenue.

Source: Capital IQ: Figures include transactions that were announced during the respective period.
1. Nuance September 2012 press release

2012 M&A Activity

Strong volume of acquisitions by private equity investors.

Many private equity firms continued to invest in HCIT in the second half of 2012. For example, Thoma Bravo, Ferrer Freeman & Company, One Equity Partners and JMI Equity all made acquisitions across a wide-range of healthcare technology segments during the period.

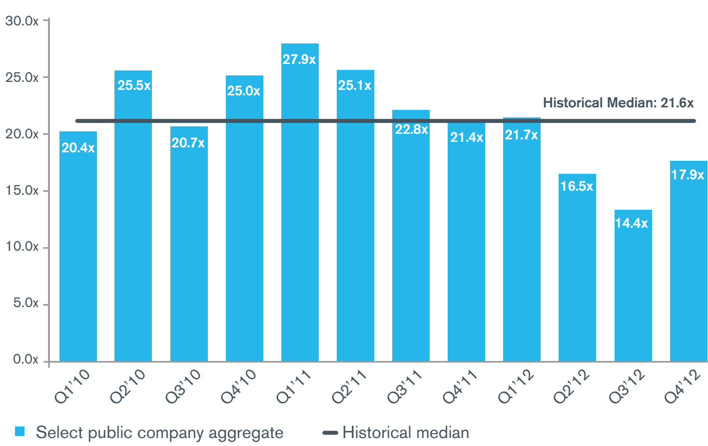
- Activity in the coding and transcription segment was highlighted by the August 2012 acquisition of M*Modal by One Equity Partners for $1.1 billion. The transaction marked One Equity Partners' entrance into the clinical documentation segment at a time when the demand for healthcare information is at a historic high.
- In November 2012, Thoma Bravo acquired Mediware Information Systems, a clinical and performance management information software company, for $196.3 million. Immediately following this transaction, in December 2012 Mediware acquired MediServe Information Systems, a software provider to rehabilitation and respiratory care communities, in an effort to project its reach beyond the hospital.

Strategic buyers continue consolidation across all segments of HCIT.

Nuance, Cerner, McKesson (NYSE:MCK), Humana (NYSE:HUM), athenahealth and Roper Industries (NYSE:ROP) were some of the corporations that made acquisitions during the period in segments ranging from consulting and transcription services to business intelligence and EMR software.

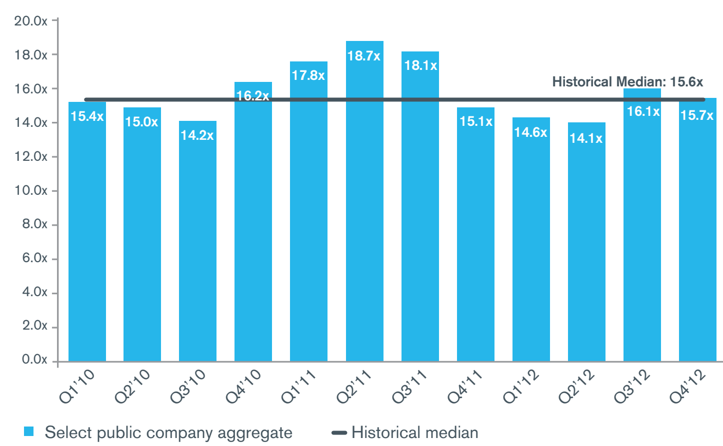
- Insurers continued to acquire health information exchange companies. Humana, the managed healthcare company, acquired Certify Data Systems in November. According to Humana's Senior Vice President and Chief Information and Service Officer Brian LeClaire, the acquisition is expected to bring Humana closer to providers and influence physician practice patterns by creating a virtual integrated delivery healthcare system.[1] The acquisition by Humana follows similar acquisitions by Aetna (NYSE:AET), which bought Medicity in January 2011, and UnitedHealth Group's (NYSE:UNH) Ingenix, which bought Axolotl in August 2010.
- There were also multiple acquisitions in the HCIT consulting segment such as SAIC's (NYSE:SAI) acquisition of maxIT Healthcare in August 2012, for $493 million from Riordan, Lewis & Haden, and Nuance's acquisition of J.A. Thomas & Associates for $265 million in October 2012. maxIT is expected to complement SAIC's July 2011 acquisition of Vitalize Consulting Solutions by expanding its client base and increasing its EHR and integration capabilities. Similarly, Nuance anticipates that J.A. Thomas & Associates will complement its acquisition of Quantim and will provide an integrated end-to-end clinical documentation platform to help hospitals transition to ICD-10.

Revenue Cycle Management Index
Quarterly LTM EBITDA Multiples (Q1 2010 - Q4 2012)



* Multiples calculated based on the average daily LTM EBITDA multiples of each company for the fiscal quarter.

Information Services Index
Quarterly LTM EBITDA Multiples (Q1 2010 - Q4 2012)

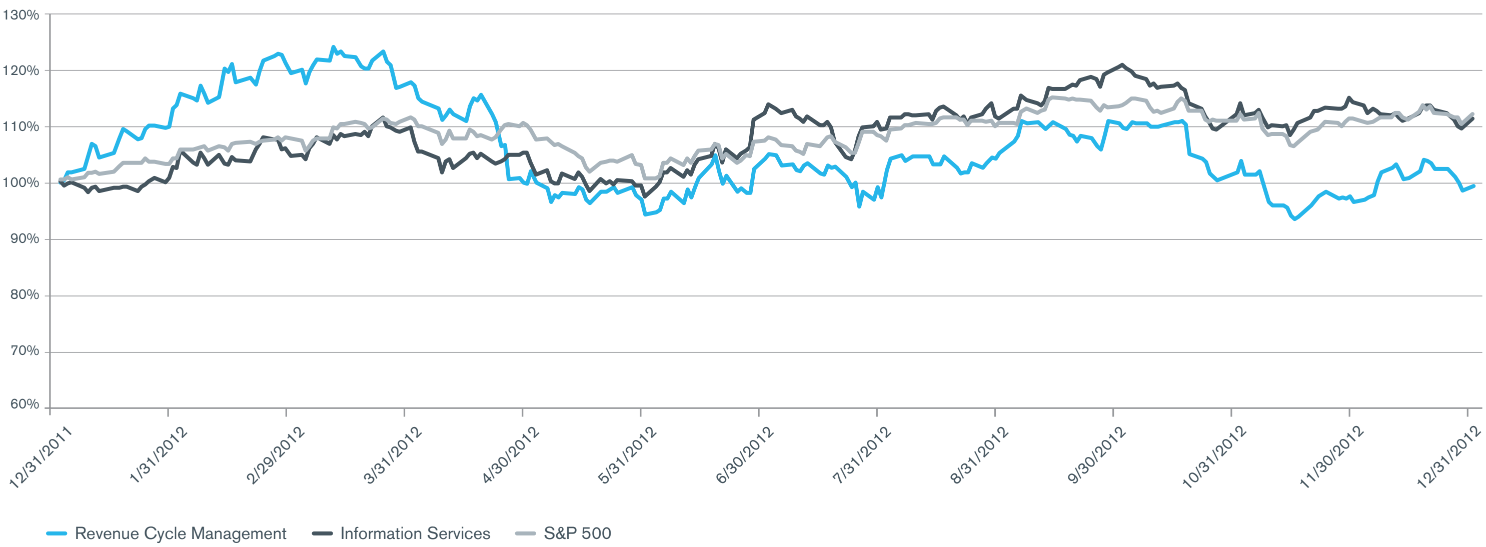


* Multiples calculated based on the average daily LTM EBITDA multiples of each company for the fiscal quarter.

Source: Capital IQ and public information
1. Humana November 2012 press release

2012 M&A Activity

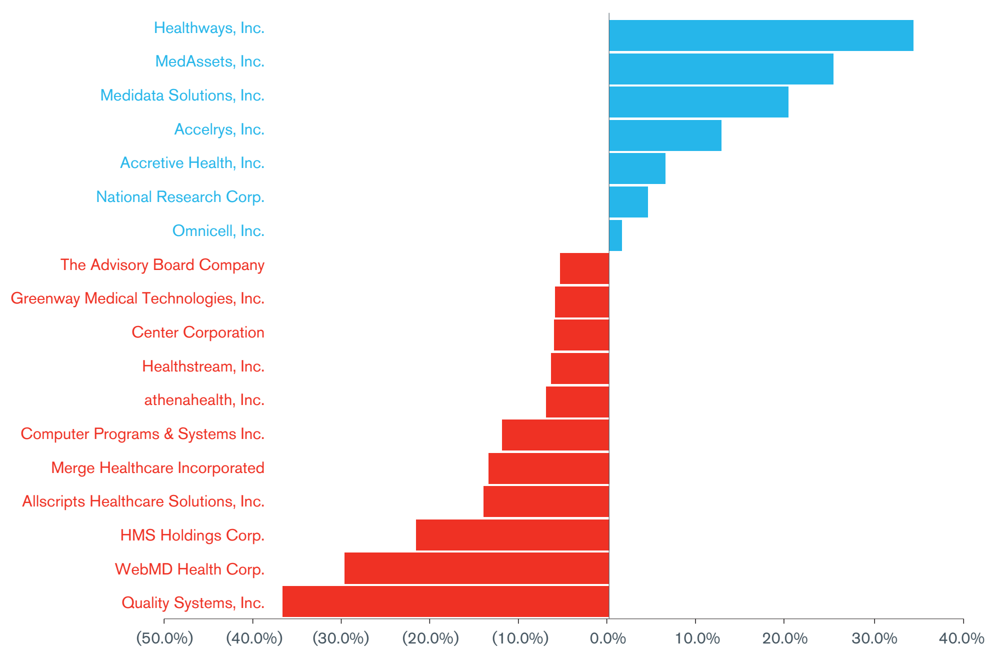
Stock Price Index
January 1, 2012 - December 31, 2012



Select Publicly Traded Companies

- **Mixed Performance in Second-Half Stock Prices.** Stock prices increased for one-third of the companies in the RCM index. Stock prices for companies in the information services index fared better with approximately 40% increasing during the second half of 2012.
- **Continued Revenue Growth and Margin Pressure.** In Q3 2012 83% of the HCIT public companies included in the indices experienced quarterly year over year revenue increases, attributable to strong customer demand and the impact of acquisitions. However, only ten of the companies reported EBITDA increases in the same period as a result of competitive pricing pressures, delays in customer orders and increased customer acquisition costs.
- **Decline in Valuation Multiples as Margins Compress.** The median EV/EBITDA multiple for the RCM companies in the index increased from 16.5x in Q2 2012 to 17.9x in Q4 2012 and the median EV/EBITDA multiple for Information Services companies increased to 15.7x in Q4 2012 from 14.1x in Q2 2012.

Stock Price Change
June 30, 2012 - December 31, 2012



Source: Capital IQ

Selected Publicly Traded HCIT Companies

Company Name	Ticker	Price 12/31/12	% Change 6/30/2012	LTM Multiples (as of 12/31/2012) Rev	LTM Multiples (as of 12/31/2012) EBITDA	LTM Mulitples (as of 6/30/2012) Rev	LTM Mulitples (as of 6/30/2012) EBITDA	Change in Multiples Rev	Change in Multiples EBITDA
Revenue Cycle Management									
Accretive Health, Inc.	AH	$ 11.58	5.7%	1.0x	32.4x	1.0x	14.9x	0.1%	118.1%
Advisory Board Co.	ABCO	46.79	(5.6%)	3.7x	24.6x	4.4x	28.7x	(16.1%)	(14.2%)
Allscripts Healthcare Solutions, Inc.	MDRX	9.42	(13.8%)	1.3x	8.7x	1.5x	9.1x	(12.7%)	(4.6%)
athenahealth, Inc.	ATHN	73.29	(7.4)	6.2x	49.6x	7.8x	51.5x	(19.9%)	(3.7%)
MedAssets, Inc.	MDAS	16.77	24.7%	3.0x	9.8x	2.9x	9.7x	2.0%	1.7%
Quality Systems Inc.	QSII	17.36	(36.9%)	2.0x	7.8x	3.5x	11.9x	(42.7%)	(34.0%)
Mean			(5.6%)	2.9x	22.2x	3.5x	21.0x	(14.9%)	10.5%
Median			(6.5%)	2.5x	17.2x	3.2x	13.4x	(14.4%)	(4.1%)
Market Capitalization-Weighted			(9.3%)	3.4x	26.6x	4.1x	25.4x	(17.3%)	4.6%
Information Services									
Accelrys Inc.	ACCL	$ 9.05	11.9%	2.3x	24.4x	2.0x	19.4x	12.6%	25.9%
Cerner Corporation	CERN	77.51	(6.2%)	4.9x	18.1x	5.8x	21.2x	(14.5%)	(14.6%)
Computer Programs & Systems Inc.	CPSI	50.34	(12.0%)	3.0x	12.6x	3.4x	13.6x	(12.0%)	(7.9%)
Greenway Medical Technologies, Inc.	GWAY	15.36	(5.8%)	3.2x	54.8x	3.7x	48.3x	(14.5%)	13.4%
Healthstream Inc.	HSTM	24.31	(6.5%)	5.5x	27.7x	6.8x	34.8x	(18.6%)	(20.6%)
Healthways Inc.	HWAY	10.70	34.1%	1.0x	7.0x	0.8x	5.6x	18.3%	25.9%
HMS Holdings Corp.	HMSY	25.92	(22.2%)	5.6x	18.4x	8.0x	26.5x	(29.9%)	(30.6%)
Medidata Solutions, Inc.	MDSO	39.18	19.9%	4.3x	25.5x	3.7x	17.7x	17.3%	44.2%
Merge Healthcare Incorporated	MRGE	2.47	(13.6%)	1.8x	9.6x	2.0x	8.8x	(10.9%)	8.5%
National Research Corp.	NRCI	54.20	3.5%	4.4x	13.6x	4.6x	14.9x	(4.0%)	(8.8%)
Omnicell Inc.	OMCL	14.87	1.6%	1.5x	11.2x	1.1x	11.2x	36.9%	(0.0%)
WebMD Health Corp.	WBMD	14.34	(30.1%)	1.1x	13.5x	1.5x	8.3x	(27.3%)	61.6%
Mean			(2.1%)	3.2x	19.7x	3.6x	19.2x	(3.9%)	8.1%
Median			(6.0%)	3.1x	15.9x	3.5x	16.3x	(11.5%)	4.2%
Market Capitalization-Weighted			(7.5%)	4.5x	18.9x	5.4x	21.2x	(16.1%)	(10.7%)

Source: Capital IQ

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