## State of the

# HEALTHCARE IT MARKET: 2016

A WHITE PAPER FOR KEYBANC CAPITAL MARKETS BY MODERN HEALTHCARE CUSTOM MEDIA

THIS WHITE PAPER EXPLORES THE CURRENT AND FUTURE HEALTHCARE IT TRENDS. IT LAYS OUT THE TECHNOLOGY UNDER DEVELOPMENT AND EXPLORES HOW IT WILL BE FUNDED.

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# RECENT MARKET (2009-2015)

The healthcare information technology (IT) market is swelling, thanks to the federal government's legislative and financial incentives for technological progress. While most industries have adopted technology much earlier, the healthcare industry is really just now catching up.

These changes are coming in waves. The first wave encouraged digital infrastructure and electronic health records adoption, a market which is now mature. This wave was initiated in 2009, when Congress passed the Health Information Technology for Economic and Clinical Health (HITECH) Act, which offered healthcare providers a carrot and stick approach to adopting meaningful use of this technology. This act incentivized hospitals, medical groups and doctors' offices with more than $30 billion to change from paper patient medical records to electronic medical records (EMRs), and use them in a meaningful way.

The push was successful, overall. As of April 2015, 95% of all eligible and critical access hospitals have demonstrated meaningful use of certified Health IT. Office-based physicians are lagging behind[i], with only 54% doing the same[ii].

The Affordable Care Act (ACA) in 2010 set the stage for the second wave of technology, which builds on EMR adoption by adding performance and quality reporting metrics into the mix. The ACA changes the payment paradigm in healthcare by tying revenue to value and outcomes, versus volume of patients seen. Thus, new technologies are necessary for gathering, sharing and analyzing vast amounts of data to manage the health of an entire patient population. Other technologies are addressing connectivity and interoperability issues, since moving to a value-based outcomes model requires better care coordination.

Another factor currently influencing the healthcare IT market is the Centers for Medicare and Medicaid (CMS) announcement in early 2015, which stated that 90% of Medicare fee-for-service payments will be linked to quality and value metrics by 2018, with smaller goals starting right away. Also by 2018, the CMS will tie 50% of all traditional Medicare payments to alternative payment models[iii]. It's not just Medicare: Of the largest private payers, 70% have the same payment goals, as do more than 50% of state governments[iv].

"The growing demand for solutions to help with the transition to value-based care, as well as evolution of new technologies designed to power the next generation of solutions for the U.S. healthcare market, creates significant opportunity for the HCIT market to more than double in the near term," said Karan Jolly, Director of Healthcare Investment Banking at KeyBanc Capital Markets. "Specific segments of healthcare IT expected to drive growth include revenue cycle management, healthcare data analytics, population health management and consumer-driven healthcare technologies."

## TYPES OF HEALTHCARE IT COMPANIES

While improving healthcare technology efficiency is a goal, the EMR adoption influenced by the HITECH Act had the opposite effect. "There's an entire industry of complementary solutions built around making some of these EMR systems more efficient, as well as facilitating the shift toward value-based care," Jolly said.

This new wave of technology companies can be divided into several categories:

**End-to-End Population Health Management Solutions:** Population health management companies are experiencing significant growth. These companies offer solutions that help providers manage the clinical and financial risk of a defined group or population. In practice, this means that healthcare providers are examining the patient populations they serve and attempting to apply best practices, analytics and connectivity to engage, influence and coordinate caregivers and patients in ways that improve care and reduce costs.

Providers can segment their population by sickness level and financial risk, for example. Based on the risk levels, healthcare providers can spend more time with at-risk patients, encouraging them to be more proactive in their health. These systems might also measure outcomes and patient satisfaction levels. Top companies in this sector include Premier, Inc., The Advisory Board Company, Allscripts, Cerner, Health Catalyst, IBM, Optum, Valence Health, Wellcentive and ZeOmega, which all offer comprehensive population health management solutions.

**Niche companies:** Some players offer more specific solutions, such as patient engagement, customer relationship management ("CRM"), data analytics and revenue cycle management. The patient engagement area includes companies such as Emmi Solutions, owned by the Cleveland-based private equity firm Primus Capital and StayWell (owned by Vestar Capital). Ongoing regulatory initiatives and increasing consumerism are forcing healthcare providers to prioritize patient experience: Press Ganey and National Research Corporation are some of the leaders in this patient experience and performance improvement space.

The proliferation of digital health data and other factors are also driving rapid adoption of predictive analytics by providers and payers, with companies such as Truven Health Analytics, Predixion and Jvion offering solutions in this realm. Finally, the shift in reimbursement models toward bundled payments, shared savings and other risk-based contracts are necessitating an increase in spending on RCM systems and outsourcing. Companies such as Etransmedia, Recondo Technology and Global Healthcare Alliance are well positioned to benefit from this shift.

## M&A AND HEALTHCARE FUNDING

Merger and acquisition (M&A) activity in the healthcare IT arena was brisk in 2015, bringing buyers from four distinct categories:

**Diversified IT vendors:** IBM made three large healthcare IT acquisitions in 2015. It purchased Explorys and Phytel, transactions worth a combined $750 million in enterprise value. It also purchased Merge Healthcare for $1 billion. Roper Technologies entered the healthcare arena in 2012, after purchasing Sunquest. Roper continued its healthcare IT expansion in 2015, purchasing ClinSys Group Ltd. and Atlas Medical[v].

**Healthcare IT vendors:** Cerner bought Siemens Health Services, the company's healthcare IT division, in 2015. In recognizing that the EMR market is now mature, large EMR players like Cerner are investing in population health systems, allowing them to tap into their own customer base to offer comparative solutions.

**Financial companies:** Private equity firms are making a push into healthcare IT. Pamplona, for example, acquired the public company MedAssets to take it private, in a $2.7 billion deal[vi]. MedAssets provides revenue cycle management for hospitals. Pamplona also bought Precyse, a performance management and technology company.

**Healthcare Services:** While Aetna and United Health have been making investments in healthcare IT for almost a decade, Cardinal Health entered the field in 2015, buying naviHealth, an analytics solution for the bundled payment initiative.

## WHO'S GETTING OUT?

Many companies are getting into healthcare IT, but some are divesting themselves of the business. Verisk Analytics, which provides analytics to end markets including insurance, financial services and energy, put its healthcare vertical up for sale during 2015. 3M, a large diversified industrialized tech company, made significant healthcare IT investments over the years, but is now considering a sale of its health data business. Siemens exited, selling its healthcare IT business to Cerner.

# IMPLICATIONS FOR M&A THROUGH 2020

"M&A in healthcare IT is expected to stay strong from 2016 to 2018," said Jolly, "and remains comparatively more profitable than most other verticals." One reason is that EMR vendors with large customer bases and footprints will be looking for new solutions to sell to their existing customers. With a maturing EMR market, these companies will need new avenues for growth.

### FINANCING ACQUISITIONS

Most new healthcare IT companies are fairly small, so debt doesn't typically play a big role in acquisitions. The purchases are primarily equity-driven rather than debt-driven, especially compared to other industries. The companies are spending money to build up salesforces and infrastructure, growing the company rather than increasing profitability. "They're getting a robust valuation in the market because of the growth, knowing that if they go public or sell via an M&A process, they have the infrastructure," said Mike Jackson, Managing Director and Group Head of Healthcare Investment Banking at KeyBanc Capital Markets.

Equity has been robust for healthcare IT since the beginning of 2013, with about 12 healthcare IT companies going public since then. Jolly expects more companies to raise money in public markets in the next 24 months.

### VENTURE CAPITAL FUNDING

Venture capital funding has tripled in the last three to four years, and 2015 set a record, Jolly said. Several Silicon Valley technology funds are recognizing the change in healthcare direction and are making significant investments.

Venture capital for healthcare IT grew from $2.2 billion in 2013, to $4.7 billion in 2014, according to Mercom Capital Group[vii]. By the end of the third quarter of 2015, the private equity and venture capital funding was already at $3.57 billion, slightly higher than for the same period in 2014[viii].

Funding was significant for the following sectors:

- health information management
- mobile health
- revenue cycle management
- telehealth
- personal health
- rating, booking and comparison shopping
- security

# IMPLICATIONS FOR FUTURE R&D

As new technologies enable healthcare IT growth, there are two segments to watch in the coming years:

Big data: Big data is already a mature strategy in industries like banking, retail and travel. Healthcare database technologies are catching up. Hadoop is one example of an SQL big data technology that's enabling the collection of massive amounts of data to analyze and develop. Big data has many promises, such as helping clinicians make better-informed financial and clinical decisions at the point of care.

In the pharmacy and biotechnology markets, analyzing big data can help meet long-term goals of customizing care delivery for individual patients. The more data that's available to show how certain patient populations behave and respond to treatment, the easier it will be to link development to a more effective, individualized treatment, Jolly said. This will eventually lead to real-time genomic medicine, shortening the lifecycle of new drug or medical device development.

Cloud storage and software: There have been valid concerns about the security of cloud storage and data breaches in numerous industries. However, healthcare typically attracts more scrutiny because patient data is protected by HIPAA. Given the cost effectiveness of updating software with a cloud solution, healthcare providers on the ambulatory side are shifting to cloud storage and software. Hospitals have a large enough scale that they tend to prefer servers.

# CONCLUSION

While the HITECH Act and ACA pushed the healthcare industry into digitization and value-based care, newer IT companies are focusing on connectivity and interoperability. Shifting toward value-based payment models require better care coordination and breaking down the silos of information across the continuum of care. Historically, payers and providers have been on opposing teams. But new payment paradigms require providers to take on more risk by proving value and better outcomes. This can't happen without new technologies, which is why the healthcare IT field will likely continue its high growth in the coming years. ■

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