More M&A expected in healthcare payment integrity space as claim errors skyrocket – industry sources
By Deborah Balshem in Ft. Lauderdale
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- Good margins, high growth attractive to private equity firms
- Possible buyers include Connolly, Emdeon, Xerox, Verisk, HMS
- Equian, Trover, Rawlings, Performant among potential targets

The medical claim errors market is expected to see increased consolidation as reimbursement models evolve and unprecedented volumes of increasingly intricate healthcare claims drive payors to outsource their internal audit and payment recovery functions, according to several industry sources.

Claim overpayments are a significant contributor to the rising costs of healthcare, with claim error rates for commercial, Medicare fee-for-service (FFS) and Medicaid FFS claims estimated to be a market opportunity in excess of USD 150bn, said Jonathan Krieger, managing director of healthcare investment banking at Berkery Noyes.

That number is expected to rise as momentum builds to replace traditional FFS models, where providers are paid for volume (per service and test), with more value-based payment models that reward providers for the quality of care they deliver and resulting clinical outcomes, Krieger said. New models include patient-centered medical homes and accountable care organizations.

The law driving the changes is the 2010 Patient Protection and Affordable Care Act, also referred to in general as healthcare reform, the Affordable Care Act, or "Obamacare".

In response, a growing number of "healthcare payment integrity" players have been actively involved in M&A, consolidating a highly fragmented market consisting of many smaller, niche players that typically focus on either pre-payment (more software-oriented) or post-payment (more services heavy) solutions, or data analytics, said Krieger and **Equian** CEO Scott Mingee.

PE firms are attracted by the margins and growth characteristics of these companies, as their revenue models are typically a percentage of the overpayments collected, added Krieger, who represented **AfterMath Claim Science** in its sale to Equian last month. Chicago-based AfterMath identifies and recovers post-payment medical claim errors.

Potential consolidators

Indianapolis-based Equian (formerly Health Systems International) has completed 10 acquisitions since being purchased by Great Point Partners in 2007. The company has a pipeline of 20 more potential targets, although its near-term focus is on integrating recent buys, Mingee told this news service last week.

Equian has grown an average of 35% annually over the last six years and is projecting revenue of close to USD 70m in 2014. The company is seen as both a potential acquirer and a near-term target, with a source noting in last week's report that Equian's owners could seek to exit as soon as next year.

Another major pure-play competitor in the space and likely acquirer is Advent International-backed **Connolly**, a payment integrity firm which merged in April with Goldman Sachs-backed **iHealth Technologies**, said Krieger, Mingee, a second industry banker and a sector analyst. The deal was rumored to be worth more than USD 1bn, according to press reports. The second banker estimated Connolly to have more than USD 100m in revenue.

Advent took over Wilton, Connecticut-based Connolly in 2012, financing the deal with USD 370m of debt and USD 363m of additional equity, according to Standard & Poor's. Goldman Sachs acquired Atlanta-based iHealth in 2006 for an undisclosed sum.

Nashville-based **Emdeon**, a provider of healthcare revenue and payment cycle management backed by the Blackstone Group and Hellman & Friedman, is another probable buyer, all sources agreed. Last year, Emdeon acquired **TC3 Health** to expand its payment integrity solutions. Irvine, California-based TC3 provides cost containment solutions including payment integrity analytics, clinical code editing and out-of-network claims cost management.

Other potential publicly traded consolidators, according to the sources, include **Affiliated Computer Systems** (ACS), a division of **Xerox** (NYSE:XRX); **Optum**, a division of **UnitedHealth Group** (NYSE:UNH); **McKesson** (NYSE:MCK); **Verisk Analytics** (NASDAQ:VRSK); **HMS Holdings** (NASDAQ:HMSY); **CGI Group** (NYSE:GIB); and **Accent**, an insurance subsidiary of **West Corp** (NASDAQ:WSTC).

HMS is seen as a likely acquirer, as it has been largely focused on government payors but has been expanding its commercial presence given a number of changes the Centers for Medicare and Medicaid Services is making to the Recovery Audit Contractor program, Mingee said. HMS has close to USD 500m in sales and a market cap of approximately USD 1.7bn.

The larger players are all looking to build services and solutions along the entire healthcare payment continuum. Most targets will be smaller companies with roughly USD 5m to USD 10m in revenue that have identified niche sectors within analytics, or pre-payment and post-payment services, opening up potential roll-up opportunities, the sources said.

'Prey or predator'

There are several larger privately held companies that are seen as "prey or predator", including **Trover Solutions** and **The Rawlings Group**, and **Performant Financial Corp**, according to two of the sources. Though big enough to potentially acquire, these companies might be best served by a sale in an effort to diversify, they suggested.

Louisville, Kentucky-based Trover, an outsourcer of insurance subrogation and claims recovery services, has been backed by ABRY Partners since January 2011. The company's 2010 revenue was roughly USD 90m, according to media reports. Privately held Rawlings is based in La Grange, Kentucky. Both focus more on the post-payment side, the sources noted.

Livermore, California-based Performant (NASDAQ:PFMT) "is a smaller version of HMS" given its government focus, and may want to merge with or sell to a more commercially focused player, according to the sources. Performant has a market cap of approximately USD 514m.

The analyst named **Truven Health Analytics** and **MedeAnalytics** as potential targets. Emeryville, California-based MedeAnalytics has been backed by Bain Capital since 2008, and according to one published report, has at least USD 70m in revenue. Veritas Capital acquired Greenwood Village, Colorado-based Truven from **Thomson Reuters** (NYSE:TRI) in 2012.

Multiples in the space are roughly 4x-8x EBITDA for companies with less than 10m in revenue and can reach 8x-12x EBITDA for larger players, said the second banker. Average EBITDA margins in the space are approximately 20% to 25%, according to Mingee.

Multiples of revenue are roughly 1x to 2.5x for companies with up to USD 50m in revenue, and 3x-4x or more for larger players, several sources agreed.

Tailwind Capital, which held Trover for roughly six years before selling to ABRY, paid USD 60m, or around 4x cash flow. Tailwind was rumored to have recouped roughly 5x its equity through the sale, while cementing an approximately 50% internal rate of return. HMS paid approximately USD 400m in December 2011 for **HealthDataInsights**, which was projected to contribute approximately USD 85m of revenue to HMS in 2012.

The insurance claims services sector, in general, has seen heightened activity, with several large recent private equity deals.

In February, **Starr Investment Holdings** purchased claims processor **MultiPlan** from private equity firms BC Partners and Silver Lake for USD 4.4bn. In October, Apax Partners spent USD 3bn to purchase **One Call Care Management** and **Align Networks**. In January, KKR paid USD 2.4bn for **Sedgwick Claims Management Services** and USD 1.1bn for **Mitchell International**.

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With USD 3trn of spending and USD 900bn of waste in the US healthcare market, according to Mingee, there is "more pressure than ever to reduce rising healthcare costs".