ARTICLE

The Importance of Health Tech Due Diligence in M&A

Lower Transaction Risk Pre- and Post-close

For prospective investors and acquirers, conducting health tech due diligence prior to a merger or acquisition has become a critical step towards understanding IT risks, costs to remediate and, most importantly, investments required to satisfy the investment thesis before the deal is finalized. The potential for technology to make or break a deal has never been greater than it is today.

The potential for technologies in healthcare to make or break a deal has never been greater than it is today. Healthcare can no longer minimize IT or view it as an afterthought if the strategic benefits of a merger, acquisition or even divestiture are to be achieved. IT has become central to deals and critical to the outcome and results of the transaction.

For the purposes of this article, "health tech" will refer to core technology systems used by providers, payers, manufacturers and suppliers.

Benefits of IT in health tech M&A

IT can be the best enabler of synergies in an M&A deal and is a critical success factor in both the operational and strategic importance of a company's value. While disruptive technologies such as cloud computing, social media, mobility and big data require a shift in consumption and delivery of IT services, with appropriate utilization of IT, potential investors can expect to:

- —Increase key goals of an M&A transaction to execute an issue-free transaction Day 1;
- —Enable realization of synergies and develop future-state platforms to support business growth driven by investment thesis; and
- —Improve capability and service delivery that adds enterprise value.

Key themes driving M&A activity

According to Pitchbook, global private equity/venture capital investments in health technology increased from $19 billion in 2016 to $75 billion in 2021 reflecting a period of rapid technology evolution.[1] Yet, only a small percentage of buyers perform health tech due diligence.

Some of the themes driving M&A activity across the healthcare landscape include:

- Biotech and patient services that involve portfolio optimization, reduction of wasteful spending, and a drive towards enhanced patient experience (in a value-based care ecosystem) requiring data analytics;
- Large-scale growth of niche health tech platforms that present opportunities for consolidation across a broader range of services;
- New business models, e.g., specialty-care platform roll-ups, focus on higher-risk populations;
- Technology disruptions include telehealth and virtual care delivery to enable quicker, more efficient and/or virtual delivery of patient care;
- Hardware servers or cloud infrastructure and artificial intelligence (AI) to enhance and improve IT bandwidth and workflow automation/simplification in areas such as claims status, inventory management and drug authorizations;
- Increasing consumerism with payer growth in high-deductible health plans; and
- Proliferation of healthcare data and Electronic Health Record digitization necessitating solutions to utilize data and identify insights to improve outcomes and reduce costs.

The role of technology in transactions has always been problematic and healthcare has proven to be no different; therefore, having a sound understanding and approach to health tech M&A is key. Several benefits from cross-industry M&A IT practices exist to help evaluate and lower health-tech transaction risk and reduce potential negative impact on M&A goals.

[1]Emerging Technology Report, 2020. Pitchbook; accessed April 4, 2022

Pre-close considerations

What do acquirers need to understand prior to close?

—IT risks that present operational, financial or commercial exposures to the target;
—Cost (hidden and unplanned);
—Resource gaps;
—Timeline;
—Transition Service Agreement (TSA) requirements;
—Level of business disruption involved in mitigating risks;
—Data protection measures and security gaps; and
—Scalability of systems.

These are important factors we see when determining limitations to a target's future growth or cost exposure that may have an impact on the acquirer's purchase price for the target. From a value perspective, acquirers need to understand how IT will be used to drive or support the target's growth and what opportunities/areas IT can refine or help efficiencies through automation or increased productivity.

In the following target acquisition scenarios, where should IT focus be placed?

—Where IT is found to have less of an operational dependency, focus should be placed on continuity of financial systems and reporting.
—In the case of a corporate acquirer, synergies of an acquisition may be more focused on driving future growth.
—For financial buyers, an investment thesis and limited duration to maximize earnings before EBITDA though revenue growth and operational efficiency may be more of a priority. In this situation, more focus may be placed on support for strategic growth initiatives over a shorter period of ownership.

Post close considerations

By analyzing views of merged or acquired businesses relative to IT, value creation may emerge from inefficiencies with information processing patterns, functional redundancies, repetitive cycles on the same source data, significant manual interventions, and overcontrolled processing and processes that often are enabled by out-of-date technology.

M&A benefits are linked to value creation such as increased market share and lower combined operating costs. An integrated value chain is linked to synergies such as shared overhead, economies of scale, greater market access and operational integration.

What should IT health tech diligence focus on?

—Architecture
—Asset management
—Business continuity management
—Change management
—Contracting and outsourcing
—Technology licensing
—IT financial control
—IT Human Resources (HR)
—Records management
—Privacy and data protection
—Project management
—Physical and environmental problem management

What are key post-close actions?

—Do not ignore IT
—Design IT for the future business strategy
—Plan for additional, unexpected costs
—Implement temporary solutions only when necessary
—Use TSAs only when necessary to bridge gaps
—Get IT involved early
—Encourage communication between IT and business leaders
—Gather requirements
—Estimate costs
—Estimate the IT timeline
—Gather as much information as possible

Objectives and Challenges of Health Tech Due Diligence

To be sure an investment gets started on the correct path, it is imperative to assess and understand technology that is being acquired — not only the technical solution, but also the back-office IT systems that will be crucial to both an organic and acquisitive growth thesis. We believe that standalone platforms with a strong growth thesis and buy-and-integrate deals are appealing now.

Regardless of deal type, the goal of health tech due diligence is to understand two things:

1. Risks that can have an impact on value creation, which should ideally be accounted for by the buyer post-acquisition.
2. Capital and operating expenses required to meet the investment thesis during the hold period.

Buyers should also understand unknown risks, one-time IT costs to integrate the acquisition (for instance, setting up an ERP system), impact of the acquisition on recurring IT costs to run the business (for instance, maintenance cost of ERP licensees and support) and an evaluation of opportunities (for instance, rationalization of similar applications).

For standalone diligence or buy-and-grow deals, what factors may affect how the deal unfolds?

—Back-office IT systems (e.g., payroll payment), front-end interfaces such as time and entry, and access to benefits that are typically interlinked with other applications, such as HR and finance;

—Database management services and any potential database reconfiguration;

—Creation of new data views, data extracts, and on-demand support for ad-hoc data requests;

—Controls for data transfer processes that involve Personal Health Information (PHI);

—Misaligned IT organization structure and/or key IT person risks; and

—Custom code (if applicable), custom application architecture, proper coding techniques, proper open-source usage, security controls built into the code, scalability, and key-person risks

What do you typically see impact a buy-and-integrate deal (including carve-out deals)?

—Set-up of new applications and related processes;
—Cloud solutions considerations for IaaS, PaaS, SaaS or legacy systems as well as suitability in terms of scale, integration complexity, elasticity, maturity, data transfers, and privacy and security;
—Application rationalization such as data center, server consolidation, data storage optimization;
—Functional TSAs that have an IT implication, e.g., finance and operations;
—Technical support function optimization;
—Transaction closing date for systems such as payroll and benefits;
—Employee transition to new HR processes;
—Network connectivity;
—Establishment of connectivity to buyer
—Secure access to TSA services
—Data segregation in terms of application level, user level and infrastructure level
—Access to legacy email system for historical mail and transition of historic data from the legacy system to the buyer email system
—Communication in terms of fixed phone line telephone systems, and mobile devices
—Prolonged security incidents and business interruptions because of no integration of incident response and business continuity plans
—Increased technical vulnerabilities around transition and storage of sensitive information
—Lack of appropriate control coverage for technology changes.

The post-merger integration environment provides an opportunity to make a substantial transition to the cloud solution.

What key factors should be considered regarding cloud solution transitions?

—Business requirements not being met by current solutions, e.g., EHR/EMR systems, claims processing systems, pharmacy dispensing systems, lab systems and order fulfilment systems;
—Migration and cost required;
—End-of-life schedule for servers;
—Software license renewal schedule;
—Skill sets required to support various current applications and technologies;
—Risks in current environment, e.g., availability, support, and stability; and
—Timing and funding availability for migration.

Best Practices

Best practices are intended to guide and steer the transaction in the proper direction; however, they cannot cover every single healthcare situation. The following represents our knowledge and experiences spanning the healthcare landscape with various deal sizes and transaction complexity, working in predictable and repeatable ways for mergers, acquisitions and integrations.

Early identification and execution of health technology changes will require an in-depth understanding of applications enabling the business, the underlying infrastructure support and the data involved with applications, including:

- —Getting IT involved early;
- —Designing IT for future business strategy;
- —Planning for additional, unexpected costs;
- —Implementing temporary solutions only when necessary, conducting IT risk and control self-assessments;
- —Employing strong user access provisioning and certification practices;
- —Implementing data management controls; and
- —Capturing business intent for third-party contracts, and familiarity with suppliers and their contracts.

As with other industries, the healthcare industry has a critical dependency on IT systems, both back-office and custom (if present). Underestimating these complexities and the effect of technology components can have an impact on the deal.

It is critical to find experts that are equipped with an understanding of health tech domains to be able to assess IT operations and demonstrate how current-state IT risks could impact M&A objectives and goals.

FTI Consulting is an independent global business advisory firm dedicated to helping organizations manage IT change and mitigate IT risks involved in M&A integration. Our experts have worked on many healthcare due diligence deals and have assisted clients to successfully overcome IT pre-close and post-integration challenges. The value-add of having this advanced knowledge of the healthcare tech landscape helps improve IT and business alignment and organizational success.

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