CENTRAL AND EASTERN EUROPE

Four reasons to be positive about investing in Central and Eastern Europe

Is it worth investing in Central and Eastern Europe – and if so, where? How does the health landscape differ from Western Europe? And what are the sectors to watch?

Eilert Hinrichs from global strategy consulting firm L.E.K. Consulting gave the key-note speech at the CEE discussion at HBI 2017.

Hinrichs says there is scope for optimism in CEE – for four main reasons:

ONE Growth momentum

"There is growth momentum. The public sector is not providing what people want. There is significant latent demand to be tapped into," he said. He expects public healthcare expenditure in CEE to grow on a par with Western Europe – while private spend exceeds Western levels.

TWO Multiple unconsolidated sectors

"There are multiple unconsolidated sectors, as CEE healthcare market is still in its rapid development phase, there is plenty of room for consolidation. But it will be hard work – you can't buy four or five platforms and you're done." You can read more about CEE consolidation here.

THREE The opportunity to participate and drive structural system upgrade

The poor state of public healthcare provides an opportunity for private providers. Hinrichs says the ongoing transition of health systems in CEE provides an opportunity to capture 'local leader' positions.

FOUR Skilled and relatively cheap personnel

This cost advantage provides an opportunity to develop medical tourism business models – but this is counter balanced by the risk of brain drain faced by all CEE countries which we deal with here.

But where should you look? Hinrichs is clear that the starting point for anyone considering the region for the first time has to be the big four based on population – Poland, Romania, Czechia and Hungary – which have 80m of CEE's 125m residents.

The opportunities in CEE, he explains, are obvious from the figures: "The fundamental difference between East and Western Europe is how much money is spent on healthcare. In the West, we are easily spending three or four times as much as in the east, and there is a significant opportunity to increase the amount being spent – and the service provided."

Healthcare expenditure per capita for 2014 was between €400 (Romania) and €1,100 (Czechia) compared to the likes of Germany (€4,000), France (€3,600) and the UK (€3,500).

Hinrichs explains: "In the West, we have systems that are well financed, while in the East because of the [poor] state of public providers, people are spending significantly more out of their pockets – this should be interesting to the private sector. The mindset is 'if I want good healthcare, I need to do something about it'.

Up until recently, there's been a clear frontrunner in CEE M&A activity.

Eilert Hinrichs, L.E.K. Consulting

Hinrichs says: "Poland was the darling with regard to M&A with almost 50% of transactions over the last five years. The key target type is hospitals [specialist and general] then outpatient-clinic based models. These are the two key sectors really."

There was a "bubble", he added, from around 2012 with the sale of Lux Med which triggered interest. But looking at Q1 of 2017, he concedes, "there looks to be significant slowdown in interest".

There are two main problems in the region, Hinrichs says.

ONE Unstable regulatory environment

Frequent legislative changes in healthcare are a serious challenge for the investors. It is important to consider the risk of possible re-evaluation of reimbursement in the context of the limited budgets for healthcare in CEE.

Hinrichs adds "To mitigate this, I would focus entirely on private pay because there's demand there but it's not without risk. Alternatively, become a sub-contractor for public healthcare providers."

TWO Relatively low valuation of public-paid procedures

Reimbursement rates are generally significantly lower than those in the majority of Western European countries.

As for which sectors he thinks have the most potential, he singles out IVD (in vitro diagnostics) / labs.

Hinrichs explains: "Why IVD? Unprecedented growth in IVD expenditure dynamics continues throughout CEE. It provides the opportunity to benefit materially from both private-pay and public funds – and the segment is somewhat shielded from unfavourable legal changes."

Why CEE hospital operators need to think small before thinking big

In Central and Eastern Europe, the public hospital infrastructure is old, and consolidation difficult with so many small players. Why would anyone buy an old, failing public hospital – and what margins might consolidating operators hope to make? HBI 2017 pulled together a panel of expert CEOs for their advice.

Things are changing in CEE. While there is still a residue of Eastern Bloc sensibility that gives rise to an expectation that healthcare should be free, there's a growing understanding that you have to pay for quality, and for a timely service.

The opportunity for consolidation of smaller operations and making savings seems obvious, but is it realistic?

As Eilert Hinrichs from global strategy consultants L.E.K. Consulting puts it, "You are buying into a platform you can grow, but it's not like in the west where you can buy [big] three or four times and have a finished product. It needs a bit more work."

Fady Chreih, CEO of large Romanian operator Regina Maria, agrees, adding: "We did four or five M&A last year. The tickets were very small if we compare them to Western Europe but you do quick ones, you do them smoothly, and you integrate them."

Prof Attila Vegh, CEO of Penta Hospital Group, CEE's largest hospital chain, agrees that combining smaller acquisitions is still a profitable option. He explains: "Healthcare feels like the last untouched industry. Since 1990, when the Berlin Wall fell, these countries economies have been transformed.

"The reason why there are not many sizeable acquisition targets is because the share of private patients is relatively small. In most of the markets less than 5% are private patients. This limits the opportunities.

"But, this relatively small percentage of private patients is growing double digit.

"One trick is to have contracts with public insurers – and that's possible in some of the markets. It's possible in Slovakia, in Czechia, in Poland. At Penta, 80-95% of revenues depending on the market come from public payors.

"It increases our exposure to changes in legislation but it's a way to get significant market share.

"The biggest challenge for private companies managing public hospitals is that these contracts don't seem to grow – and there's no real opportunity to get new contracts. In Serbia, Croatia, and Hungary, each country has one institution with a small contract with a national payor, that's almost insignificant, and in others like Poland and Czechia, you have a number of private hospitals that have contracts with public payors but there are almost no new contracts granted to private institutions."

Public hospitals are often in poor condition and running at a loss. Could they ever be a worthwhile buy? Vegh thinks so, notwithstanding that some of the hospitals up for sale are 30, 40, even 50 years old.

He explains: "You have to believe you can turn them around – there are plenty of opportunities to improve their efficiency. Centralised hospitals have 30-50 people in admin. We need three or four. Procurement is centralised."

The alternative is to buy what Vegh calls a 'pre-private' hospital, the margins of which will vary according to how they have been run. Vegh be-

lieves double digit margins should be possible.

He explains: "We believe consolidated groups should operate in double digit margins, probably in excess of 15%, despite a tariff that's much lower, because wages are lower too.

"We are not there yet, our [Penta's] consolidated EBITDA is still below 10% but we should be able to get to where the consolidated groups are."

Ultimately however, the key to success is vertical integration, Vegh says. He explains: "We believe the only game in town will be to not only integrate horizontally, but vertically. We have 32 hospitals, and 66 outpatient facilities. And sometimes, you just have to buy what's available. Inpatient markets are barely growing, if at all, but outpatient markets are building much faster.

"The more you connect the dots along the pathway, the more influence you have and the greater the chance to reduce costs through a capitation model. But you need to control a bigger part of the pathway – even outpatient and inpatient is not even a small part."

And what would he target first?

"Cardiac, orthopaedic, and neuro-psychiatric rehabilitation are opportunities. There are varying levels of private players in that space, a few in Poland, a few in Hungary, a few in Slovakia, a few in Czechia – and at the moment rehab space is still dominated by the state, which is free."

Central European brain drain and how to stop it

One of the major problems faced by operators in Central and Eastern Europe (CEE) is brain drain – but how do you stop staff leaving for better paid jobs in the West, and if they do leave, how do you tempt them back? We asked three leading CEE CEOs at HBI 2017.

Prof Attila Vegh, CEO of Penta Hospital Group, CEE's largest hospital chain, sees the problem like this: "Staffing is the major issue, there's a major lack of managerial and clinical talent. In some specialities the average age of staff is over 55.

"Between 2005 and 2015 the percentage of nurses above 50 we employed went from 5% to 35%. These figures are alarming. There's a whole generation who have left for Western countries and our hospitals have pretty much no one between 35 and 50. These people are working in Western markets and the brain drain is ongoing."

But Vegh claims there is evidence of a reversal of brain drain as people realise they don't have to go abroad to improve their lifestyle. He explained: "I enjoy working in Eastern Europe as our generation have come to believe that if they work hard here they can make a better life than their parents and grandparents had. They emotionally buy into wanting to work hard. And there is the 'mother I'm coming home' theme that sees people returning to their families.

"Yesterday I was talking about a tertiary hospital which we are looking to build in the capital of Slovakia and we think we will be able to staff every single department with people who are returning from western institution. We should be able to attract every single department head.

"The biggest problem we have is we don't get people who have passed their specialist education, in their late 30s and 40s who speak four languages and were educated in medical universities after the fall of the Berlin Wall."

Historically retaining nursing staff in CEE was less of an issue – they were not generally multi-lingual and that limited their options.

Vegh explained: "An increasing number of nurses are mobile. We've started seeing, especially on the western border of Czechia, that we don't get nurses as they are working in Germany for three to five times the salary."

One solution is to poach nurses from a neighbouring country where salaries are less generous. Vegh said: "We're trying to attract nurses from Slovakia, in Slovakia we are attracting them from the Ukraine – you look one country to the East!"

According to Eilert Hinrichs from global strategy consultants L.E.K. Consulting, the problem is not unique to CEE, but it is feeling it more. He explained: "In the private sector we should be able to retain staff better. But it's a global problem – Germa-ny, the UK, France – they all have significant staffing prob-lems, though I think it's being felt more in the East than the West."

Fady Chreih, CEO of Regina Maria, one of the two largest operators in Romania, has three tried and tested suggestions to hold onto staff. He said: "First, we've been investing in education, creating a pipeline for nurses, taking them onboard almost before they finish their higher education.

"Second, we've seen we can stop the brain drain in some specialities where we've heavily invested in medical equipment and we can show staff the same standards they might find in the UK, Italy or France.

"And third, the larger we are the more complex the patients we get for our doctors to take care of. Part of the reluctance to remain in CEE has been around getting access to patients. So more important than stopping the brain drain is stopping medical tourism. When the patients stay, so do the professionals."