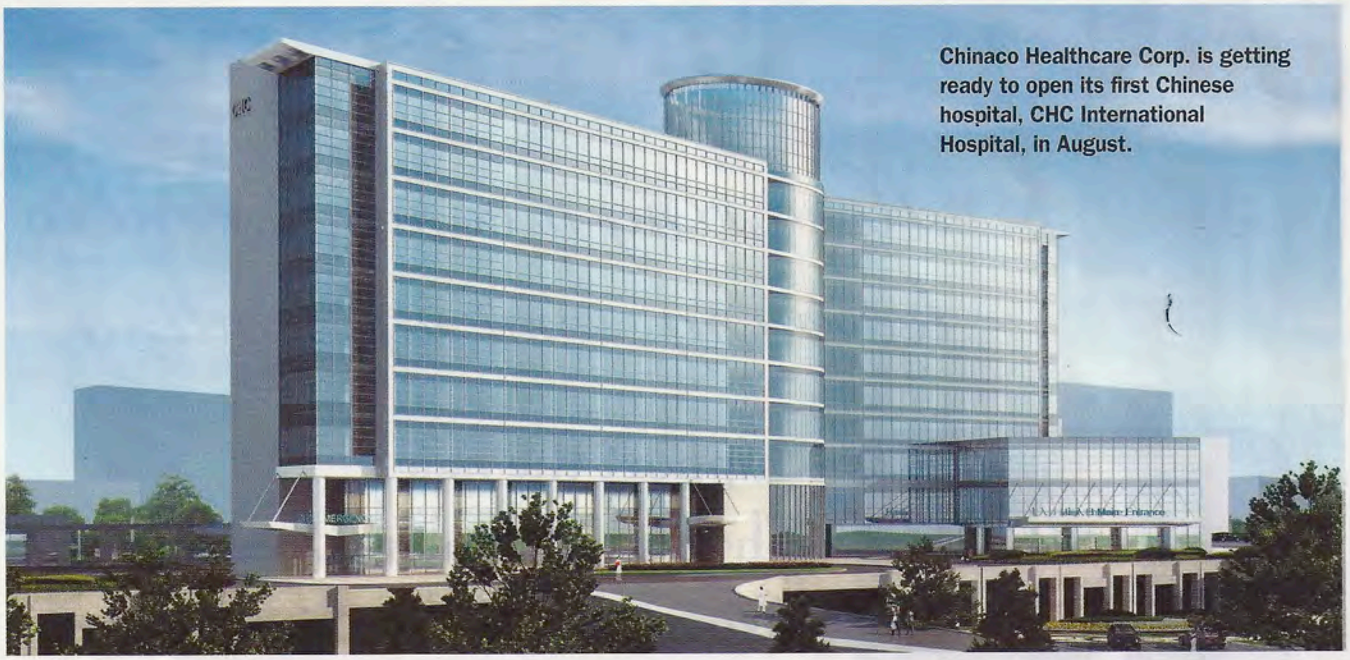
INTERNATIONAL » *Beth Kutscher*



Chinaco Healthcare Corp. is getting ready to open its first Chinese hospital, CHC International Hospital, in August.

Eastern opportunities

HCA founders look to nascent Chinese market

The team behind one of the largest and most successful hospital chains in the U.S. is getting closer to breaking into new territory 10,000 miles away in what could be a sign of things to come.

Chinaco Healthcare Corp.—the Nashville-based company started by members of the Frist family, including Dr. Thomas Frist Jr., who founded hospital giant HCA with his father, Dr. Thomas Frist Sr., in 1968—is getting ready to open the doors of its first hospital in the Chinese city of Cixi in August.

While other healthcare companies have been in China for years serving expatriate patients, CHC is leading a wave of companies looking to serve Chinese patients in a market that's increasingly open to foreign entrepreneurs.

CHC holds a 70% stake in a joint venture with the municipal government of Cixi to build and operate CHC International Hospital, a 500-bed facility that will serve as a replacement for 150-bed Second People's Hospital.

CHC's investment has topped $140 million. The hospital will serve public- and private-pay patients and offer all major specialties. Charles Elcan, president and co-founder of CHC, said the group sees a relatively clear path to admitting its first patients this year. "It's just a matter of construction," he said.

David Stewart, an architect overseeing the project at Nashville-based Gresham, Smith and Partners, described the hospital as a modern building of "nearly all glass" and some stone. Rooms can be adapted to fit one to three beds, in order to accommodate VIP as well as public-pay patients. "There's a lot of flexibility in terms of using the facilities," he said. "One of the challenges was knowing what kind of payment people will be bringing with them."

China's fast-growing economy has lured international investors for several years now, but until recently, healthcare was not at the top of the agenda. Although U.S. investors kept a close eye on the sector, they saw too much uncertainty in reimbursement and regulatory constraints. Yet a 2009 healthcare reform package—which aims to provide near-universal insurance coverage, increase spending and upgrade healthcare facilities over a number of years—has created new interest in the Chinese healthcare sector.

A 2010 report from McKinsey & Co. suggested that private healthcare providers stand to benefit from new regulations that allow doctors to practice at more than one medical center and remove reimbursement restrictions on private hospitals. As a result, the consulting firm estimated that private hospital operators could move beyond the VIP and expatriate market they currently serve.

While private hospitals represented only 6.5% of the market in 2010, the government has set a goal to privatize as many as 20% of hospital beds by 2015. In addition, the government last year removed the 70% cap on foreign ownership of healthcare facilities.

"Until 2009, the hospital industry was a nonchanging industry," said Sheldon Dorenfest, founder of the Dorenfest China Healthcare Group, an investment and consulting firm. "The only change made was in IT."

These days, however, "the growth is unlimited; the infrastructure is state-of-the-art," he said. "The opportunity is so great ... investors are saying, now is the time."

Chinaco Healthcare Corp. has at least three other projects in the pipeline, Elcan said, including plans to take a majority interest in other hospitals. He also conceded that the market appears to be getting more competitive. "There are people asking questions, poking around," he said. "We're seeing more people looking at China."

One other organization that's setting up shop in China is the University of Pittsburgh Medical Center system, which recently opened a Beijing office. Yet Charles Bogosta, president of UPMC's international and commercial services division, noted that the system is taking an "incremental approach" to entering the market.

"Our approach in China has been extremely cautious," he said, adding that reimbursement for an office visit can be as low as $2.

Still, Bogosta said, the long-term return on investment is likely to be "significant" over time. "We believe that the market will change," he said.

UPMC has three joint venture agreements in place with Chinese firms to develop cancer centers. It also provides consulting and second-opinion services.

The system, which has an educational affiliation with the University of Pittsburgh School of Medicine, also brings medical students to China for training—and UPMC hopes to help guide the country through the changes occurring in healthcare. "This is very mission-driven," Bogosta said.

Benjamin Shobert, founder of Rubicon Strategy Group, a consulting firm for companies looking at emerging markets, said that the return on investment may be as far as five or six years out.

A host of challenges face hospital operators such as how to handle underperforming employees in a country where doctors and nurses are considered public servants, as well as generating referral networks and competing with public hospitals that have VIP wings.

As a result, Shobert said, U.S. hospital chains are likely to wait at least another year or two before entering the market, though they might find other ways to participate. Opportunities exist for U.S. hospitals to run a specialty practice, such as cancer care, at an established Chinese facility. "Oncology's going to be a core growth opportunity," Shobert said.

Most of the new private hospitals will focus first on the upper middle class before trickling down to the middle class, Shobert said. "The expat market is pretty much gone," he said, as companies such as publicly traded Chindex International have saturated the market for expatriate patients.

Chindex, which operates healthcare facilities through its United Family Healthcare division, did not respond to a request for comment.

Dorenfest noted that the first U.S. ventures in China are likely to be learning experiences. He pointed to cultural differences—such as the Chinese desire to be treated by "famous doctors" who may be hard to attract from their current hospitals—as well as financial issues in a market where patients pay more out of pocket than anywhere else in the world.

Still, investors are likely to be drawn by the burgeoning opportunities, especially as the U.S. market reaches its peak.

"The opportunity for people coming—take my word for it—is not very clear," Dorenfest said. "They're giving birth in China, where in the U.S., they're grandfathers." «