Initiating Coverage

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21 May 2008

TMC Life Sciences Berhad

Price:	*RM2.03*
Market Capitalisation:	*RM375.9m*
Board:	*Mesdaq*
Sector:	*Trading/Services*
Stock Code:	*0101*
Recommendation:	*BUY*

Key Stock Statistics	FY07	FY08F	FY09F
EPS (sen)	5.0	7.0	9.5
P/E on EPS (x)	40.4	39.0	21.3
Dividend/Share (sen)	0.8	0.8	0.8
NTA/Share (RM)	0.41	0.45	0.49
Book Value/Share (RM)	0.41	0.45	0.49
Issued Capital (m shares)	185.2	185.2	185.2
52-weeks Share Price Range (RM)			1.00-2.03

Major Shareholders:	%
Dr Colin Lee Soon Soo	24.00
Berjaya Group	20.60
Skim Amanah Saham Bumiputera	5.20

Per Share Data	FY06	FY07	FY08F	FY09F
Year-end 31 Dec				
Book Value (RM)	0.29	0.41	0.45	0.49
Cash Flow (sen)	(3.2)	7.7	9.5	12.8
Earnings (sen)	5.3	5.0	7.0	9.5
Dividend (sen)	1.0	0.8	0.8	0.8
Payout Ratio (%)	13.8	10.9	7.8	5.7
PER (x)	38.2	40.4	39.0	21.3
P/Cash Flow (x)	(37.6)	14.3	11.5	8.6
P/Book Value (x)	7.0	5.0	4.5	4.1
Dividend Yield (%)	0.2	0.2	0.4	0.4
ROE (%)	18.2	12.4	15.6	19.3
Net Gearing (%)	n.c.	n.c.	10.3	21.0

P&L Analysis (RMm)	FY06	FY07	FY08F	FY09F
Year-end 31 Dec				
Revenue	25.1	31.4	56.6	92.3
Operating Profit	12.6	13.2	18.9	26.7
Depreciation	1.1	1.8	3.8	3.8
Net Interest	0.5	0.3	(0.3)	(0.6)
Pre-tax profit	12.6	13.2	18.9	26.7
Effective Tax Rate (%)	29.1	29.9	29.9	29.9
Net Profit	8.9	9.3	13.0	17.6
Operating Margin (%)	50.1	41.9	33.4	29.0
Pre-tax margin (%)	50.1	41.9	33.4	29.0
Net margin (%)	35.6	29.6	22.9	19.1

1. Investment Highlights/Summary:

- TMC Life Sciences (TMC) was established in 1994 and is one of Malaysia's leading fertility treatment companies, producing more than one-third of all test-tube babies in Malaysia.
- The group is moving into a high growth period with initial contributions from new businesses in hospital management and services, stem cell storage, and the provision of wellness programmes from 2008.
- In terms of competition, TMC competes with fertility centres locally (in the public and private sectors), regionally (eg. Singapore) and overseas (eg. UK and USA). The differentiating factor for TMC versus most of its competitors is its high average success rate, which is comparable to top fertility centres around the world.
- Revenue and earnings are expected to register strong growth rates over 2008 and 2009, reflecting initial contributions from new businesses as well as continued growth at its core fertility operations, underpinned by increasing awareness of advanced fertility treatments.
- TMC's shares are currently trading at their 12-month high of RM2.03/share, with PE ratios of 39.0x to Dec 2008 and 21.3x to Dec 2009 based on our forecasts. We believe share price performance should continue to be well supported by positive news flow with the opening of the new hospital, and possibly further share accumulation by major shareholder, Berjaya Group.
- Accounting for the group's high projected earnings growth over 2008-2009, we value TMC based on a price-earnings-to-growth ratio (PEGR) basis. We initiate coverage on TMC with a **BUY** recommendation and price target of RM2.30/share, based on the market average PEGR of 1.18x.

2. Background:

- ***Corporate Profile***

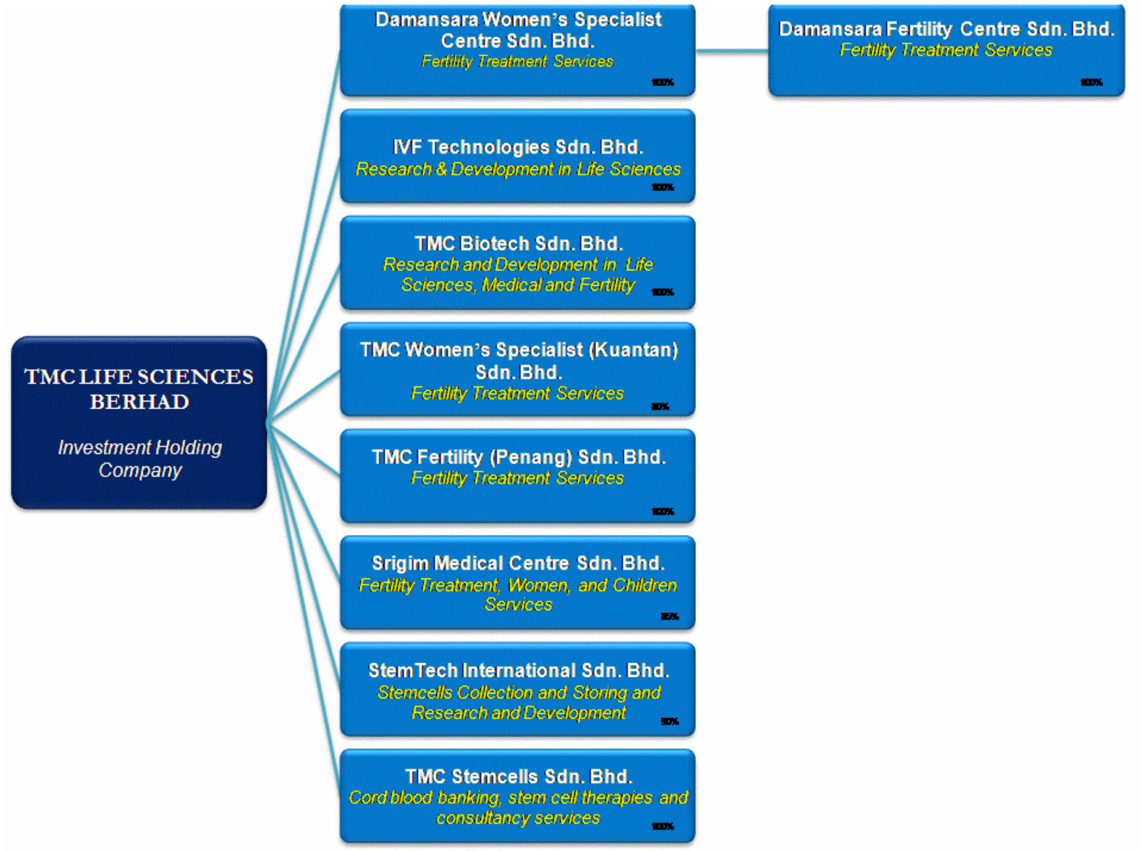
TMC Life Sciences Berhad (TMC) is the investment holding company of Damansara Women's Specialist Centre Sdn Bhd and Damansara Fertility Centre Sdn Bhd, also known as TMC Fertility Centre.

Established in 1994, the group provides fertility treatment and general obstetrics and gynaecology (O&G) services to local and foreign patients. The group is one of few centres in Malaysia and the region providing a comprehensive range of fertility services.

According to a speech made by YB Dato' Dr Chua Soi Lek, former Minister of Health of Malaysia in February 2006, Malaysia has to date, approximately 3 public and about 30 private centres offering test-tube baby services in one way or another.

TMC was listed on Mesdaq on 6 Oct 2005.

- ***Corporate Structure***



Source: TMC Life

- ***Business***

TMC believes it is a market leader in Assisted Reproductive Technologies (ART), accounting for about one-third of all test-tube babies produced in Malaysia.

Its pregnancy success rates are comparable to top In-Vitro Fertilisation (IVF) centres in the UK and USA. Early successes include Malaysia & Singapore's first reported IVF surrogate baby in 1995 and Malaysia's first frozen embryo baby in 1996.

The group currently has 6 fertility treatment centres:

1. Damansara Utama, Selangor
2. Kepong, Kuala Lumpur
3. Johor Bahru, Johor
4. Sibu, Sarawak,
5. Kuantan, Pahang, and
6. Penang.

On 17 Mar 2008, TMC had proposed to acquire the entire equity interest in Srigim Medical Centre, which operates a private specialist hospital in Penang for a total of RM13.4m including the acquisition of land.

The acquisition of Srigim, has added a sixth fertility treatment centre to TMC's network of branches, and will facilitate the group's expansion in the northern region and attract more foreign patients. Srigim's patient base includes those from Perlis, Kedah and Perak as well as Indonesia, particularly Medan, Pantai Acheh in Sumatra, and Jakarta.

Foreign patients accounted for 20% of group revenue in 2007, up from 16.1% in 2006, with these patients coming mainly from Indonesia, Japan, Singapore, Australia, the UK and India. Foreign patients' spending per visit was around double the amount spent by local patients in 2006 and 2007.

Year	Revenue Contribution from Foreign Patients
2002	<1%
2003	2%
2004	5%
2005	10.6%
2006	16.1%
2007	20%

Source: TMC Life

Revenue per visit (RM)	FY07	FY06
Foreign	~ 1,930	~ 1,700
Local	~ 905	~ 900

Source: TMC Life

The group plans to develop regional markets through health tourism activities and the formation of strategic alliances with medical or commercial partners. Targeted overseas markets include Indonesia, Singapore, Philippines, Japan, and China. TMC's Johor branch is positioned to cater to the Johor market as well as patients from Singapore and Indonesia, while the Sibu centre aims to serve Sarawak, Sabah and countries surrounding East Malaysia.

Products and services offered by TMC include:

- ART:
  - IVF
  - Gamete Intra-Fallopian Transfer (GIFT)
  - Intra-Cytoplasmic Sperm Injection (ICSI)
  - Blastocyst transfer
  - Sperm and embryo banking
  - Cryopreservation and frozen embryo transfer (FET)
  - Micro-Epididymal Sperm Aspiration (MESA) / Percutaneous Epididymal Sperm Aspiration (PESA) / Testicular Epididymal Sperm Aspiration (TESA)
- Advanced laparoscopic surgery:
  - Keyhole surgery
  - Minimally invasive surgery

- Pre-implantation Genetic Diagnosis (PGD)

Demand for TMC's products and services are supported by factors such as:

- Social trends including late marriages and women's increasing focus on careers versus having children earlier;
- Increasing affordability for specialised fertility treatments due to rising incomes; and
- Increasing awareness of advanced fertility treatments.

TMC's differentiating factors, relative to some of the other IVF centres in the region and overseas include:

- High average success rates, supported by:
  - R&D efforts focused on ART
  - Specialist doctors and embryologists dedicated to fertility treatment
  - Advanced and comprehensive facilities
- Providing training for clinician, embryologists and nurses.

TMC's average success rate of 41% compares well with some of the top IVF centres in Singapore and the UK.

Institution	Average Success Rate
SINGAPORE CENTRES	
Gleneagles Hospital	28%
KK Women's & Children Hospital	25%
Mount Elizabeth Hospital	25%
National University Hospital	26%
Thomson Medical Centre	19%
Singapore General Hospital	16%
Source: MOH, Singapore, Information Paper: 2004/05, IN-VITRO FERTILISATION (IVF) IN SINGAPORE: CHARGES AND SUCCESS RATES	
DAMANSARA FERTILITY CENTRE (2003)	41.0%
Source: As published in 61st Annual Meeting of the American Society for Reproductive Medicine, and 51st Annual Meeting of the Canadian Fertility and Andrology Society, Montreal, Canada, October 2005	

Source: TMC Life

Rank*	TOP UK IVF CENTRES (Latest Results)	Live Birth Rate**
1	Assisted Reproduction & Gynaecology Centre	50.7%
	TMC FERTILITY CENTRE year 2006	41.3%***
2	UCH London, ACU, University College Hospital	38.8%
3	Essex Fertility Centre	31.9%
4	NURTURE	31.0%
5	The Woking Nuffield Hospital	30.6%
6	St James Hospital, Leeds	27.1%
7	Centre of Reproductive Medicine Sheffield Fertility Centre	26.1%
8	Guy's & St. Thomas Hospital	26.0%
9	Centre for Reproductive Medicine, University Bristol	25.3%
10	Clarendon Wing, Leeds	21.8%

* Ranking based on success rate reported to HFEA
** Source: http://guide.hfea.gov.uk
*** Included in presentation/submission to 14th World Congress on In Vitro Fertilization and 3rd World Congress on In Vitro Maturation, Montreal, Canada in Sept 2007

Source: TMC Life

To achieve even higher pregnancy rates and remain the industry leader, TMC plans to continue investing in research and development (R&D) activities with the formation of an R&D International Advisory Panel to advise the group on its R&D plans and projects. TMC typically allocates about 10% of its annual revenue for R&D purposes. An International Advisory Panel (IAP) has also been commissioned to provide advice on R&D plans and projects.

TMC’s medical milestones include:

- 1995 Produced South East Asia's first reported IVF surrogate baby
- 1996 Produced Malaysia's first frozen embryo transfer baby
- 1997 Produced Malaysia's first conception twins (born 1.5 years apart)
- 1999 Produced the first donated frozen embryo pregnancy in Malaysia
- 2001 Obtained higher IVF pregnancy rates compared to all 67 IVF centres in the UK (2001)
- 2002 Produced Malaysia's first blastocyst transfer IVF baby
- 2003 Produced Malaysia's first freeze-thaw blastocyst transfer pregnancy
- 2004 Produced Malaysia's first pregnancy following PGD
- 2005 Produced Malaysia's first PGD twins
- 2005 TMC's embryo transfer technique, protocol and communication system was accepted for publication and presentation at the Conjoint Annual Meeting of the American Society for Reproductive Medicine (ASRM) and Canadian Fertility Andrology Society in Montreal, Canada.
- 2006 TMC's mathematical model for individualised treatment of polycystic ovarian syndrome, rate of improvement on air quality affected by usage of laminar flow in an IVF laboratory, and aneuploidy rate in patients of different age groups undergoing IVF-PGD presented at the Inaugural Congress of Asia Pacific Initiative of Reproductive Endocrinology in Changsha, China.
- 2004-2006 Achieved Pre-Implantation Genetic Diagnosis (PGD) first-attempt successes. Produced Malaysia and Singapore's:
    - 1st Day-3 PGD
    - 1st Day-5 PGD
    - 1st Day-6 PGD
    - 1st Sequential PGD
    - 1st 7-probe PGD

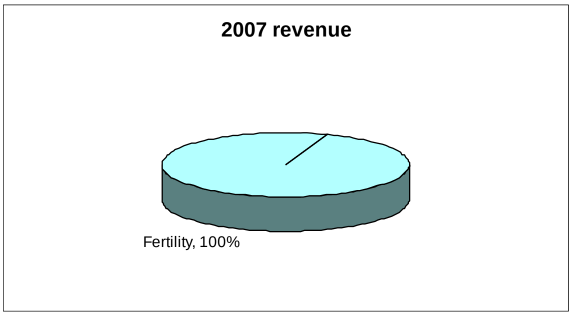
In terms of revenue and earnings breakdown, TMC is transforming itself from a group largely focused on fertility treatments to include other services such as hospital management and services, stem cell storage, and the provision of wellness programmes from 2008.

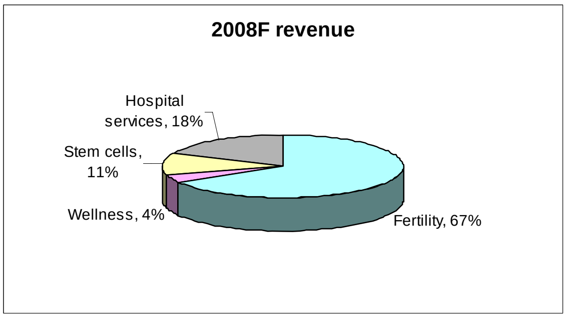
As at 31 Dec 2007, the group derived about 80% of its revenue from fertility treatment services, while the balance was revenue from other medical services. In the five years from 2002-2007, TMC’s revenues recorded a compounded annual growth rate (CAGR) of 28.4% whilst net profits recorded a CAGR of 38.1%.

From 2008, TMC is expected to derive revenue from four income streams instead of just one previously:

1) TMC Fertility Centres: To meet demand from the local and foreign markets, underpinned by the group’s consistently-high pregnancy rates comparable to world-standards.
2) Tropicana Medical Centre: Due to commence operations later this year, Tropicana Medical Centre will be the group’s flagship tertiary hospital, focused on providing not only fertility, women and children’s healthcare services, but also other medical specialist disciplines.
3) Tropicana Wellness programme: As a complementary service to Tropicana Medical Centre, the subscription-based Tropicana Wellness programme provides an incentive to the public to be proactive about managing their health, enabling the group to embark on wellness tourism.
4) StemTech International: Fully licensed by the Ministry of Health Malaysia, the subsidiary is a stem cell services provider positioned to capture in-house demand from the group’s fertility centres as well as from Tropicana Medical Centre, in addition to demand from the general public.

Segmental revenue breakdown





Source: TMC Life, NRA forecasts

3. <u>Earnings Outlook:</u>

The group recently released its 4Q07 results to 31 Dec 2007:

- 4Q07 revenue of RM8.6m grew by 29.7% yoy whilst net profit of RM1.6m declined by 31.6% yoy. Margins were compressed due to:
  - o Higher marketing and related expenses for the prepaid subscription-based healthcare wellness program, where related revenue is deferred as the Tropicana Medical Centre had not commenced operations;
  - o Additional staff costs in preparation for the opening of the group's flagship tertiary hospital, Tropicana Medical Centre later this year; and
  - o Start up costs at two of the group's recently incorporated subsidiaries, namely TMC Women's Specialist (Kuantan) Sdn Bhd and Stemtech International Sdn Bhd.
- For the full year to 31 Dec 2007, TMC achieved total revenue of RM31.4m and net profit of RM9.3m, registering yoy increases of 25.0% and 4.3% respectively. Operating margins for 2007 stood at 45.5%, 7.1%-points lower than the previous financial year.

Earnings outlook and growth prospects:

- Based on our estimates, 2008 revenue and net profits are expected to post 80% and 39% year-on-year growth respectively, with first-time contributions from new businesses in hospital services, stem cells storage and wellness programmes. The relatively smaller projected growth rate in earnings relative to revenue is due to lower expected margins at the three new businesses relative to the more lucrative fertility treatment operations.
- The outlook for fertility-related services in South East Asia remains bright as social trends such as an increasingly career-focused outlook and delayed marriages increase the inherent biological factors that cause infertility.
- Medical tourism is also increasing in the region due to rising healthcare costs and long waiting periods in developed countries. Beneficiaries of this trend include hospitals in Singapore (Parkway Holdings, Raffles Medical) and Thailand (Bumurungrad Hospital). Locally, players such as KPJ Healthcare Bhd, Pantai Holdings Bhd and Gleneagles have also taken efforts to attract foreign patients due to the higher average spend per patient on account of their more comprehensive treatment courses.
- Medical tourism has been growing by 20-30% per annum, far exceeding the 4-6% growth in general travel bookings recorded in 2006. Abacus International estimates that the medical tourism industry was worth approximately US$500m in 2006 and is projected to be worth at least US$4.4bn by 2012.
- In addition to the positive industry outlook, TMC group's growth prospects should also be supported by the addition of three new business operations:
  - o The expected opening of Tropicana Medical Centre by 2Q08 or 3Q08.
  - o The new stem cell processing and banking, clinical applications and related R&D business commenced operations in late 2007. Progress to date has been encouraging and the group's management is confident of its prospects.
  - o TMC has also entered into a contract with Tropicana Wellness Sdn Bhd (formerly known as GE Wellness Sdn Bhd) to promote subscription-based healthcare programs. TMC is

confident that the tie-up with Tropicana Wellness would lead to greater awareness of TMC's services and in turn result in a positive impact on the group's profitability.

4. Valuation:

We believe TMC is not directly comparable to regional healthcare companies at this stage as TMC is only just beginning to enter the tertiary hospital and general healthcare businesses, from being largely a fertility treatment specialist.

At current levels, TMC is trading at 39.0x to Dec 2008 and 21.3x to Dec 2009 based on our forecasts, relative the average PE multiples of around 18x to FY08 and 15x to FY09 for several ASEAN healthcare companies including Parkway, Raffles, Bangkok Chain and Thomson.

As a result of the low earnings base, our estimates for TMC's prospective EPS growth rates of 39.2% for 2008 and 36.1% for 2009 are very much ahead of the average EPS growth rates for the ASEAN healthcare companies of 16.6% and 19.4% respectively.

We have valued TMC based on a price-earnings-to-growth ratio (PEGR) basis, taking into account the group's strong earnings growth potential going forward. Based on our forecasts, TMC's 2007-2009F EPS compound annual growth rate (CAGR) is 37.7%, which is more than three times the market average 2007-2009F EPS CAGR of 11.8%.

Using TMC's current 2008F PER of 39.0x, we arrive at a PEGR of 1.04x for the stock, which is at a 12.4% discount to the market's PEGR of 1.18x. Assuming a target PEGR of 1.18x, we arrive at our price target for TMC of RM2.30/share, which suggests an upside of 14% from current levels.

5. Recent Developments:

Recent developments include:

- 29 Feb 2008: The release of 4Q07 results as detailed above;
- 24 Mar 2008: The acquisition of an 85% equity stake in Srigim Medical Center in Penang for a total of RM13.4m to be financed by internal funds and borrowings. The acquisition is to facilitate TMC Life's expansion to the northern region and to attract foreign patients entering via Penang;
- 5 May 2008:
    - Proposed increase in authorised share capital from RM25m comprising 250m shares of RM0.10 each, to RM100m comprising 1bn shares of RM0.10 each;
    - Proposed renounceable rights issue of 185.2m new shares of RM0.10 each on basis of 1 rights share for every 1 existing TMC Life share held at an indicative issue price of RM0.20 per rights share;
    - Proposed bonus issue of 231.4m new share of RM0.10 each on basis of 5 bonus share for every 4 rights share subscribed;
    - Proposed transfer of listing from Mesdaq to Main Board of Bursa after the proposed rights issue and bonus issue.

6. Investment Risk:

Investment risks include:

- Rising competition both locally and around the region, with new as well as established tertiary healthcare providers competing for the same medical tourism dollar;
- Margins and pricing pressure due to the competitive operating environment;
- Rising marketing and staff costs;
- Volatile stock market conditions, which may affect potential customers' affordability or purchasing power.

7. Balance Sheet:

TMC ended 2007 with an estimated net cash position of RM8.4m. Based on our estimates the group is expected to go into a net debt position in 2008, due to outflows for new acquisitions such as Penang's Srigim, as well as higher working capital requirements. Net gearing is however expected to remain low at an estimated 10.3% by the end of 2008.

We expect the group to maintain its dividend payout as well as fund further R&D activities.

Balance Sheet (RMm)	FY05	FY06	FY07	FY08F
Year-end 31 Dec				
Total Assets	27.0	40.3	70.1	95.1
Fixed Assets	27.9	46.4	76.8	76.8
Current Assets	2.0	2.4	2.1	4.5
Long Term Assets	27.9	46.4	76.8	76.8
Current Liabilities	2.8	8.5	8.8	19.1
Long Term Liabilities	3.3	3.2	6.5	14.0
Share Capital	16.8	16.8	18.5	18.5
Shareholders Funds	41.0	49.0	75.3	83.3

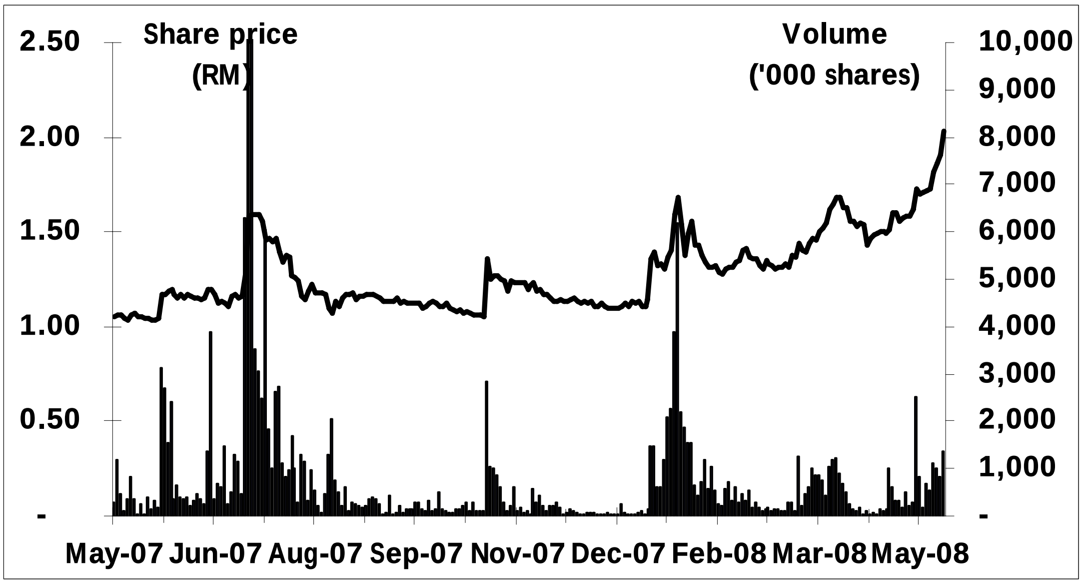
Source: Annual reports, NRA estimates

8. Recommendation

TMC's shares are currently trading at their 12-month high of RM2.03/share, with PE ratios of 39.0x to Dec 2008 and 21.3x to Dec 2009 based on our forecasts.

We believe share price performance should continue to be well supported by positive news flow with the opening of the new hospital, and possibly further share accumulation by major shareholder, Berjaya Group.

Accounting for the group's high projected earnings growth over 2008-2009 with an estimated EPS CAGR of 37.7%, we value TMC based on a price-earnings-to-growth ratio (PEGR) basis. We initiate coverage on TMC with a **BUY** recommendation and price target of RM2.30/share, based on the market average PEGR of 1.18x.



Source: The Star