STANDARD & POOR'S

TMC Life Sciences

Recommendation: **HOLD**

Stock Code: 0101 | Bloomberg: TMCL MK | Price: MYR1.55 | 12-Month Target Price: MYR1.60 | Date: March 31, 2008

Board: Mesdaq

Sector: Trading/Services

GICS: Health Care/Health Care Services

Market Value - Total: MYR287.0 mln

Summary: TMC Life Sciences (TMCL) is a leader in the provision of fertility treatment services in Malaysia and the Asian region. Its delivery rate per embryo transfer is among the highest in the world. As a growth strategy, it is also building its own hospital as well as venturing into stem cell-related business and wellness programs.

Analyst: Alexander Chia, ACA

Highlights

- TMCL has positioned itself as the leading fertility treatment center in Malaysia and in the region through its proven track record of successful baby delivery rate, which is comparable to the best centers in the world.
- As part of its growth strategy, TMCL has ventured into full-fledged hospital services, stem cell harvesting and storage business as well as wellness programs. The expansion is synergistic to its existing core business and bodes well for the future of the group going forward.
- We project 2008 revenue and earnings at MYR49.8 mln (+58% YoY) and MYR8.8 mln (-5% YoY) respectively. Although new revenue streams will push revenue higher, we expect its bottom-line to be subdued in the near term due to the gestation and consolidation of their new businesses.
- 2009 will be a breakthrough year for TMCL with revenue and net profit expected to surge to MYR88.9 mln (+79%) and MYR14.6 mln (+66% YoY), arising from full-year contribution from its hospital services and normalization of operations from the new ventures.

Investment Risks

- Risks to our recommendation and target price include slowdown in the economy, which may hurt spending power, delay in the opening of Tropicana Medical Centre (TMC) and potential perception of political instability by foreigners which may affect medical tourism.

Recommendation

- We initiate our coverage by recommending Hold on TMCL recommendation and a 12-month target price of MYR1.60, which includes a projected dividend of 0.75 sen.
- We derive our target price by pegging its 8 sen 2009 EPS against the lower end of its historical PER multiple of 20x, which ranges from 20x to 33x. The premium is accorded for its high profitability and high growth potential. Our lower end target PER reflects the prevailing weak market environment that may be reluctant to accord significant valuation premiums to high beta stocks.
- We like TMCL's leading position in the fertility treatments services, proven treatment track record, high profitability, hands-on management and clear growth strategy. Its new ventures appear synergistic and complementary to its existing core business and augurs well for the group going forward.
- However, price upside in the near term may be muted as 2008 is a consolidation year and earnings potential will only kick in 2009 assuming all expansion plans are on track.
- After the gestation period, TMCL will emerge as a much more prominent group offering comprehensive healthcare services, specialising in fertility issues as well as women and children's health.
- In a statement in its 2007 annual report, TMCL recognized its Corporate Social Responsibilities, emphasizing community issues especially those involving childless couples, children and education.

Key Stock Statistics

FY Dec.	2007	2008E
Reported EPS (sen)	5.0	4.7
PER (x)	30.8	32.8
Dividend/Share (sen)	0.8	0.8
NTA/Share (MYR)	0.35	0.45
Book Value/Share (MYR)	0.41	0.45
No. of Outstanding Shares (mln)	185.2	
52-week Share Price Range (MYR)	0.99 - 1.68	
Major Shareholders:	%	
Dr. Colin Lee	24.0	
Berjaya Group	17.9	
Skim Amanah Saham Bumiputera	5.2	

Per Share Data

FY Dec.	2005	2006	2007	2008E
Book Value (MYR)	NA	0.29	0.41	0.45
Cash Flow (sen)	5.0	6.0	5.8	6.7
Reported Earnings (sen)	4.6	5.3	5.0	4.7
Dividend (sen)	1.0	1.0	0.8	0.8
Payout Ratio (%)	15.5	13.8	14.9	15.9
PER (x)	33.4	29.2	30.8	32.8
P/Cash Flow (x)	31.3	26.0	26.7	23.1
P/Book Value (x)	NA	5.3	3.8	3.5
Dividend Yield (%)	0.6	0.6	0.5	0.5
ROE (%)	NA	21.1	15.0	11.1
Net Gearing (%)	NA	0.0	0.0	3.1

Note: FY05 numbers are on proforma basis

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Background

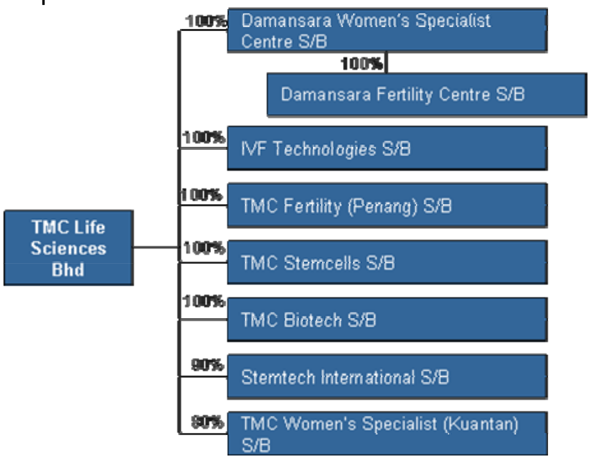
Corporate Profile

TMC Life Sciences Bhd (TMCL) was incorporated in 2003 and was listed on Bursa Malaysia's MESDAQ market in October 2005. The group is primarily involved in the provision of comprehensive fertility treatment services.

Founder and Managing Director, Dr. Colin Lee, began the business in 1994 with the set-up of Damansara Women's Clinic / Damansara Fertility Centre. A series of restructuring exercises that took place thereafter led to the present structure. Dr. Colin Lee is the largest shareholder in TMCL with a 24.0%-stake, followed by Berjaya Group (17.9%) and Skim Amanah Saham Bumiputera (5.2%).

Out of the 9-person board of directors (excluding the alternate director), four are independent directors, which meets the Bursa Malaysia's listing requirements of having one-third or minimum two independent directors. The board is led by Professor Emeritus Dato' Dr. Khalid Bin Abdul Kadir, who is an independent non-executive chairman.

Corporate Structure



Source: Company data

Business

TMCL provides comprehensive fertility treatment services such as investigation of infertility, provision of medical advice and medical procedures to assist conception. The group also provides a range of obstetrics and gynaecology services. The available medical procedures at TMCL are as follows:-

- Intra-Uterine Insemination (IUI)
- Assisted Reproductive Technology (ART)
  - In-Vitro Fertilization (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
- Pre-Implantation Genetic Diagnosis (PGD)

TMCL takes great pride in the success of its clinical-assisted pregnancy rates, which are tabled below:-

Per Embryo Transfer	2006
Clinical Pregnancy Rate	55.3%
Ongoing Pregnancy / Delivery Rate	46.1%
Babies Born / Expected to be born	75.2%
Implantation Rate	35.4%

Management believes TMCL's achievement is on par, if not better than, most of the top fertility centers in the UK, USA and Singapore. The success rates of the fertility centers range between 20% and 40% in the UK and USA, while in Singapore, it is between 15% and 30%. This is in contrast to the over 40% delivery rate at TMCL.

Management credits its achievements to its R&D focus and initiatives. Since inception, the R&D team has pioneered some of the advances in fertility services in Malaysia. Its subsidiary which focuses on human life sciences research and improvement of fertility treatment procedures, TMC Biotech, has recently been granted the BioNexus status. Among the incentives under the BioNexus status include either 100% income tax-exemption for 10 years commencing from the first year of profitability, or Investment Tax Allowance of 100% on the qualifying capital expenditure incurred within five years.

TMCL estimates it has over 20% of market share amongs~~t~~ local fertility centers and accounts for a third of all test tube babies produced in Malaysia. Other major milestones achieved include producing South East Asia's first reported IVF surrogate baby, Malaysia's first frozen embryo transfer baby, first conception twins, and first PGD twins.

The group currently has medical teams comprising seven doctors and 11 embryologists, which is believed to the largest number of embryologists under one roof in South East Asia. In 2007, TMCL performed 827 ART cycles (+27% YoY) and 139 PGD procedures (+60% YoY).

TMCL's main fertility center, known as the TMC Fertility Centre (formerly Damansara Fertility Centre), is in Petaling Jaya, Selangor while its other four branches are in Kepong, Johor Bahru, Sibu and Kuantan. It recently marked its presence in Penang, proposing the acquisition of an 85% stake in Srigim Medical Centre (Srigim) for MYR4.2 mln. The acquisition comes with a profit guarantee of MYR0.7 mln for one year starting from completion of acquisition. Srigim is currently a women's and children's hospital. TMCL plans to expand its services to include fertility treatments to serve local as well as foreign clientele from neighboring countries.

Foreign customers, mainly from Indonesia, Japan, Singapore, Australia, UK and India, contributed 20% to the group's revenue in 2007, up from 16% in 2006. TMCL also marketed its services in Vietnam, Philippines, and Brunei, and expects the revenue contribution from foreign customers to continue its uptrend.

As part of the strategic long term growth plan, management has been expanding its businesses into related fields over the last two years. It is building its own medical center, Tropicana Medical Centre (TMC), in Kota Damansara, Selangor. The construction of the women and children specialist center is now 90% completed and is slated to commence business in 3Q08. The total investment is approximately MYR95 mln, financed via a combination of internal funds and borrowings. The 8-storey building with 220,000 sq ft built-up area will house 179 beds and 52 specialist clinics. This is a strategic move for the group to capture the downstream income of fertility treatment services.

We do not foresee any issues in attracting specialist doctors to join the medical center as we understand management has received interest from over 100 doctors vying for the 52 vacancies. TMC will generate revenue from, among others, small profit-sharing from doctors' revenue, clinic rental, hospital bed charges and sale of drugs.

Poised to be a new prominent medical center in town, TMC is modeled after a medical-tourism hospital with facilities and amenities matching that of a 5-star hotel. This is also part of the group's strategy to attract more foreign customers with higher spending power

In order to maximize the utilization of TMC, the group has also introduced subscription-based healthcare and wellness programs to capture a bigger customer base. The group has appointed a marketing agent who undertakes to achieve MYR42 mln sales over the next five years.

In 2007, the group further ventured into the cord blood and adult stem cell harvesting, processing and storage business through the setting up of Stemtech International (Stemtech). Stemtech is one of four companies in this field locally.

Earnings Outlook

Between 2004 and 2007, TMCL's revenue from fertility treatment services doubled to MYR31.4 mln from MYR16.6 mln, while net profit grew at a 3-year CAGR of 16% to MYR9.3 mln from MYR6.0 mln.

The group has consistently been generating EBITDA margin in excess of 50% between 2004 and 2006. In 2007, EBITDA margin declined to 45% mainly due to set-up costs incurred at Stemtech and the new Kuantan branch, marketing expenses recognized for the wellness programs, as well as increase in headcount in preparation for TMC.

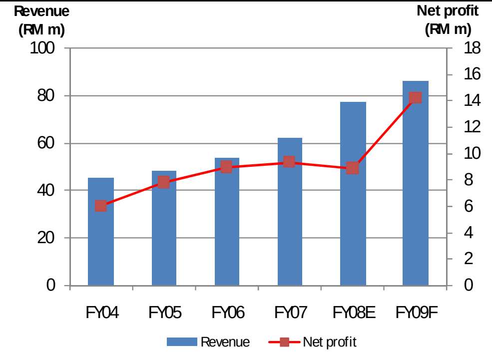
From 2008 onwards, the group will have four revenue streams instead of just one – fertility treatment services, hospital services, wellness programs, and stem cell services. As such, we project 2008 revenue to surge to MYR49.8 mln (+58.4% YoY), based on a 15% growth in its existing fertility treatment business, 4-month contributions from TMC, six-month contributions from Srigim, as well as small contribution from Stemtech and the wellness programs. Nonetheless, our net profit estimate is lower at MYR8.8 mln (-5% YoY) due to expected higher fixed overheads and operating costs as well as financing expenses incurred before the businesses reach critical mass volume.

We expect 2009 performance to improve considerably post the gestation period. Our revenue and net profit estimates stand at MYR88.9 mln (+79% YoY) and MYR14.6 mln (+66% YoY) respectively, driven by continued growth from fertility treatment services, full-year contributions from TMC and Sigim, and higher contributions from Stemtech and the wellness programs. Going forward, we estimate EBITDA margin to stabilize at the 30%-level.

With the acquisition of Srigim and investment in TMC, we believe the group will incur borrowings for partial funding. We estimate gearing to rise to 0.4x in 2009 which is still a comfortable level.

Overall, 2008 will be a consolidation year for the group after its various expansion exercises. Its growth strategy is in synch with the existing core business with all the new ventures being synergistic and complementary in nature. This certainly augurs well for TMCL going forward once the operations stabilize from 2009.

EPMB historical & projected future financial performance



Source: Company data, S&P Equity Research

Valuation

As there are no direct listed peers in fertility treatment services, we have selected several healthcare operators in the region as comparison.

Comparative Valuations

	TMC Life Sciences	Parkway Holdings	Raffles Medical	Thomson Medical
Bloomberg Code	TMCL MK	PWAY SP	RFMD SP	THOM SP
Share Price @ Mar. 27, 2008	1.55	3.57	1.26	0.62
Currency	MYR	SGD	SGD	SGD
Mkt. Cap (mln)	287.0	2753.3	649.9	181.0
Ave. Daily Vol. ('000)	788	1858	426	224
PER FY08 (x)	32.4	25.9	21.4	15.9
PER FY09 (x)	20.2	23.0	17.0	14.1
P/B	3.8	4.7	3.2	2.0
Yield (%)	0.5	2.0	0.7	2.0
FYE	Dec	Dec	Dec	Aug

Source: Bloomberg, Company data

We have excluded KPJ Healthcare Bhd (KPJ MK, MYR3.16, Buy) from the comparison due to its relatively low profitability level as compared to TMC, while Stemlife Bhd (STEM MK, MYR2.18, Not Ranked) is trading at a rich PER of 65x.

Based on the data above, it appears that TMCL is currently trading at a premium compared to the healthcare operators in Singapore. Historically, TMCL has been trading at a high PER multiple, ranging from 20x to 33x. The premium accorded is largely for its high profitability and high growth potential. Discounting 2008, being the consolidation year, the group's outlook and potential remain bright beyond 2008, which justifies the higher than average PER multiples.

We have decided use 2009 EPS instead of 2008 as it is more reflective of the growth potential of the group. Pegging TMCL's 2009 EPS of 8 sen against a target PER of 20x yields a 12-month target price of MYR1.60 after including our projected dividend of 0.75 sen. The 20x target PER is derived from the lower end of its historical PER range.

While we are positive on TMCL's high growth potential, our conservative approach is premised upon the prevailing weak market environment that may be reluctant to accord significant valuation premiums to high beta stocks.

TMC Life Sciences

Recommendation: **HOLD**

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Recent Developments

17 Mar. 2008: TMCL proposed acquisition of 85%-interest in Srigim Medical Centre Sdn. Bhd. for MYR4.2 mln in cash, with the option to acquire the remaining 15% at MYR1.9 mln in three years from the date of agreement. The acquisition comes with a profit guarantee of MYR0.7 mln for the first year of operation under TMCL. The group also announced proposed acquisition of land and building where Srigim Medical Centre currently sits on for a cash consideration of MYR7.3 mln.

13 Feb. 2008: Received exemption from the Ministry of International Trade and Industry from having to meet the 30% Bumiputera equity requirement

Profit & Loss

FY Dec. / MYR mln	2006	2007	2008E	2009E
Reported Revenue	24.9	31.4	49.8	88.9
Reported Operating Profit	12.6	12.9	12.0	21.3
Depreciation & Amortization	-1.1	-1.4	-3.7	-9.7
Net Interest Income / (Expense)	0.0	0.0	-0.7	-2.4
Reported Pre-tax Profit	12.6	13.2	11.5	19.2
Effective Tax Rate (%)	29.1	29.9	24.0	24.0
Reported Net Profit	8.9	9.3	8.8	14.6
Reported Operating Margin (%)	50.6	41.0	24.1	23.9
Reported Pre-tax Margin (%)	50.6	41.9	23.2	21.5
Reported Net Margin (%)	35.9	29.6	17.6	16.4

Source: Company data, S&P Equity Research

Balance Sheet

FY Dec. / MYR mln	2006	2007
Total Assets	60.7	90.6
Fixed Assets	20.1	46.7
Current Assets	14.3	13.8
Other LT Assets	6.9	10.9
Current Liabilities	8.5	8.8
LT Liabilities	52.2	81.8
Share Capital	16.8	18.5
Shareholders' Funds	49.0	75.4

Source: Company data

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Glossary

Strong Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.
Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months, with shares rising in price on an absolute basis.
Hold: Total return is expected to closely approximate the total return of the KLCI or KL Emas Index respectively, over the coming 12 months with shares generally rising in price on an absolute basis.
Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months and share price is not anticipated to show a gain.
Strong Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months by a wide margin, with shares falling in price on an absolute basis.

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Recommendation and Target Price History

Date	Recommendation	Target Price
New	Hold	1.60