

## Stemlife Bhd

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### Subscribe

KLCI	967.56
IPO Price	RM0.33
Fair Value	RM0.81
Tentative listing date	17 Oct
Upside To Target	+145.5%

#### Stock Codes

BMSB	NA .
Bloomberg	NA .

#### Stock and Market Data

Listing	MESDAQ
Syariah Compliance	YES
Share capital	165.0m
Market Cap @ RM0.33	RM54.5m
Market Cap @ RM0.81	RM133.6m

#### Fundamentals – FY06E

ROA	11.7%
ROE	12.2%
NTA (RM)	0.19
Price/NTA (x)	1.7x
Yield (%)	0%
Debt/equity	0.0x

#### Shareholders Post IPO

HSC Health Care Sdn Bhd	20.6%
Low Su-Shing	12.9%

#### Important Dates

Closing date	5 Oct
Balloting	10 Oct
Listing date	17 Oct

### Subscribe: prospects look bright

- **Promising growth prospects.** Development of new therapies and increasing awareness of personal healthcare should spur demand for stem cell storage. The group's expansion in Thailand and future plans to penetrate Indonesia will further add exponential growth prospects in the medium term. The stem banking industry is estimated to grow at a CAGR of 33.8% in Malaysia, 73.9% in Thailand and 58.5% in Indonesia from 2005 to 2010.
- **Consistent revenue flow almost guaranteed.** A consistent stream of revenue is almost guaranteed for the long term from locked-in annual storage fee. Good growth prospects in its customer base will provide the assurance of improving recurring revenue.
- **Already in growth cycle phase.** Group revenue is mainly derived from Umbilical Cord Blood Stem Cells (UCBSC) banking. Potential is significant given Malaysia's 500,000 birth rate annually. Tapping a mere 1% to 2% of that pool annually could greatly enhance its growth. StemLife captures 63% of UCBSC market share in Malaysia. At current upfront and annual fee structure, the group will gain 1.6% increase in profit after tax (PAT) for every 1% increase in sales volume. Elsewhere, a 1% increase in product price is likely to result in a 3.7% gain in PAT.
- **Potential in PBSC and therapy is tremendous.** The Peripheral Blood Stem Cell (PBSC) banking and therapy segment is likely to be the next growth segment for the group. While its is much more costlier than UCBSC, the market is wider than USBSC. Revenue from therapy services is estimated to be approximately RM30,000 per procedure.
- **Dividend likely to be high.** The management guidance pointed to 50% dividend payout ratio going forward.
- **Valuation.** The stock is fairly valued at RM0.81 based on a Discounted FCFF three-stage growth methodology at a WACC of 16.09%. We have opted to value the stock using this method given that the group is relatively young and it is growing at a relatively high rate (the stem banking industry in Malaysia is estimated to grow at a CAGR of 33.8% from 2005 to 2010).

#### EARNINGS & VALUATION PROFILE

FYE 31Dec(RMm)	2004	2005	2006E	2007F	2008F
Revenue	3.3	7.6	13.8	18.2	24.4
Growth	170.9%	129.6%	82.0%	32.2%	33.8%
PBT	1.2	2.4	3.9	6.2	8.3
Growth	-305.2%	101.8%	58.1%	60.4%	33.8%
Margin	36.8%	32.3%	28.1%	34.1%	34.1%
PAT	1.2	2.0	3.8	6.1	8.1
Growth	-305.2%	68.9%	85.0%	59.7%	33.8%
Net margin	36.8%	27.0%	27.5%	33.2%	33.2%
EPS (sen)	0.7	1.2	2.3	3.7	4.9
GDPS (sen)	0.0	0.0	0.0	1.0	1.8
PER(x) @ RM0.33	44.9	26.6	14.4	9.0	6.7
PER(x) @ RM0.81	110.2	65.2	35.3	22.1	16.5
Yield @ RM0.33	0.0%	0.0%	0.0%	3.0%	5.5%

Source: SBBSP



## THE IPO

**...offering 40.0m shares at RM0.33**

The group is making a public offering of 40m shares or 24% of its enlarged share capital. The scheduled date for listing on the MESDAQ board is on 17 October 2006. Closing date for application is on 5 October 2006.

	No of shares (m)
<b>Public issue</b>	
• Malaysian public	8.25
• Private placement, restricted offer	21.75
• Directors and eligible employees	10.00
<b>Grand Total</b>	<b>40.00</b>

Gross proceeds totalling RM13.2m from the public issue will be used for the following purposes:

	Amount RMm)
Third laboratory	2.6
Additional laboratory equipment	3.0
Logistics expansion	0.6
Branch expansion	2.5
Working capital	2.5
Listing expenses	2.0
<b>Total</b>	<b>13.2</b>

## COMPANY AND BUSINESS BACKGROUND

**One stop centre ...**

StemLife is a one-stop stem cell service provider and is the first to provide a full stem cell services in Malaysia. StemLife introduced stem cell banking in Malaysia in 2001 and incorporated its UCBSC.

**Available nationwide ...**

The group offers UCBSC banking services throughout Peninsular and East Malaysia but currently only made available its PBSC banking facility in Kuala Lumpur. It has sales and marketing offices in Kuala Lumpur, Subang, Penang, Johor, Ipoh, Kuantan, Kota Kinabalu and Kuching. It currently targets mainly areas where there is a higher proportion of middle class and above as a platform to penetrate to the population.

**Stem cell therapy – a natural alternative**

Stem cell therapy is a natural and sustained healing alternative versus drug treatments and surgery. Stem cells can provide cellular and tissue regeneration to be used when trying to try to cure or reduce the effects of certain diseases and/or genetic disorders.

These stem cells are able to renew and replace a damaged bone marrow to provide undiseased cells to a recipient's blood system and improve a person's immune system to cure, protect and prevent against diseases and stimulate the regeneration of damaged cells. There are 3 main sources of stem cells, namely bone marrow, umbilical cord blood and peripheral blood.

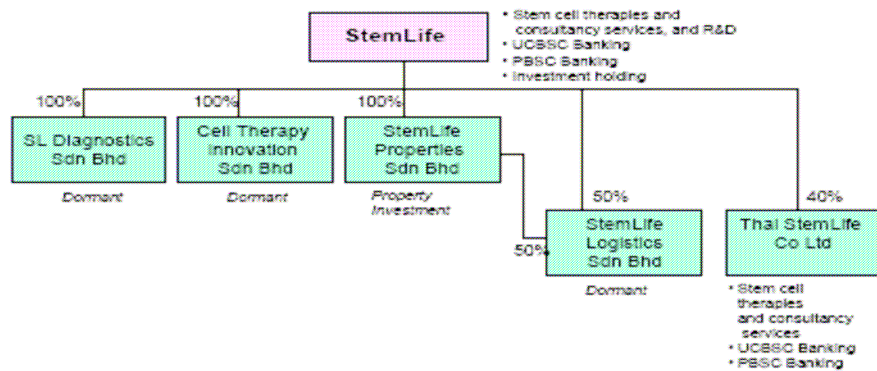


**...72 diseases treatable with stem cell therapy**

There are currently over 72 diseases that are treatable with stem cell therapy. Active research is ongoing for Alzheimer's disease, Parkinson's disease, bone and cartilage damage, and stroke.

**Corporate structure...**

## CORPORATE STRUCTURE



Source: Stemlife Bhd

## BUSINESS SEGMENT

**UCBSC banking ...**

### UCBSC Banking

StemLife provides client counseling, collection, transportation, processing and cryo-preservation of UCBSC for a fee. After the baby is borne, the remaining blood from the cut umbilical cord is collected into a blood bag. The filled blood bag is then sent to the group's laboratory for processing, testing and long-term cryo-preservation. StemLife reserves the banked unit for the family's use in the future. The processing fee UCBSC is RM2,500 for enrolment and RM250 per year after the baby's first birthday.

**PBSC Banking ...**

### PBSC Banking

For adults, StemLife provides services for the harvesting, processing, testing and cryo-preservation of the stem cells from the blood of the individual. The cryo-preserved unit may be used immediately in a stem cell transplant or cryo-preserved for use in the future. The processing fee for PBSC banking is about RM15,000 while the annual storage fee is RM1,800 per annum.

## MARKET

**Global stem cell industry still at infancy stage..**

The stem cell banking Industry is still in its infancy stage. Stem cell banking industry is still an infancy stage globally. Banking of stem cells started in the US in the early 1990s while the first stem banks in Europe and Asia were set up during 1996-1997.

The future growth in the sector is likely to be driven by breakthroughs in the medical application of cord blood stem cells to life threatening diseases including cancer. Increasing awareness of personal healthcare, rising



**...Potential is significant..**

affluence and the rising willingness to pay for the best health protection are expected to add to the growth potential for this sector going forward.

The potential for customer base to grow is tremendous as it is still at its infancy stage. Revenue will increase in tandem with the maturity of the industry. Also, a growing number of ageing people made aware of the benefit of stem cell therapies will provide significant expansion in demand especially for the PBSC segment for the group in the future.

It was estimated that 50,680 procedures were treatable by stem cell therapy in 2005. Market value for stem cell therapy is huge, estimated at RM1.52bn in 2005 on assumption that it costs on average RM30,000 per procedure.

Stemlife is gearing its position to leverage on the rising awareness of the benefit of stem cell therapies going forward. Key advantage for Stemlife is that it also provides full stem cell services including consultancies as well as therapies. Stemlife develops transplant protocol for various therapeutic applications. While the applications are developed jointly with specialists, it is still exclusive to Stemlife.

Given that the therapies are at the same center as the stem cell bank, costs for these transplant procedures are expected to be less than those available elsewhere. At the same time, it will create additional rise in demand for its banking facilities relative to its competitors.

In Malaysia, UCBSC banking dominates 99.3% of total storage for the stem cell banking industry. PBSC banking accounts only a mere 0.7%, thus the market potential in tapping the PBSC market.

**Target for UCBSC banking**

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Targets for UCBSC are expectant mothers. The birth rate of approximately 500,000 per annum places expectant mothers in Malaysia as the major target for growth.

The group expects to tap 5,000 to 10,000 births per annum on assumption that 20% are private hospital births and given 5% to 10% of mothers opt for UCBSC banking services.

**Target for PBSC banking**

...

Elsewhere, the target group for PBSC comprises mostly individuals who have either been diagnosed or have a family history of a disease treatable with stem cells. While potential is great, the growth will likely be constrained by a relatively expensive upfront and storage fee. The processing fee for PBSC banking is about RM15,000 while the annual storage fee is RM1,800 per annum relative to UCBSC of RM2,500 for enrolment fee and RM250 per year after the baby's first birthday.



## SWAP ANALYSIS

### STRENGTHS

#### Competitive Edge

**Amongst the most competitive fees in the region...**

- UCBSC banking fees from StemLife's is among the most competitive in the region.

Companies	Country	Year started UCBSC banking	Fees Upfront	Annual Upfront
StemLife	Malaysia	2002	RM2,500	RM250
CryoCord Sdn Bhd	Malaysia	2003	RM2,500	RM250
CordLife	Singapore	2001	S\$1400 (RM3,261)	S\$250 (RM582)
StemCord Private Ltd	Singapore	2002	S\$1000 (RM2,329)	S\$500 (RM1,165))
Thai StemLife	Thailand	2005	Bt 40,000 (RM3,928)	Bt 6,000 (RM589)
HealthBaby (HK) Biotech Co.Ltd	HK	2006	HK\$11,800 (RM5,587)	HK\$2000 (RM947)

**...Competitive edge: market leader & pioneer status...**

- Market leader and pioneer status puts it at the forefront in Malaysia's stem cell/regenerative medicine market. The group incorporated its UCBSC banking in 2002, followed by its stem cell applications consultancy in 2004. It is the first company to start a private stem cell bank in Malaysia. StemLife captured 63% share of the Malaysian private UCBSC banking market in 2005.
- Stemlife is the only company in Malaysia to provide private PBSC banking for future use. Relative to the painful bone marrow extraction process, the harvesting stem cell option provided by the group is non-invasive and pain free.
- It has the expertise to facilitate stem cell therapies. StemLife can and has the skill to prepare stem cells for stem cell transplants. The group has so far initiated 21 transplants for the treatment of leukemia, thalassemia major, heart disease, diabetic foot ulcer and lymphoma. Results have been positive with complete or partial disappearance of the symptoms of the disease for the leukemia and lymphoma cases, and positive improvements for the heart and diabetic foot ulcer cases. The group plans to be more progressively in offering therapies for tendon, ligaments and joint conditions in the next 2 years.
- The group has world-class laboratory and cryogenics facility. It operates its cryo-preservation, processing and testing facility at its laboratories in Cyberjaya and Kuala Lumpur. For its external quality assurance program, Stemlife has registered with the College of American Pathologists (CAP) since 2003. It is currently in the final stage of the CAP accreditation process. With the attainment of the CAP recognition, it will be one of the few laboratories in the South East Asia to have met the standards of excellence for laboratory testing and processing.
- StemLife has a clientele base of over 7,000 customers. This will ensure a relatively healthy recurring revenue stream for the group going forward.

**...world class laboratory and cryogenics facility...**



### ***Barriers to entry...***

#### **Barriers to entry**

- Technical dependence and technology transfer costs to obtain advice on the equipment required and operational process flow could begin at a minimum of about US\$1m. A restricted pool of experienced technical specialists is a constraint. Prospective new entrants must possess highly specialized technical know-how.
- Start up losses due to the absence of economy of scale could deter new entrants. According to management, operational efficiency is achieved at a monthly average of 250 UCBSC samples collected, tested, processed and stored after two years of losses. New entrance is expected to incur losses in the initial stages.

### ***Regulations restrictions...***

#### **Regulations restrictions.**

- As of 1 May 2006, StemLife's activities came under the purview of the Private Healthcare Facilities and Services (PHFS) Act, 1998 and its subsidiary legislation i.e. the Private Healthcare Facilities and Services (Private Hospitals and Other Private Healthcare Facilities) Regulations 2006.
- Under the PHFS Act, it is required to apply for an approval to maintain its current operation.
- After having received the approval, StemLife is required to apply for a license from the Ministry of Health within 3 years from the date of the issuance of the approval. Steps are being taken by StemLife to comply with the provisions of the Act and Regulations.

#### **WEAKNESSES**

***... Highly dependence on the success rate of stem cell therapies.***

***... Highly dependence on key management...***

***...Government incentives may result in too many players...***

- **Highly dependence on the success rate and R&D of stem cell therapies.** Demand would be highly dependant on the number of stem cell applications and therapies that are discovered, developed and made known and available to the public. Limited growth in the number of stem cell applications and therapies due to constraint of funds in the stem cell R&D could negatively impact the business and financial prospects of the company.
- **Highly dependence key management and technical personnel and directors.** The loss of highly skilled personnel may have a material and adverse effect on the group.
- There are 2 government policies which could likely attract new entrances in the stem cell banking industry in Malaysia:
  1. the 'Biotechnology Policy 2005'; and
  2. the policies implemented by the Multimedia Super Corridor

A 10 year tax free incentive will enable private stem cell banks incorporated in Malaysia to operate with significant advantage versus regional private stem cell banking enterprises.

There is a possibility that foreign competitors with greater financial and other resources may enter and compete in the segments within which it operates. A market with too many operators who may resort to price wars may limit StemLife's ability to expand its customer base.

#### **COMPETITION**

StemLife's only other competitor in Malaysia is a private company called CryoCord Sdn Bhd in respect of UCBSC.



## PROSPECTS AND FUTURE PLANS

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### *Future plans..*

### ***Strengthens its presence***

### ***Increase domestic and regional geographical reach***

### **Future Plans**

The Group has outlined the following strategies over the next two years

**Strengthens its presence.** The group plans to maintain its leading position and strengthen its brand 'StemLife' name through:

1. Private seminars to special interest groups, associations, and large corporations
2. Participating in conferences, exhibitions and trade shows
3. Feature articles in national newspapers
4. Selective advertisements in related magazines, journals, etc
5. Conducting and participating in ante-natal classes
6. Brochures placed in strategic locations
7. Continuing medical education (CME)
8. In-house newsletter "REGENERATION" to customers, and medical specialists
9. Its official website at [www.stemlife.com](http://www.stemlife.com)

### **Domestic expansion**

- The group plans to expand current branches in Penang, Johor Bahru, Kuching, Kota Kinabalu and Ipoh to serve as regional branch offices in anticipation of increasing demand for UCBS banking in these areas.
- Stemlife also wants to enhance its logistics operations via the purchase of vans to enable the movement of samples from its branch offices to its laboratories in Cyberjaya and Kuala Lumpur.
- There are plans to build a third laboratory at a location to be identified which will have facilities for processing and testing of collected blood samples, cryo-preservation of stem cells and therapeutic research. This is to facilitate an expected increase in the number of new customers and allow StemLife to handle any increase in samples. The third laboratory will also help the Company to enhance its stem cell therapeutic business.
- It will also upgrade existing laboratories to keep in line with technological developments. This will include automation of certain processes, expansion of its PBSC business and the purchase of additional cryogenic tanks.

### **Regional expansion**

- There are also plans to set up stem cell banks with strategic local partners Thailand and Indonesia. It is also gearing to provide technical assistance in the setting up of a stem cell bank and the local partner will provide the infrastructure and logistics arrangements.
- StemLife has signed a 40:60 joint venture with Superior BioTech Ltd and Jetanin Co. Ltd in April 2005 to form Thai StemLife. This collaboration will enable StemLife to tap into its partners' resources and experience in medical biotechnology and medical care to jointly promote stem cell banking in Thailand. The key personnel in Jetanin is Dr Jongjate Aojanepong, a leading in-vitro fertilisation specialist in Thailand. Thai StemLife is currently the only private stem cell bank in Thailand to provide UCBS banking, PBSC banking and stem cell therapies and consultancy services operating based on StemLife's operational model.



***Future development of Stem Cell therapies..***

***R&D programmes...***

- The group has also spread its wing to Indonesia in the form of a representative office in Jakarta to promote stem cell banking in Indonesia.
- Future services of stem cell therapies over the next two years are:
  1. Stem cell applications for tendon and ligament injuries to be made available in 2007
  2. Stem cell therapy for neurological conditions and cartilage damage to be made available in 2008
- R&D programs with universities and specialist private medical research centers will be carried out in the areas of stem cell expansion and cancer immunotherapy through the use of dendritic stem cells. Current R&D projects is with the National University of Singapore (NUS) and Cryo Stemcell Karnataka Private Ltd.
- Exploring other potential collaborative opportunities with stem cell companies with therapeutic experience to train local specialists and the treatment of spinal cord injury and cartilage damage.
- Stemlife also plans to tie-ups with medical practitioners to widen its scope of business. Its first such partnership is with HSC Healthcare Sdn Bhd (HSC).
- StemLife has entered into a strategic alliance with HSC in April 2006. HSC is a leading private medical centre for heart treatment. HSC will refer its patients to StemLife where appropriate and vice versa. So far, this strategic alliance has resulted in 5 stem cell heart transplants.
- StemLife has also signed a MoU with Gleneagles Hospital (Kuala Lumpur) Sdn Bhd and HSC to set up a Stem Cell Resource and Therapy Centre in Gleneagles Intan Medical Centre (GIMC) in June 2006. The centre is expected to provide StemLife with an avenue to create and promote awareness of the benefits of using stem cells in therapies.

**PROFITABILITY**

***UCBSC signed up cases to grow by 61.5% in FY06...***

Management expects UCBSC sign-up cases to grow by 61.5% in FY06 and 20% in FY07. This translated to 4,800 and 5,760 UCBSC new sign up cases for FY06 and FY07 respectively.

UCBSC banking is expected to contribute 88.8% and 86.2% to group revenue for FY06 and FY07 respectively. The listed price for UCBSC first year enrolment is RM2,500. Subsequent storage fee is RM250 per annum.

***Stronger growth expected from PBSC segment..***

Elsewhere, strong growth for PBSC sign-up cases is also estimated to be robust at 380% and 50% for FY06 and FY07 respectively given the small start up base value. For FY06, management estimated 120 PBSC cases to sign up while FY07 sign-up cases are expected to increase to 180 cases. Relatively costlier enrolment fee of 15,000 and storage fee of RM1,800 per annum is anticipated to contain prospect to those who have either been diagnosed or have a family history of a disease treatable with stem cells.



**Pat margin to improve to 33.2% in FY07...**

Fixed costs per unit will likely be reduced as the group reached economies of scale going forward. PAT margin is estimated to improve to 27.3% in FY06 and 33.2% in FY07 from 26.9% in FY05.

Prospect of an almost assured recurring revenues provides the company with the platform for profit visibility and relatively strong cash flows going forward and should lead to high dividend payout ratio. Management guidance pointed to a payout ratio of 50%.

Earnings are estimated to grow by 85.7% and 59.6% for FY06 and FY07 respectively in line with as strong prospect of an expanding customer base.

### **VALUATION & RECOMMENDATION**

**Fairly valued at RM0.81**

Given that the group is relatively young and is growing at a high growth rate (the stem banking industry in Malaysia is estimated to grow at a CAGR of 33.8% from 2005 to 2010), we have opted to value the stock using DCF (Discounted Cash Flow) three-stage growth model for the group's OpFCF at a WACC of 16.09%. Based on this methodology, the stock is fairly valued at RM0.81.

<b>The Valuation</b>	
PV of FCFF during high growth phase =	\$ 127
PV of Terminal Value =	\$ 109
Value of Operating Assets of the firm =	\$ 236
Value of Cash & Non-operating assets=	\$ 18.68
Value of Firm =	\$ 255
- Value of Outstanding Debt =	\$ 121
Value of Equity =	\$ 134
- Value of Equity Options =	\$ -
Value of Equity in Common Stock =	\$ 134
<b>Value of Equity per share =</b>	<b>\$ 0.81</b>

**Subscribe for exposure and growth in stem cell industry..**

We recommend investors to subscribe to the IPO to capitalise on the tremendous growth prospect of Stemlife and as an entry vehicle to participate in the high growth stem cell industry.



### Definition of Investment Ratings

Stocks ratings used in this report are defined as follows:

<b>BUY</b>	Share price expected to appreciate 10% or more over a 12-month period
<b>HOLD</b>	Share price expected to be between 0% and 10% over a 12-month period
<b>SELL</b>	Share price expected to depreciate over a 12-month period

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