

# Megachem Limited

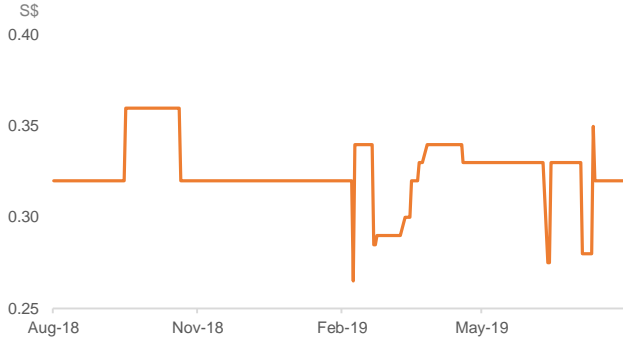
Date: 20 August 2019

**BUY**  
(Maintained)

**Target Price: S\$0.50**  
(+56%)

**MGCM SP**

**Price: S\$0.320** (as at 19 August 2019)



Share price	1M	3M	6M	1Y
Megachem Limited	-3.0%	-3.0%	0.0%	0.0%
Catalist Index	-4.9%	-4.6%	-9.7%	-26.5%

<b>Market capitalisation</b>	S\$42.7m						
<b>Current Price</b>	S\$0.320						
<b>Shares outstanding</b>	133.3m						
<b>Free Float</b>	16%						
<b>Major shareholders</b>	<table border="0"> <tr> <td>Chew (Choon Tee Sidney)</td> <td>35.2%</td> </tr> <tr> <td>Chori Co., Ltd</td> <td>30.0%</td> </tr> <tr> <td>Tan Bock Chia</td> <td>19.1%</td> </tr> </table>	Chew (Choon Tee Sidney)	35.2%	Chori Co., Ltd	30.0%	Tan Bock Chia	19.1%
Chew (Choon Tee Sidney)	35.2%						
Chori Co., Ltd	30.0%						
Tan Bock Chia	19.1%						
<b>Recommendation of other brokers</b>	N/A						

Source: Company data, Bloomberg, SAC Advisors

## Analyst

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## Key Financials

Year ended December (S\$ m)	FY2016	FY2017	FY2018	FY2019F	FY2020F	FY2021F
<b>Revenue</b>	99.8	108.1	117.9	129.3	139.4	150.7
<b>% Growth</b>	-9.8%	8.4%	9.1%	9.7%	7.8%	8.1%
<b>Gross profit</b>	25.3	26.6	29.4	32.1	34.6	37.4
<b>Gross profit margin</b>	25.3%	24.6%	24.9%	24.8%	24.8%	24.8%
<b>Profit/(loss) before tax</b>	3.6	5.2	5.4	6.1	6.6	7.2
<b>Profit/(loss) before tax margin</b>	3.7%	4.8%	4.6%	4.7%	4.8%	4.8%
<b>Core profit attributable to owners</b>	2.9	3.6	4.1	4.9	5.3	5.8
<b>EPS/(LPS) (cents)</b>	1.53	3.18	3.06	3.69	4.01	4.37
<b>P/E (x)</b>	20.9	10.1	10.5	8.7	8.0	7.3
<b>Net Debt/Equity</b>	0.09	0.16	0.15	0.13	0.13	0.13
<b>Dividend (cent)</b>	1.2	1.2	1.5	1.3	1.4	1.5
<b>Dividend yield (%)</b>	3.8%	3.8%	4.7%	4.1%	4.4%	4.8%

Source: Company data, SAC Advisors

## 1H2019 revenue impacted by weaker market conditions

Megachem announced a revenue of S\$55.8 million for 1H2019, a 5.5% or S\$3.2 million decrease as compared to 1H2018. Following a record performance for FY2018, weaker market conditions and waning business confidence amongst customers led to a fall in sales across various markets as the Group was hit by a double whammy of falling demand and softer prices. The Group's two largest contributor in ASEAN and North Asia saw sales fall by S\$1.6 million and S\$1.5 million respectively as compared to a year before. This was partially offset by higher sales in the European market, which saw a sales increase of S\$1.1 million in 1H2019.

**Gross margin remained stable at around 25%.** The 1H2019 gross margin was relatively unchanged at 25.2% as compared to the gross margin of 25.3% in 1H2018. But as compared to 2H2018 gross margin, there was an improvement of 0.6 percentage point due to lower inventory write down and higher gross profit margins across certain market such as North Asia and Middle East. Overall, gross profit fell 5.8% year-on-year due to the lower sales.

**Net profit before tax decreased by 15.4% to S\$2.6 million.** Due to the lower sales and lower gross profit, Megachem's 1H2019 profit before tax and net profit fell by 15.4% and 16.0% to S\$2.6 million and S\$2.0 million as compared to a year ago. The decrease was partly cushioned by S\$0.6 million lower total net losses in foreign exchange and fair value of forward contracts and listed equity.

**Megachem declared an interim dividend of S\$0.5 cents per share.** Despite the more challenging business environment, Megachem continued to pay out dividend to reward its shareholders. The interim dividend of S\$0.5 cents a share represented a dividend payout ratio of 34.7% for the financial performance recorded in 1H2019.

**Maintain BUY.** Megachem is trading at 8.7x FY19F P/E, which is a 40% discount compared to the sector average of 14.6x. While some valuation gap is warranted given Megachem's smaller operational size, the company's prudent management, consistent dividend yield, diverse customer profile and products, as well as the presence in the highly regulated industry, especially in the Asian countries, justified a higher valuation for the Group. As such, we maintained our valuation at S\$0.50 per share.

**Key risks:** Subjected to macroeconomic volatility brought about by the trade war.

## Weaker market conditions dampened 1H2019 performance

### Revenue Breakdown By Segment

Revenue breakdown (S\$mil)	1H19	2H18	1H18
Distribution	54.1	56.9	57.3
Manufacturing	1.7	2.0	1.7
<b>Total</b>	<b>55.8</b>	<b>58.9</b>	<b>59.0</b>

Source: SAC Advisors, Company data

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### Revenue Breakdown By Geography

Revenue breakdown (S\$mil)	1H19	2H18	1H18
ASEAN	36.6	37.7	38.1
North Asia	6.8	7.8	8.3
Europe	4.9	4.5	3.8
Middle East	2.3	2.7	2.5
South Asia	3.4	3.5	2.9
Australia	1.8	2.5	2.9
America	0.1	0.1	0.5

Source: SAC Advisors, Company data

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## Company background

Megachem started its operation in Singapore in 1988. Within a year, the company expanded into Malaysia. Since then, the company has been spreading its wings globally. Listed on the Singapore Stock Exchange in 2003, Megachem is today the leading chemical player in Singapore and the region with presence in 11 countries and reaches more than 30 countries around the world. The company offers one-stop specialty chemical solutions, providing integrated value-added services including contract manufacturing that tailors to customers' needs and distribution. In 2016, its associated company, Megachem (Thailand) Public Co Ltd made its IPO debut on the Stock Exchange of Thailand.

### Core businesses:

#### (1) Chemical Distribution

Megachem distributes and sells over 1,500 different types and grades of specialty chemicals to more than 2,000 companies in diverse industries. These include polymerization, paint and ink coatings, adhesives, construction, electronics, rubber and plastics, photographic, food and beverage, flavor and fragrance, pharmaceutical, industrial cleaning, metal finishing, water treatment, personal care as well as oil and gas industry. The majority of Megachem's customers are formulators who buy specialty chemicals as part of their intermediate manufacturing or processing requirements, or applicators and end-users. Chemical distribution contributed 97.6% of the total sales in 2017.



Source: Company data

**(2) Contract Manufacturing**

Contract manufacturing division provides its customers with a one-stop integrated solution by (i) freeing up its customers' production capacity and (ii) providing a platform for its customers to penetrate into Asia without heavy investment in production facilities and logistics. Megachem is one of the leading chemical contract manufacturers in Singapore with a 49,000 square feet manufacturing facility. Many of its multinational customers rely on its highly sophisticated mixing and precision-blending services.



Source: Company data

**Megachem's business model**



Source: company

## Recommendation

Megachem trades at about 40% discount to the sector average. Given that Megachem's margins are better than the sector average, we believe the discount reflects Megachem's much smaller operation size and lower valuation accorded to Catalyst companies. Nonetheless, we think that the valuation gap is too wide even after taking into account of its operation size.

We value Megachem at S\$0.50 which is based on DCF (at 8.5% WACC and terminal growth rate of 3%). This translates to an implied FY19F P/E of 13.5x which is still lower than the global specialty chemical distributors.

We like the company's strong corporate governance and prudent management. Moreover, Megachem is also in an industry with high barriers to entry and resilient pricing and demand as proven over the steady top and bottom lines over the years. Megachem's triple focus on Asia, products and customers also put it on track to explore any growth opportunities. We believe Megachem will gradually narrow the gap of its margins versus the peers in the longer term as Megachem gradually shifts more of its sales exposure to higher margin segments. Last but not least, Megachem also offers attractive dividend yield of 4.8% to 5.7% and continued to promise to hand out dividends in the long run.

## Peer comparison

Name	Ticker & Exchange	Mkt Cap (\$M)	Last Px (\$GD)	Revenue Latest FY (\$M)	Gross Profit Latest FY (\$M)	GM: Latest FY	NI/Profit: Latest FY (\$M)	PM: Latest FY	P/E: Latest FY (X)	P/B: Trailing 12M (X)	Dividend Yield: Trailing 12M	Debt Ratio: Latest FY	ROE
BRENTAG AG	BNR GR	9711	62.85	19987.4	4127.6	20.7%	734.0	3.7%	12.7	1.9	2.9%	27.9%	14.9%
UNIVAR INC	UNVR US	4426	26.25	11646.5	2563.5	22.0%	232.5	2.0%	11.7	1.8	N/A	45.1%	0.2%
IMCD NV	IMCD NA	4818	91.60	3789.0	853.8	22.5%	159.4	4.2%	29.3	3.8	1.3%	24.7%	14.2%
LAUTAN LUAS TBK PT	LTLS IJ	96	0.06	670.9	122.2	18.2%	19.0	2.8%	4.7	0.5	6.2%	40.8%	10.4%
SAMCHEM HOLDINGS BHD	SAHB MK	55	0.20	366.1	32.0	8.8%	7.2	2.0%	8.5	1.1	4.9%	48.3%	13.8%
UNION PETROCHEMICAL PCL	UKEM TB	29	0.02	133.8	16.4	12.3%	1.5	1.1%	21.0	0.7	1.9%	25.6%	2.7%
MEGACHEM THAILAND PCL	MGT TB	34	0.08	27.5	8.1	29.3%	2.1	7.5%	14.4	2.0	5.3%	9.6%	13.2%
<b>Average</b>		<b>2738</b>	<b>25.87</b>	<b>5231.6</b>	<b>1103.4</b>	<b>19.1%</b>	<b>165.1</b>	<b>3.3%</b>	<b>14.6</b>	<b>1.7</b>	<b>3.8%</b>	<b>31.7%</b>	<b>9.9%</b>

As at 19 August 2019

Source: Bloomberg, SAC Advisors

## Income Statement (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018	FY2019F	FY2020F	FY2021F
<b>Revenue</b>	<b>99.8</b>	<b>108.1</b>	<b>117.9</b>	<b>129.3</b>	<b>139.4</b>	<b>150.7</b>
Less: Cost of sales	-74.5	-81.5	-88.4	-97.2	-104.8	-113.4
<b>Gross Profit</b>	<b>25.3</b>	<b>26.6</b>	<b>29.4</b>	<b>32.1</b>	<b>34.6</b>	<b>37.4</b>
Other operating income	0.7	2.5	0.4	0.8	0.8	0.9
Distribution costs	-14.6	-15.8	-15.7	-18.5	-19.9	-21.6
Administrative expenses	-5.0	-5.1	-5.3	-6.1	-6.6	-7.1
Other operating expenses	-2.7	-3.4	-3.5	-2.5	-2.6	-2.8
Finance expenses	-0.6	-0.5	-0.8	-0.6	-0.6	-0.6
Associate	0.6	0.8	0.8	0.8	0.8	0.8
<b>Profit before tax</b>	<b>3.6</b>	<b>5.2</b>	<b>5.4</b>	<b>6.0</b>	<b>6.5</b>	<b>7.0</b>
Tax expenses	-1.4	-1.0	-1.1	-1.2	-1.3	-1.4
<b>Profit after tax</b>	<b>2.2</b>	<b>4.2</b>	<b>4.3</b>	<b>4.9</b>	<b>5.3</b>	<b>5.8</b>
Non-controlling interests	-0.2	0.0	0.2	0.0	0.0	0.0
<b>Profit/(loss) attributable to owners of company</b>	<b>2.0</b>	<b>4.2</b>	<b>4.1</b>	<b>4.9</b>	<b>5.3</b>	<b>5.8</b>
Earnings/(loss) per share:	1.53	3.18	3.06	3.69	4.01	4.37

## Cash Flow Statement (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018	FY2019F	FY2020F	FY2021F
<b>Profit/(Loss) before tax</b>	<b>3.6</b>	<b>5.2</b>	<b>5.4</b>	<b>6.0</b>	<b>6.5</b>	<b>7.0</b>
Depreciation & amortisation	1.5	1.2	0.9	1.2	1.2	1.3
Change in working capital	-0.1	-4.2	-0.8	-0.7	-3.0	-3.4
Others	-1.5	-3.3	-1.7	-1.4	-1.6	-1.7
<b>Net Cash (used in)/ from operations</b>	<b>3.5</b>	<b>-1.1</b>	<b>3.8</b>	<b>5.2</b>	<b>3.2</b>	<b>3.4</b>
Purchase of PPE	-0.5	-0.6	-0.7	-1.5	-1.0	-1.5
Others	2.8	0.4	0.7	0.0	0.0	0.0
<b>Net Cash (used in)/ from investing</b>	<b>2.3</b>	<b>-0.2</b>	<b>0.0</b>	<b>-1.5</b>	<b>-1.0</b>	<b>-1.5</b>
Net increase in debt	-2.8	1.4	0.4	2.0	0.0	0.0
Dividend paid	-1.8	-1.7	-1.9	-1.7	-1.9	-2.0
Others	-0.6	-0.5	0.9	-0.6	-0.6	-0.6
<b>Net Cash (used in)/ from financing</b>	<b>-5.2</b>	<b>-0.8</b>	<b>0.3</b>	<b>-0.3</b>	<b>-2.4</b>	<b>-2.6</b>

## Balance Sheet (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018	FY2019F	FY2020F	FY2021F
PPE	11.4	10.9	10.7	12.6	12.4	12.7
Investment in associates	3.1	5.5	5.8	7.0	7.8	8.7
Others	0.1	0.4	0.4	0.4	0.4	0.4
<b>Total non-current assets</b>	<b>14.7</b>	<b>16.8</b>	<b>16.8</b>	<b>20.0</b>	<b>20.6</b>	<b>21.7</b>
Inventories	20.4	23.9	26.1	25.8	27.8	30.0
Trade and other receivables	24.2	27.7	24.1	29.7	32.1	34.7
Others	2.4	2.2	2.5	2.2	2.2	2.2
Cash and bank balances	11.6	9.3	12.2	11.8	11.6	10.9
<b>Total current assets</b>	<b>58.5</b>	<b>63.1</b>	<b>64.9</b>	<b>69.5</b>	<b>73.7</b>	<b>77.8</b>
<b>Total assets</b>	<b>73.2</b>	<b>79.9</b>	<b>81.7</b>	<b>89.6</b>	<b>94.3</b>	<b>99.6</b>
Trade and other payables	13.0	15.6	12.0	17.0	18.3	19.8
Borrowings	12.4	14.6	18.2	14.6	14.6	14.6
Others	0.1	0.4	0.2	0.4	0.4	0.4
<b>Total current liabilities</b>	<b>25.5</b>	<b>30.6</b>	<b>30.5</b>	<b>32.0</b>	<b>33.4</b>	<b>34.8</b>
Borrowings	2.9	2.1	1.3	4.1	4.1	4.1
Others	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total non-current liabilities</b>	<b>2.9</b>	<b>2.1</b>	<b>1.3</b>	<b>4.1</b>	<b>4.1</b>	<b>4.1</b>
Share Capital	15.9	15.9	15.9	15.9	15.9	15.9
Retained earnings	30.6	33.3	35.5	39.6	43.1	46.9
Other reserve	-4.5	-4.5	-4.2	-4.5	-4.5	-4.5
Total shareholder's equity	42.0	44.6	47.2	50.9	54.4	58.2
Non-controlling interests	2.8	2.6	2.8	2.5	2.4	2.4
<b>Total equity</b>	<b>44.8</b>	<b>47.2</b>	<b>49.9</b>	<b>53.4</b>	<b>56.9</b>	<b>60.6</b>

## Ratios

FYE Dec	FY2016	FY2017	FY2018	FY2019F	FY2020F	FY2021F
<b>Profitability (%)</b>						
Gross profit/(loss) margin	25.3%	24.6%	24.9%	24.8%	24.8%	24.8%
Operating profit/(loss) margin	4.5%	3.9%	4.6%	4.1%	4.1%	4.2%
Profit/(loss) before tax margin	3.7%	4.8%	4.6%	4.4%	4.4%	4.5%
<b>Liquidity (x)</b>						
Current ratio	2.3	2.1	2.1	2.2	2.2	2.2
Quick ratio	1.5	1.3	1.3	1.4	1.4	1.4
Interest coverage ratio	8.0	7.9	6.8	10.4	11.3	12.3
Net Debt to Equity	0.1	0.2	0.2	0.1	0.1	0.1
<b>Valuation (x)</b>						
P/E	20.9	10.1	10.5	8.7	8.0	7.3
P/B	1.0	0.9	0.9	0.8	0.8	0.8
P/NTA	1.0	0.9	0.9	0.8	0.8	0.8
<b>Cash Conversion Cycle</b>						
Trade receivable days	91.6	87.6	87.6	84.0	84.0	84.0
Inventory days	101.4	99.2	98.6	96.7	96.7	96.7
Trade payable days	66.4	64.0	62.1	63.9	63.9	63.9
CCC days	126.6	122.8	124.1	116.8	116.8	116.8
<b>Returns</b>						
Return on equity	5.0%	9.1%	9.8%	9.4%	9.6%	9.8%
Return on asset	3.0%	5.5%	5.9%	5.7%	5.8%	6.0%
<b>Dividend payout ratio</b>	<b>78.4%</b>	<b>37.7%</b>	<b>35.0%</b>	<b>35.0%</b>	<b>35.0%</b>	<b>35.0%</b>

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<b>Party</b>	<b>Quantum of position</b>
Nil	Nil

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<b>Company</b>	<b>Nature of business relation</b>	<b>Date of business relation</b>
SAC Capital	Continuing Sponsor	Ongoing relations

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Analyst name	Quantum of position
Nil	Nil

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