

# Megachem Limited

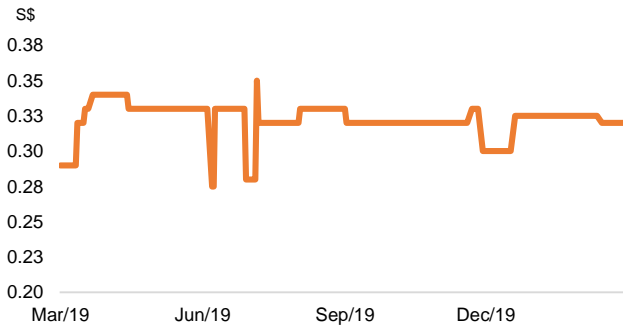
Date: 26 March 2020

**BUY**  
(Maintained)

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

**MGCM SP**

**Price: S\$0.320** (as at 25 March 2020)



Share price	1M	3M	6M	1Y
Megachem Limited	-3.0%	-3.0%	0.0%	0.0%
Catalist Index	-21.9%	-26.6%	-27.8%	-31.3%

<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>	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 Capital

## Analyst

Terence Chua +65 6232 3236  
[tchua@saccapital.com.sg](mailto:tchua@saccapital.com.sg)

**Earnings recovery in 2H2019, FY2019 impacted marginally by economic uncertainty**

Megachem grew 2H2019 revenue by 4% over 1H2019, to S\$58.0m. For the FY2019, the Group reported revenue of S\$113.8m, a 3.5% decline from FY2018. The dip in revenue was due to lower average selling prices for specialty chemical products, while volume held stable. Barring the impact of Covid-19, revenue is expected to be maintained as Megachem's products cater to diverse industrial users.

Distribution segment posted a 3.6% yoy sales decline to S\$110.8m. The Manufacturing segment was stable at S\$3.7m, compared with FY2018. As Megachem focuses on the high-mix low volume specialty chemical products, its gross margins are more superior and less volatile at about 24.8% (FY18: 25.0%), compared with peers that offer commodity chemical products.

**FY2019 net profit fell 5.8% to S\$3.8m, weighed down by higher finance costs with the adoption of SFRS 16.** Higher associates' earnings and recovery of bad debts from Venezuela contributed to the bottomline.

**Balance sheet improved** with net gearing edging lower to 6.7% from 14.6% in FY2018. Trade receivables days and inventory days are healthy at 84 and 97 days respectively. Cash conversion cycle improved from 124 days to 117 days. In spite of this, the stock is trading at 0.8x price to book value of S\$0.372, which we deem unjustified.

**Megachem declared a final dividend of 1.0 cents per share for FY2019.** Together with the 0.5 cents per share paid in 1H2019, total FY2019 dividend is maintained at 1.5 cents per share. This represents a payout ratio of 52.1%.

**Maintain BUY.** Megachem is trading at 8.0x our FY20F P/E, which is a more than 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, justifies a higher valuation for the Group. As we monitor the impact of the Covid-19 virus, we may need to adjust our forward assumptions. We maintained our BUY rating and target price at S\$0.50 per share.

**Key risks:** Macroeconomic volatility brought about by the trade war & Covid-19.

## Key Financials

Year ended December (S\$ m)	FY2016	FY2017	FY2018	FY2019	FY2020F	FY2021F
<b>Revenue</b>	99.8	108.1	117.9	113.8	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	1.5	1.4	1.5
<b>Dividend yield (%)</b>	3.8%	3.8%	4.7%	4.7%	4.4%	4.8%

Source: Company data, SAC Capital

## Outlook challenging but Group's operations stable

### Revenue Breakdown By Segment

Revenue breakdown (S\$mil)	2H19	1H19	2H18
Distribution	55.9	54.1	56.9
Manufacturing	2.1	1.7	2.0
<b>Total</b>	<b>58.0</b>	<b>55.8</b>	<b>58.9</b>

Source: SAC Capital, Company data

### Revenue Breakdown By Geography

Revenue breakdown (S\$mil)	2H19	1H19	2H18
ASEAN	37.0	36.6	37.7
North Asia	8.8	6.8	7.8
Europe	4.4	4.9	4.5
Middle East	3.1	2.3	2.7
South Asia	2.3	3.4	3.5
Australia	2.3	1.8	2.5
America	0.1	0.1	0.1

Source: SAC Capital, Company data

**Megachem announced 2H2019 revenue of S\$58.0 million**, 4% higher as compared to 1H2019. For the FY2019, the Group reported a revenue of S\$113.8 million, a 3.5% decline from last year. The decrease was mainly due to lower contribution from the Distribution segment, which saw a 3.6% y-y dip in sales to S\$110.8 million in FY2019, as a result of broad-based decline across most major markets. The Manufacturing segment remained stable at S\$3.7 million from same period last year.

Despite external uncertainties that saw an overall decline in the Group's sales this year, we see underlying demand remain resilient for 2019. For FY2020, the Group flagged the ongoing Covid-19 virus and trade tensions as the biggest risk to their performance for the year. We may need to adjust our forward assumptions as we continue to monitor the impact of the Covid-19 virus on the global economy.

**Group's revenue impacted by lower chemical prices, volume stable.** For FY2019, the weak economic climate affected chemical prices though sales volume remained stable. We see overall revenue of S\$113.8 million for FY2019 as being relatively resilient. This is also evident in the Group's overall gross profit margin, which has remained relatively stable and in-line with the Group's historical performance. For FY2019, the Group reported gross profit margin of 24.8% for the year vs. 25.0% last year.

**Net profit decreased 5.8% for FY2019 to S\$3.8 million.** The Group reported overall net profit attributable to equity holders of S\$3.8 million for FY2019, which was 5.8% lower vs. last year as the fall in top-line affected overall profitability. Despite recording a higher share of associate's profits and higher other income, the Group still saw an overall decline in net profit dragged down by higher total operating expenses and finance costs.

For FY2019, the Group's share of profit of associated companies improved mainly due to absence of impairment loss from a discontinued business and higher profits contribution from an acquired distribution business. Finance costs however, increased due to higher interest rates and adoption of SFRS 16.

**Megachem declared a final dividend of S\$1.0 cents per share for FY2019.** Together with the S\$0.5 cents per share declared in the 1H2019, the Group will be paying out S\$1.5 cents per share for FY2019 in-line with the previous year. The total payout represents a total dividend payout of 52.1% of their overall earnings.

Despite the challenging environment, we think the Group can sustain their dividends going forward as they have a healthy cash balance of S\$14.9 million as at FY2019 without any major capital expenditure spending expected for FY2020 and have a net gearing of just 7%.

## Group’s financial position improved for FY2019

As a result of better collection and lower inventory purchases, the Group generated positive cash flows from operating activities of S\$6.6 million vs. the S\$2.6 million generated last year. This was used to reduce borrowings and other financing obligations, resulting in a S\$4.1 million deficit from financing activities. As a whole though, cash increased by S\$2.7 million for FY2019, resulting in an ending cash balance of S\$14.9 million for FY2019.

### Cash Flow (Snapshot)

(S\$mil)	FY2019	FY2018
Cash (used in)/from operating activities	6.6	2.6
Cash (used in)/from investing activities	0.3	(0.04)
Cash (used in)/from financing activities	(4.1)	0.3
Net change in cash	2.7	2.9
Beginning cash balance	12.2	9.3
Ending cash balance	14.9	12.2

Source: SAC Capital, Company data

**Maintain BUY.** Megachem is trading at 8.0x our FY20F P/E, which is a more than 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. Their improved cash position also means that the Group’s net asset value increased from S\$0.3538 in FY2018 to S\$0.3724 for FY2019. As such, we maintained our BUY rating and target price at S\$0.50 per share.

## 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 data

## Income Statement (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018	FY2019	FY2020F	FY2021F
<b>Revenue</b>	<b>99.8</b>	<b>108.1</b>	<b>117.9</b>	<b>113.8</b>	<b>139.4</b>	<b>150.7</b>
Less: Cost of sales	-74.5	-81.5	-88.4	-85.6	-104.8	-113.4
<b>Gross Profit</b>	<b>25.3</b>	<b>26.6</b>	<b>29.4</b>	<b>28.2</b>	<b>34.6</b>	<b>37.4</b>
Other operating income	0.7	2.5	0.4	0.6	0.8	0.9
Distribution costs	-14.6	-15.8	-15.7	-15.5	-19.9	-21.6
Administrative expenses	-5.0	-5.1	-5.3	-5.5	-6.6	-7.1
Other operating expenses	-2.7	-3.4	-3.5	-2.9	-2.6	-2.8
Finance expenses	-0.6	-0.5	-0.8	-0.8	-0.6	-0.6
Share of profit from Associates	0.6	0.8	0.8	1.1	0.8	0.8
<b>Profit before tax</b>	<b>3.6</b>	<b>5.2</b>	<b>5.4</b>	<b>5.0</b>	<b>6.5</b>	<b>7.0</b>
Tax expenses	-1.4	-1.0	-1.1	-1.0	-1.3	-1.4
<b>Profit after tax</b>	<b>2.2</b>	<b>4.2</b>	<b>4.3</b>	<b>4.0</b>	<b>5.3</b>	<b>5.8</b>
Non-controlling interests	-0.2	0.0	0.2	0.1	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>3.8</b>	<b>5.3</b>	<b>5.8</b>
Earnings/(loss) per share:	1.53	3.18	3.06	2.88	4.01	4.37

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

FYE Dec	FY2016	FY2017	FY2018	FY2019	FY2020F	FY2021F
<b>Profit/(Loss) before tax</b>	<b>3.6</b>	<b>5.2</b>	<b>5.4</b>	<b>5.0</b>	<b>6.5</b>	<b>7.0</b>
Depreciation & amortisation	1.5	1.2	0.9	0.9	1.2	1.3
Change in working capital	-0.1	-4.2	-0.8	1.5	-3.0	-3.4
Others	-1.5	-3.3	-1.7	0.2	-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>7.5</b>	<b>3.2</b>	<b>3.4</b>
Purchase of PPE	-0.5	-0.6	-0.7	-0.5	-1.0	-1.5
Others	2.8	0.4	0.7	0.7	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>0.3</b>	<b>-1.0</b>	<b>-1.5</b>
Net increase in debt	-2.8	1.4	2.6	-1.3	0.0	0.0
Dividend paid	-1.6	-1.6	-1.9	-1.7	-1.9	-2.0
Others	-0.6	-0.5	0.9	-1.1	-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>-4.1</b>	<b>-2.4</b>	<b>-2.6</b>

## Balance Sheet (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018	FY2019	FY2020F	FY2021F
PPE	11.4	10.9	10.7	10.3	12.4	12.7
Investment in associates	3.1	5.5	5.8	6.6	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	25.4	27.8	30.0
Trade and other receivables	24.2	27.7	24.1	22.9	32.1	34.7
Others	2.4	2.2	2.5	2.7	2.2	2.2
Cash and bank balances	11.6	9.3	12.2	14.9	11.6	10.9
<b>Total current assets</b>	<b>58.5</b>	<b>63.1</b>	<b>64.9</b>	<b>65.9</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>86.2</b>	<b>94.3</b>	<b>99.6</b>
Trade and other payables	13.0	15.6	12.0	12.1	18.3	19.8
Borrowings	12.4	14.6	18.2	17.6	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	0.9	4.1	4.1
Others	0.0	0.0	0.0	2.6	0.0	0.0
<b>Total non-current liabilities</b>	<b>2.9</b>	<b>2.1</b>	<b>1.3</b>	<b>3.4</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	37.6	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	49.6	54.4	58.2
Non-controlling interests	2.8	2.6	2.8	2.8	2.4	2.4
<b>Total equity</b>	<b>44.8</b>	<b>47.2</b>	<b>49.9</b>	<b>52.4</b>	<b>56.9</b>	<b>60.6</b>

## Ratios

FYE Dec	FY2016	FY2017	FY2018	FY2019	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 (%)	8.4%	15.5%	14.6%	6.8%	6.6%	6.4%
<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	92	88	88	84	84	84
Inventory days	101	99	99	97	97	97
Trade payable days	66	64	62	64	64	64
CCC days	127	123	124	117	117	117
<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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