

Megachem Limited

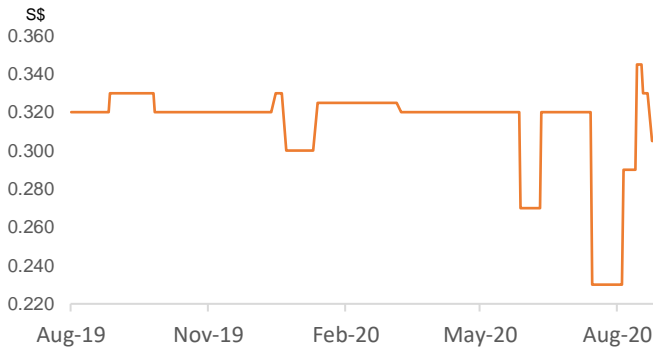
Date: 26 August 2020

BUY
(Maintained)

Target Price: S\$0.50
(+64%)

MGCM SP

Price: S\$0.305 (as at 25 August 2020)



Share price	1M	3M	6M	1Y
Megachem Limited	32.6%	-4.7%	-6.2%	-4.7%
Catalist Index	14.5%	44.9%	25.5%	20.8%

Market capitalisation	S\$40.7m						
Current Price	S\$0.305						
Shares outstanding	133.3m						
Free Float	13.7%						
Major shareholders	<table border="0"> <tr> <td>Chew (Choon Tee Sidney)</td> <td>35.3%</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)	35.3%	Chori Co., Ltd	30.0%	Tan Bock Chia	19.1%
Chew (Choon Tee Sidney)	35.3%						
Chori Co., Ltd	30.0%						
Tan Bock Chia	19.1%						
Recommendation of other brokers	N/A						

Source: Company data, Bloomberg, SAC Capital

Analyst

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Key Financials

Year ended December	FY2016	FY2017	FY2018	FY2019	FY2020F	FY2021F
Revenue (S\$ million)	99.8	108.1	117.9	113.8	112.6	117.2
Growth	-9.8%	8.4%	9.0%	-3.5%	-1.0%	4.0%
Gross profit (S\$ million)	25.3	26.6	29.4	28.2	28.4	29.8
Gross profit margin	25.3%	24.6%	25.0%	24.8%	25.2%	25.4%
Profit/(loss) before tax (S\$ million)	3.6	5.2	5.4	5.0	5.9	5.4
Profit/(loss) before tax margin (S\$ million)	3.7%	4.8%	4.6%	4.4%	5.2%	4.6%
Net Profit attributable to owners (S\$ million)	2.0	4.2	4.1	3.8	4.5	4.1
EPS/(LPS) (cents)	1.53	3.18	3.06	2.88	3.35	3.09
P/E (x)	19.9	9.6	10.0	10.6	9.1	9.9
Net Debt/Equity	0.09	0.16	0.15	0.07	0.13	0.13
Dividend (cent)	1.2	1.2	1.5	1.5	1.5	1.4
Dividend yield	3.9%	3.9%	4.6%	4.3%	4.9%	4.6%

Source: Company data, SAC Capital

Group's operations remained stable despite challenging 1H20

Slight decline in revenue due to COVID-19 pandemic. Megachem reported a 6.7% drop in revenue to S\$52.0 million for 1H20. The slower sales were largely because of the imposed lockdown and restrictions on business operations by many countries brought about by the COVID-19 situation. Both segments reported lower sales for 1H20.

Geographically, sales to key markets of ASEAN and North Asia bore the brunt of the decrease, recording a 9.3% decline to S\$33.2 million and a 16.8% decline to S\$5.7 million for 1H20 respectively. This was partially offset by higher sales in Europe, Middle East, Australia and America.

Net profit surged 39.9% for 1H20 to S\$2.8 million. Despite a fall in revenue, the Group reported a higher net profit on the back of a surge in other income and higher contribution from associated companies. Other income increased due to higher grant income, net foreign exchange gain, fair value gain from listed equity security and higher bad debt recovered while the Group's share of profit of associated companies rose as a result of higher demand for cleaning chemicals due to the COVID-19 situation. The Group had proposed an interim dividend of 0.5 Scents per share for 1H20.

Diversified business model cushioned impact. In 1Q20, business in China was significantly impacted as the country started to impose lockdown and quarantine measures, but the impact was mitigated by Megachem's geographical diversity as most of the other market segments experienced growth in sales. In fact, 1Q20 experienced a 3.4% y-o-y sales growth. In 2Q20, as COVID-19 started to affect the other markets, a gradual return to normal in China accompanied by the pent-up demand built up in the first quarter as well as the Group's diversified industry range helped to soften the impact on the Group.

Maintain BUY. Megachem is currently trading at 9.1x our FY20F P/E, which is a discount compared to the sector average of 16.1x. Given the Group's resilient diversification business model and the gradual return of businesses arising from the easing of containment measures around the world, we believe that our estimates are well achievable. At this point, we maintain our BUY rating and target price at S\$0.50 per share while we monitor the impact of the COVID-19 pandemic.

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

Group's operations remained stable despite challenging first half

Revenue Breakdown By Segment

Revenue breakdown (S\$mil)	1H20	2H19	1H19
Distribution	50.5	55.9	54.1
Manufacturing	1.6	2.1	1.7
Total	52.0	58.0	55.8

Source: SAC Capital, Company data

Revenue Breakdown By Geography

Revenue breakdown (S\$mil)	1H20	2H19	1H19
ASEAN	33.2	37.0	36.6
North Asia	5.7	8.8	6.8
Europe	5.0	4.4	4.9
Middle East	3.5	3.1	2.3
South Asia	2.0	2.3	3.4
Australia	2.3	2.3	1.8
America	0.1	0.1	0.1

Source: SAC Capital, Company data

Slight decline in revenue due to COVID-19 pandemic. Megachem reported a 6.7% drop in revenue to S\$52.0 million for 1H20. The slower sales were largely because of the imposed lockdown and restrictions on business operations by many countries brought about by the COVID-19 situation. Both segments reported lower sales for 1H20, in which the Distribution segment recorded a 6.7% fall to S\$50.5 million while the Manufacturing segment recorded a 6.7% fall to S\$1.6 million.

Geographically, sales to key markets of ASEAN and North Asia bore the brunt of the decrease, recording a 9.3% decline to S\$33.2 million and a 16.8% decline to S\$5.7 million for 1H20 respectively. This was partially offset by higher sales in Europe, Middle East, Australia and America.

Net profit surged 39.9% for 1H20 to S\$2.8 million. Despite a fall in revenue, the Group reported a higher net profit on the back of a surge in other income and higher contribution from associated companies. Other income increased by 371.0% to S\$1.1 million for 1H20 due to higher grant income, net foreign exchange gain, fair value gain from listed equity security and higher bad debt recovered while the Group's share of profit of associated companies rose 86.2% to S\$0.9 million as a result of higher demand for cleaning chemicals due to the COVID-19 situation. Overall, Megachem achieved a higher net profit after tax of 39.9% to S\$2.8 million as compared to S\$2.0 million from a year ago. The Group had proposed an interim dividend of 0.5 Scents per share for 1H20.

Diversified business model cushioned impact. In 1Q20, business in China was significantly impacted as the country started to impose lockdown and quarantine measures, but the impact was mitigated by Megachem's geographical diversity as most of the other market segments experienced growth in sales. In fact, 1Q20 experienced a 3.4% y-o-y sales growth. In 2Q20, as COVID-19 started to affect the other markets, a gradual return to normal in China accompanied by the pent-up demand built up in the first quarter as well as the Group's diversified industry range helped to lessen the impact felt by the Group.

Maintain BUY. Megachem is currently trading at 9.1x our FY20F P/E, which is a discount compared to the sector average of 16.1x. Given the Group's resilient diversification business model and the gradual return of businesses arising from the easing of containment measures around the world, we believe that our estimates are well achievable. Nonetheless, as we continue to monitor the impact of the Covid-19 virus, we may need to adjust our forward assumptions. At this point however, we maintain 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
Revenue	99.8	108.1	117.9	113.8	112.6	117.2
Less: Cost of sales	(74.5)	(81.5)	(88.4)	(85.4)	(84.3)	(87.4)
Gross Profit	25.3	26.6	29.4	28.2	28.4	29.8
Other operating income	0.7	2.5	0.4	0.6	1.4	0.5
Distribution costs	(14.6)	(15.8)	(15.7)	(15.5)	(16.0)	(16.6)
Administrative expenses	(5.0)	(5.1)	(5.3)	(5.5)	(5.3)	(5.5)
Other operating expenses	(2.7)	(3.4)	(3.5)	(2.9)	(2.9)	(3.0)
Finance expenses	(0.6)	(0.5)	(0.8)	(1.0)	(1.0)	(1.0)
Share of profit from Associates	0.6	0.8	0.8	1.1	1.2	1.3
Profit before tax	3.6	5.2	5.4	5.0	5.9	5.4
Tax expenses	(1.4)	(1.0)	(1.1)	(1.0)	(1.2)	(1.1)
Profit after tax	2.2	4.2	4.3	4.0	4.7	4.3
Non-controlling interests	(0.2)	0.0	0.2	0.1	0.2	0.2
Profit/(loss) attributable to owners of company	2.0	4.2	4.1	3.8	4.5	4.1
Earnings/(loss) per share:	1.53	3.18	3.06	2.88	3.35	3.09

Cash Flow Statement (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018	FY2019	FY2020F	FY2021F
Profit/(Loss) for the year	2.2	4.2	4.3	4.0	4.7	4.3
Depreciation & amortisation	1.5	1.2	0.9	1.3	1.2	1.4
Change in working capital	(0.1)	(4.2)	(2.5)	1.5	0.3	(1.4)
Others	(0.1)	(2.3)	(0.1)	(0.2)	0.6	(0.4)
Net Cash (used in)/ from operations	3.5	(1.1)	2.6	6.6	6.1	3.9
Purchase of PPE	(0.5)	(0.6)	(0.7)	(0.5)	(0.9)	(0.9)
Others	2.8	0.4	0.7	0.7	0.0	0.0
Net Cash (used in)/ from investing	2.3	(0.2)	0.0	0.3	(0.9)	(0.9)
Net increase in debt	(2.8)	1.4	2.9	(1.4)	0.0	0.0
Dividend paid	(1.8)	(1.7)	(1.9)	(1.8)	(2.1)	(2.0)
Others	(0.6)	(0.5)	(0.7)	(0.9)	(1.0)	(1.0)
Net Cash (used in)/ from financing	(5.2)	(0.8)	0.3	(4.1)	(3.1)	(3.0)

Balance Sheet (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018	FY2019	FY2020F	FY2021F
PPE	11.4	10.9	10.7	10.3	9.9	9.6
Right of use assets	0	0	0	2.8	3.1	3.5
Investment in associates	3.1	5.5	5.8	6.6	7.8	9.2
Others	0.1	0.4	0.4	0.5	0.5	0.5
Total non-current assets	14.7	16.8	16.8	20.0	21.4	22.8
Inventories	20.4	23.9	26.1	25.4	24.5	25.5
Trade and other receivables	24.2	27.7	24.1	22.9	23.3	24.2
Others	2.4	2.2	2.5	2.6	2.6	2.6
Cash and bank balances	11.6	9.3	12.2	14.9	16.9	16.9
Total current assets	58.5	63.1	64.9	65.9	67.4	69.3
Total assets	73.2	79.9	81.7	86.2	88.5	91.3
Trade and other payables	13.0	15.6	12.0	12.1	11.9	12.4
Borrowings	12.4	14.6	18.2	17.6	17.6	17.6
Others	0.1	0.4	0.2	0.6	0.6	0.6
Total current liabilities	25.5	30.6	30.5	30.3	30.1	30.5
Borrowings	2.9	2.1	1.3	0.9	0.9	0.9
Others	0.0	0.0	0.0	2.6	2.6	2.6
Total non-current liabilities	2.9	2.1	1.3	3.4	3.4	3.4
Share Capital	15.9	15.9	15.9	15.9	15.9	15.9
Retained earnings	30.6	33.3	35.5	37.6	40.1	42.3
Other reserve	(4.5)	(4.5)	(4.2)	(3.9)	(3.9)	(3.9)
Total shareholder's equity	42.0	44.6	47.2	49.6	52.1	54.4
Non-controlling interests	2.8	2.6	2.8	2.8	2.9	3.0
Total equity	44.8	47.2	49.9	52.4	55.0	57.4

Ratios

FYE Dec	FY2016	FY2017	FY2018	FY2019	FY2020F	FY2021F
Profitability (%)						
Gross profit/(loss) margin	25.3	24.6	25.0	24.8	25.2	25.4
Profit/(loss) before tax margin	3.7	4.8	4.6	4.4	5.2	4.6
Net margin	2.2	3.9	3.6	3.5	4.1	3.7
Liquidity (x)						
Current ratio	2.3	2.1	2.1	2.2	2.2	2.3
Quick ratio	1.5	1.3	1.3	1.3	1.4	1.4
Interest coverage ratio	7.5	10.8	8.2	5.9	6.8	6.3
Net Debt to Equity (%)	8.4	15.5	14.6	6.8	2.7	2.6
Valuation (x)						
P/E	19.9	9.6	10.0	10.6	9.1	9.9
P/B	0.9	0.9	0.8	0.8	0.7	0.7
Returns (%)						
Return on equity	4.8	9.8	8.9	7.9	8.8	7.7
Return on asset	2.7	5.5	5.0	4.6	5.1	4.6
Dividend payout ratio	78.4	37.7	45.7	45.1	45.0	45.0

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