

Megachem Limited

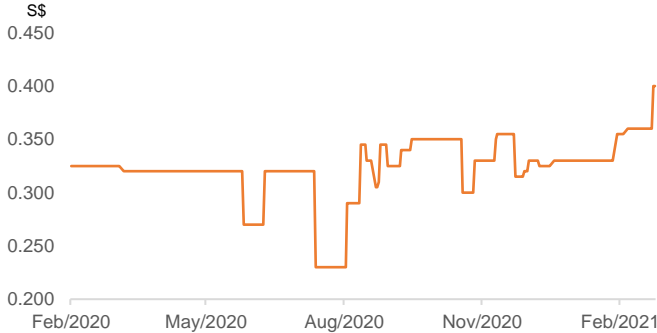
Date: 1 March 2021

BUY
(Maintained)

Target Price: S\$0.500
(+25.0%)

MGCM SP

Price: S\$0.400 (as at 26 February 2021)



| Share price | 1M | 3M | 6M | 1Y |
|------------------|-------|-------|-------|-------|
| Megachem Limited | 21.2% | 27.0% | 29.0% | 23.1% |
| Catalist Index | -3.7% | 6.5% | 0.4% | 30.5% |

| | | | | |
|---------------------------------|--|--|--|--|
| Market capitalisation | S\$53.3m | | | |
| Current Price | S\$0.400 | | | |
| Shares outstanding | 133.3m | | | |
| Free Float | 13.6% | | | |
| Major shareholders | Chew (Choon Tee Sidney) 35.4% Chori Co., Ltd 30.0% Tan Bock Chia 19.1% | | | |
| Recommendation of other brokers | N/A | | | |

Source: Company data, Bloomberg, SAC Capital

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Remained resilient amidst challenging business climate

FY2020 net profit rose despite a fall in sales. Revenue fell 7.5% from S\$113.8 million in FY2019 to S\$105.2 million in FY2020. The fall was largely due to lower selling prices while volume decline was marginal. Volume recovered in 2H2020 after the decline in 1H2020 due to lockdowns in the non-essential industries to prevent the spread of COVID-19. Net profit, however, rose 32.0% to S\$5.3 million, thanks to 1) higher gross margin (+0.4 ppt), 2) government grant of S\$1.2 million, 3) higher contribution from Thai associate underpinned by strong demand for cleaning chemical products, and 4) forex gain. Even excluding government grant, net profit was still 3.9% higher.

Diversified sector coverage and geography smoothened impact from COVID-19. As chemicals are classified as essential products, Megachem was allowed to operate within certain restrictions. While sales to non-essential industries such as construction, coatings and metal finish sectors were reduced, the Group's diversified market segments allow it to benefit from other industries, such as electronics and healthcare sectors, which saw higher demand for computers, semiconductors and cleaning products. On the supply side, the Group's diversified supply sources minimized any impact of the supply chain disruption.

Maintain BUY. The stock is trading at 12.9x FY2021F P/E. Amidst challenging global business environment, the Group had delivered resilient performance, helped by its diversified range of chemical products and geographical coverage. We are cautiously optimistic that the recovery momentum in 2H2020 will carry through to FY2021. Nonetheless, COVID-19 remains a risk factor which could affect our earnings estimates if renewed lockdowns take place. At this point, we maintain our BUY rating and target price at S\$0.50 per share.

Key risks: Macroeconomic volatility brought about by trade tensions & pandemic.

Key Financials

| Year ended December | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021F |
|---------------------------------|--------|--------|--------|--------|--------|---------|
| Revenue (S\$ million) | 99.8 | 108.1 | 117.9 | 113.8 | 105.2 | 117.2 |
| Growth (%) | -9.8% | 8.4% | 9.0% | -3.5% | -7.5% | 11.4% |
| Gross profit (S\$ million) | 25.3 | 26.6 | 29.4 | 28.2 | 26.5 | 29.8 |
| Gross profit margin (%) | 25.3% | 24.6% | 25.0% | 24.8% | 25.2% | 25.4% |
| Profit before tax (S\$ million) | 3.6 | 5.2 | 5.4 | 5.0 | 5.9 | 5.4 |
| Profit before tax margin (%) | 3.7% | 4.8% | 4.6% | 4.4% | 5.6% | 4.6% |
| Net Profit (S\$ million) | 2.0 | 4.2 | 4.1 | 3.8 | 5.0 | 4.1 |
| EPS (cents) | 1.53 | 3.18 | 3.06 | 2.88 | 3.77 | 3.09 |
| P/E (x) | 26.1 | 12.6 | 13.1 | 13.9 | 10.6 | 12.9 |
| Net Debt/Equity (x) | 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 |

Source: Company data, SAC Capital

Group remained resilient amidst challenging business climate

Revenue Breakdown By Segment

| Revenue breakdown (\$mil) | 2H20 | 1H20 | 2H19 |
|---------------------------|-------------|-------------|-------------|
| Distribution | 51.3 | 50.5 | 55.9 |
| Manufacturing | 1.9 | 1.6 | 2.1 |
| Total | 53.2 | 52.0 | 58.0 |

Source: SAC Capital, Company data

Net profit rose despite a fall in sales. Megachem reported a 7.5% drop in revenue from S\$113.8 million in FY2019 to S\$105.2 million in FY2020. The fall in sales was largely due to a decrease in demand for products in the non-essential industries which were forced to temporarily halt operations as a result of the COVID-19 situation in early 2020. Both segments reported lower sales for FY2020, in which the Distribution segment recorded a 7.5% fall to S\$101.8 million while the Manufacturing segment recorded a 7.4% fall to S\$3.5 million. Geographically, the Group saw biggest decline in sales in its two largest markets in ASEAN and North Asia, which recorded lower sales of 10.9% to S\$65.5 million and 17.9% to S\$12.8 million respectively. This was partially offset by higher sales in Europe, Australia, South Asia and America.

Revenue Breakdown By Geography

| Revenue breakdown (\$mil) | 2H20 | 1H20 | 2H19 |
|---------------------------|------|------|------|
| ASEAN | 32.4 | 33.2 | 37.0 |
| North Asia | 7.1 | 5.7 | 8.8 |
| Europe | 4.5 | 5.0 | 4.4 |
| Middle East | 3.0 | 3.5 | 3.1 |
| South Asia | 3.0 | 2.0 | 2.3 |
| Australia | 3.1 | 2.3 | 2.3 |
| America | 0.1 | 0.1 | 0.1 |

Source: SAC Capital, Company data

Despite a fall in revenue, Megachem reported a higher net profit for FY2020 on the back of higher other income, higher contribution from associated companies as well as lower operating expenses and financial cost. Other income more than tripled to S\$1.9 million due to higher grant income, net foreign exchange gain and fair value gain from listed equity security while the Group's share of profit of associated companies rose 43.6% to S\$1.6 million as a result of higher demand for cleaning chemicals due to the COVID-19 situation in the first half of the year. Total operating expenses and finance costs were reduced by 3.2% to S\$24.1 million mainly due to lower travelling and transport expenses and finance cost. As a result, the Group achieved a higher net profit after tax of 32.0% to S\$5.3 million as compared to S\$4.0 million from a year ago. Excluding grant income of approximately S\$1.2 million, the Group's net profit after tax still managed to expand 3.9% year on year in FY2020.

Diversified business model continued to mitigate COVID-19 impact.

As chemicals are considered essential products, Megachem was allowed to operate within certain restrictive measures. While sales to non-essential industries such as construction, coatings and metal finish sectors were affected, the Group's diversified market segments allow it to benefit from other growth markets, such as the electronics and healthcare sectors, which benefited from an increase in demand for computers, semiconductors and cleaning products. On the supply side, the Group's diversified supply sources also ensured that impact of the supply chain disruption on the Group was not significant.

Maintain BUY at the target price of S\$0.50 per share. Megachem is currently trading at 12.9x our FY2021F P/E. Given the Group's resilient showings in the challenging global business climate helped by the success of its diversified business model, coupled with improvement in the 2H2020 financial performance, we are cautiously optimistic that the Group will be able to push on ahead in FY2021. Nonetheless, as we continue to monitor the impact of the Covid-19 pandemic, 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 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021F |
|--|--------------|--------------|--------------|--------------|--------------|
| Revenue | 108.1 | 117.9 | 113.8 | 105.2 | 117.2 |
| Less: Cost of sales | (81.5) | (88.4) | (85.4) | (78.7) | (87.4) |
| Gross Profit | 26.6 | 29.4 | 28.2 | 26.5 | 29.8 |
| Other operating income | 2.5 | 0.4 | 0.6 | 1.9 | 0.5 |
| Distribution costs | (15.8) | (15.7) | (15.5) | (14.9) | (16.6) |
| Administrative expenses | (5.1) | (5.3) | (5.5) | (5.7) | (5.5) |
| Other operating expenses | (3.4) | (3.5) | (2.9) | (2.8) | (3.0) |
| Finance expenses | (0.5) | (0.8) | (1.0) | (0.7) | (1.0) |
| Share of profit from Associates | 0.8 | 0.8 | 1.1 | 1.6 | 1.3 |
| Profit before tax | 5.2 | 5.4 | 5.0 | 5.9 | 5.4 |
| Tax expenses | (1.0) | (1.1) | (1.0) | (0.7) | (1.1) |
| Profit after tax | 4.2 | 4.3 | 4.0 | 5.3 | 4.3 |
| Non-controlling interests | 0.0 | 0.2 | 0.1 | 0.2 | 0.2 |
| Profit/(loss) attributable to owners of company | 4.2 | 4.1 | 3.8 | 5.0 | 4.1 |
| Earnings/(loss) per share: | 3.18 | 3.06 | 2.88 | 3.77 | 3.09 |

Cash Flow Statement (\$\$ m)

| FYE Dec | FY2017 | FY2018 | FY2019 | FY2020 | FY2021F |
|--|--------------|------------|--------------|--------------|--------------|
| Profit/(Loss) for the year | 4.2 | 4.3 | 4.0 | 5.3 | 4.3 |
| Depreciation & amortisation | 1.2 | 0.9 | 1.3 | 1.2 | 1.4 |
| Change in working capital | (4.2) | (2.5) | 1.5 | 0.6 | (1.4) |
| Others | (2.3) | (0.1) | (0.2) | (0.9) | (0.4) |
| Net Cash (used in)/ from operations | (1.1) | 2.6 | 6.6 | 6.1 | 3.9 |
| Purchase of PPE | (0.6) | (0.7) | (0.5) | (0.4) | (0.9) |
| Construction-in-progress | 0.0 | 0.0 | 0.0 | (2.4) | 0.0 |
| Others | 0.4 | 0.7 | 0.7 | 0.5 | 0.0 |
| Net Cash (used in)/ from investing | (0.2) | 0.0 | 0.3 | (2.4) | (0.9) |
| Net increase in debt | 1.4 | 2.9 | (1.4) | 0.0 | 0.0 |
| Dividend paid | (1.7) | (1.9) | (1.8) | (2.1) | (2.0) |
| Others | (0.5) | (0.7) | (0.9) | (0.6) | (1.0) |
| Net Cash (used in)/ from financing | (0.8) | 0.3 | (4.1) | (2.8) | (3.0) |

Balance Sheet (\$\$ m)

| FYE Dec | FY2017 | FY2018 | FY2019 | FY2020 | FY2021F |
|--------------------------------------|-------------|-------------|-------------|-------------|-------------|
| PPE | 10.9 | 10.7 | 10.3 | 9.9 | 9.6 |
| Construction-in-progress | 0.0 | 0.0 | 0.0 | 2.8 | 0.0 |
| Right of use assets | 0.0 | 0.0 | 2.8 | 2.7 | 2.7 |
| Investment in associates | 5.5 | 5.8 | 6.6 | 7.6 | 9.2 |
| Others | 0.4 | 0.4 | 0.5 | 0.7 | 0.5 |
| Total non-current assets | 16.8 | 16.8 | 20.0 | 23.6 | 22.1 |
| Inventories | 23.9 | 26.1 | 25.4 | 24.4 | 25.5 |
| Trade and other receivables | 27.7 | 24.1 | 22.9 | 24.2 | 24.2 |
| Others | 2.2 | 2.5 | 2.6 | 2.9 | 2.6 |
| Cash and bank balances | 9.3 | 12.2 | 14.9 | 16.2 | 16.9 |
| Total current assets | 63.1 | 64.9 | 65.9 | 67.7 | 69.3 |
| Total assets | 79.9 | 81.7 | 86.2 | 91.3 | 91.3 |
| Trade and other payables | 15.6 | 12.0 | 12.1 | 13.5 | 12.4 |
| Borrowings | 14.6 | 18.2 | 17.6 | 16.8 | 17.6 |
| Others | 0.4 | 0.2 | 0.6 | 0.6 | 0.6 |
| Total current liabilities | 30.6 | 30.5 | 30.3 | 30.9 | 30.5 |
| Borrowings | 2.1 | 1.3 | 0.9 | 2.6 | 0.9 |
| Others | 0.0 | 0.0 | 2.6 | 2.6 | 2.6 |
| Total non-current liabilities | 2.1 | 1.3 | 3.4 | 5.1 | 3.4 |
| Share Capital | 15.9 | 15.9 | 15.9 | 15.9 | 15.9 |
| Retained earnings | 33.3 | 35.5 | 37.6 | 40.7 | 42.3 |
| Other reserve | (4.5) | (4.2) | (3.9) | (4.2) | (3.9) |
| Total shareholder's equity | 44.6 | 47.2 | 49.6 | 52.4 | 54.4 |
| Non-controlling interests | 2.6 | 2.8 | 2.8 | 2.9 | 3.0 |
| Total equity | 47.2 | 49.9 | 52.4 | 55.3 | 57.4 |

Ratios

| FYE Dec | FY2017 | FY2018 | FY2019 | FY2020 | FY2021F |
|---------------------------------|--------|--------|--------|--------|---------|
| Profitability (%) | | | | | |
| Gross profit/(loss) margin | 24.6 | 25.0 | 24.8 | 25.2 | 25.4 |
| Profit/(loss) before tax margin | 4.8 | 4.6 | 4.4 | 5.6 | 4.6 |
| Net margin | 3.9 | 3.6 | 3.5 | 5.0 | 3.7 |
| Liquidity (x) | | | | | |
| Current ratio | 2.1 | 2.1 | 2.2 | 2.2 | 2.3 |
| Quick ratio | 1.3 | 1.3 | 1.3 | 1.4 | 1.4 |
| Interest coverage ratio | 10.8 | 8.2 | 5.9 | 9.2 | 6.3 |
| Net Debt to Equity (%) | 15.5 | 14.6 | 6.8 | 5.7 | 2.6 |
| Valuation (x) | | | | | |
| P/E | 11.3 | 11.8 | 12.5 | 9.6 | 11.7 |
| P/B | 1.1 | 1.1 | 1.0 | 1.0 | 0.9 |
| Returns (%) | | | | | |
| Return on equity | 9.8 | 8.9 | 7.9 | 9.8 | 7.7 |
| Return on asset | 5.5 | 5.0 | 4.6 | 5.7 | 4.6 |
| Dividend payout ratio | 37.7 | 45.7 | 45.1 | 39.8 | 45.0 |

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|-----------------------------|---------------------------|
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