

Megachem Limited

Date: 23 August 2021

BUY (Maintained)

BBG	MGCM SP
Market Cap	S\$52.0 m
Price (20 August 2021)	S\$0.390
52-week range	S\$0.290 – S\$0.450
Target Price	S\$0.550
Shares Outstanding	133.3 m
Free Float	15.5 %
Major Shareholder	Chew Choon Tee 35.4% Chori Co Ltd 30.0% Tan Bock Chia 19.1%

P/BV (06/21)	0.9x
Net Debt to EBITDA (12/20)	2.1x

Source: Company data, Bloomberg, SAC Capital

A record 1H, tailwinds sustainable into 2H

1H came in ahead of our estimate as the Group booked 26.7% revenue growth to S\$65.9m (56.2% of our FY21E forecasts), its best half-year performance. Gross margin dipped slightly to 24.9% due to higher input costs and freight charges. Net profit of S\$3.8m was 92.7% of our FY21E forecasts.

Switch in industry dynamics works in its favour. Megachem benefitted from the following tailwinds: 1) demand uncertainty resulted in customers opting for smaller and more frequent purchases from distributors like Megachem, instead of buying direct from chemical producers in larger quantities and hold stock; 2) supply chain bottleneck led to customers turning to sources that are nearer their manufacturing bases. Megachem's established global logistic network gives them the edge; 3) surge in demand for specialty chemicals used in cleaning and disinfection, technology and healthcare sectors; and 4) firmer oil and commodities prices pushing up the prices of specialty chemicals which are passed on to the customers. These trends are likely to stay post pandemic.

Diversified sector and geographical coverage. Megachem supplies a wide range of specialty chemicals used in many industries, and this insulates it from the vagaries of any single sector. For instance, it is expected to benefit from capacity build-up of the Malaysian glove manufacturers, who require chemicals for coating and polymers. Megachem is also well-positioned to ride on the capacity expansion of the semiconductor sector in Penang. It is constructing a new warehouse in Malaysia to position for the expected demand uptick. ASEAN markets (59.4% of sales) are expected to lead growth in 2H as the economies re-open and manufacturing activities pick up with higher vaccination rate.

Maintain BUY at a higher target price of S\$0.55 (from S\$0.50). Our DCF-derived (COE:8.3%) target price translates into FY21E P/E of 11.4x and P/B of 1.3x. We raised our FY21E topline estimates by 13.5% and bottom line estimates by 56.1%, to take into account more customer wins and improved net margins from operating leverage. We have also adjusted our FY22E topline estimates and bottom line estimates upwards by 12.5% and 41.9% respectively.

Key risks: Pandemic on-off lockdowns and political tensions that disrupt manufacturing activities.

Analyst

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Key Financials

Year ended Dec (S\$'Mil)	FY2018A	FY2019A	FY2020A	FY2021E	FY2022E
Revenue	117.9	113.8	105.2	133.1	134.4
EBIT	5.4	4.9	5.1	7.1	6.6
Net profit	4.1	3.8	5.1	6.4	6.1
EPS (S\$ cents)	3.06	2.88	3.85	4.83	4.58
DPS (S\$ cents)	1.50	1.50	1.50	1.64	1.65
Net Cash / (Debt)	(7.3)	(3.5)	(3.1)	(10.8)	(9.1)
Valuation					
EBIT Margin (%)	4.5%	4.3%	4.8%	5.3%	4.9%
ROIC (%)	8.4%	7.6%	8.6%	9.0%	8.4%
EV/EBITDA (x)	10.4	10.7	10.3	7.8	8.2
P/E (x)	12.7	13.5	10.0	8.1	8.5
Dividend Yield (%)	3.8	3.8	3.8	4.2	4.2

Record half driven by demand recovery

By Segment

Revenue (\$m)	1H21	2H20	1H20
Distribution	63.4	51.3	50.5
Manufacturing	2.5	1.9	1.6
Total	65.9	53.2	52.0

By Geography

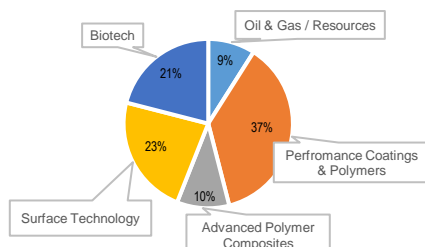
Revenue (\$m)	1H21	2H20	1H20
ASEAN	39.1	32.4	33.2
North Asia	7.7	7.1	5.7
Europe	8.3	4.5	5.0
Middle East	3.7	3.0	3.5
South Asia	2.7	3.0	2.0
Australia	4.4	3.1	2.3
America	0.1	0.1	0.4

Source: Company Data, SAC Capital

Megachem's 1H results came ahead of our estimate as the Group recorded a 26.7% yoy rise in revenue to S\$65.9 million (56.2% of our FY21 forecasts), achieving its best half-year sales figure. Gross profit margin dipped slightly from 25.4% in 1H20 to 24.9% due to both higher material costs and higher freight charges attributed to global shortage of shipping containers. Overall, net profit grew by 34.0% yoy to S\$3.8 million (92.7% of our FY21 forecasts).

Improved business environment benefited the Group. Megachem benefitted from the following tailwinds: 1) demand uncertainty resulted in customers opting for smaller and more frequent purchases from distributors like Megachem, instead of buying direct from chemical producers in larger quantities and the need to hold stock; 2) supply chain bottleneck led to customers turning to supply that are nearer their manufacturing bases. Megachem's established global logistic network gives them the edge; 3) surge in demand for specialty chemicals driven by cleaning and disinfection, technology and healthcare sectors; and 4) firmer oil and commodities prices leading to an increase in the prices of specialty chemicals which are passed on to the customers. These trends are likely to stay post pandemic.

Industry Coverage



Diversified sector and geographical coverage to benefit from uneven global economic recovery. Megachem caters to a board spectrum of sectors including performance coating and polymers, surface technology, resources, oil & gas, advanced polymer composites as well as biotech. This insulates it from the vagaries of any single sector. Megachem is expected to benefit from capacity build-up of the Malaysian glove manufacturers, who require chemicals for coating and polymers and is also well-positioned to ride on the capacity expansion of the semiconductor sector in Penang. It is constructing a new warehouse in Malaysia to position for the expected demand uptick.

At the same time, the Group's extensive global distribution network allows it to serve its customers in a quicker and better manner. With its extensive network of distribution and warehousing points in Singapore, Malaysia, Indonesia, Thailand, Philippines, Vietnam, Myanmar, China, India, UAE, Australia and the United Kingdom serving customers in 32 countries around the World, the Group is able to effectively connect its suppliers and customers across the different geographical locations. ASEAN markets (59.4% of sales) are expected to lead growth in 2H as the economies re-open and manufacturing activities pick up with higher vaccination rate.

Maintain our call at BUY at a higher target price of S\$0.55 (from S\$0.50). Our DCF-derived (COE:8.3%) target price translates into a FY21E P/E of 11.4x and P/B of 1.3x. We raised our FY21E topline estimates by 13.5% and bottom line estimates by 56.1%, to take into account more customer wins and improved net margins from operating leverage. We have also adjusted our FY22E topline estimates and bottom line estimates upwards by 12.5% and 41.9% respectively.

Income Statement (\$\$'million)

FYE Dec	FY2018	FY2019	FY2020	FY2021E	FY2022E
Revenue	117.9	113.8	105.2	133.1	134.4
Cost of sales	(88.4)	(85.6)	(78.7)	(100.1)	(101.1)
Gross profit	29.4	28.2	26.5	33.0	33.3
Other income	0.4	0.6	1.9	1.1	0.8
Distribution cost	(15.7)	(15.5)	(14.9)	(17.7)	(18.0)
Administrative expenses	(5.3)	(5.5)	(5.7)	(6.0)	(6.2)
Other expenses	(3.5)	(2.9)	(2.8)	(3.3)	(3.4)
Share of profit of joint venture	0.8	1.1	1.6	1.8	1.8
Finance expenses	(0.8)	(1.0)	(0.7)	(0.7)	(0.7)
Profit before tax	5.4	5.0	5.9	8.1	7.7
Income tax expense	(1.1)	(1.0)	(0.7)	(1.6)	(1.5)
Profit for the year	4.3	4.0	5.3	6.5	6.2
Profit/(loss) attributable to:					
Owners of the Company	4.1	3.8	5.1	6.4	6.1
Non-controlling interests	0.2	0.1	0.1	0.1	0.1
Basic and diluted earnings per share (\$\$ cents)	3.06	2.88	3.85	4.83	4.58

Cash Flow Statement (\$\$'million)

FYE Dec	FY2018	FY2019	FY2020	FY2021E	FY2022E
Profit before tax	4.3	4.0	5.3	6.5	6.2
Depreciation charges	0.9	1.3	1.3	1.3	1.4
Share of profit of joint ventures	(0.8)	(1.1)	(1.6)	(1.8)	(1.8)
Others	0.8	1.0	0.7	0.7	0.7
Changes in working capital	(2.5)	1.5	0.7	(7.5)	(0.4)
Net Cash (used in)/ from operations	3.8	7.5	6.8	0.6	7.4
Purchase of PPE	(0.7)	(0.5)	(0.4)	(1.1)	(0.8)
Others	0.7	0.7	0.4	0.0	0.0
Net Cash (used in)/ from investing	0.0	0.3	(2.4)	(3.9)	(1.3)
Net Increase in Debt	1.3	0.2	(1.6)	(0.7)	(0.7)
Dividends paid	(1.9)	(1.7)	(2.1)	(2.3)	(2.3)
Others	0.9	(2.5)	0.9	(0.0)	(0.0)
Net Cash (used in)/ from financing	0.3	(4.1)	(2.8)	(3.0)	(3.0)

Balance Sheet (\$\$'million)

FYE Dec	FY2018	FY2019	FY2020	FY2021E	FY2022E
Cash and bank balances	12.2	14.9	16.2	8.5	10.2
Financial Assets	0.4	0.2	0.4	0.4	0.4
Trade and Other Receivable	24.1	22.9	24.2	29.8	30.1
Inventories	26.1	25.4	24.4	29.1	29.4
Others	2.1	2.4	2.5	2.5	2.5
Total current assets	64.9	86.2	91.3	98.3	102.4
PPE	10.7	10.3	12.7	14.9	14.9
ROU assets	-	2.8	2.7	3.0	3.0
Investment in associate	5.8	6.6	7.6	9.4	11.2
Others	0.4	0.5	0.7	0.7	0.7
Total non-current assets	16.8	20.2	23.6	28.0	29.7
Total assets	81.7	86.2	91.3	98.3	102.4
Bank Borrowings	18.2	17.6	16.8	16.8	16.8
Trade and Other Payables	12.0	12.1	13.5	16.3	16.5
Finance leases	-	0.3	0.2	0.2	0.2
Others	0.2	0.3	0.4	0.4	0.4
Total current liabilities	30.5	30.3	30.9	33.7	33.9
Bank Borrowings	1.3	0.9	2.6	2.6	2.6
Others	-	2.6	2.6	2.6	2.6
Total non-current liabilities	1.3	3.4	5.1	5.1	5.1
Share capital	15.9	15.9	15.9	15.9	15.9
Reserves	(4.2)	(3.9)	(4.2)	(4.2)	(4.2)
Retained earnings	35.5	37.6	40.7	45.0	48.9
Equity attributable to owners of the Company	47.2	49.6	52.4	56.7	60.6
Non-controlling interests	2.8	2.8	2.9	2.8	2.8
Total equity	49.9	52.4	55.3	59.5	63.4
Total equity and liabilities	81.7	86.2	91.3	98.3	102.4

Ratios

FYE Dec	FY2018	FY2019	FY2020	FY2021E	FY2022E
Profitability (%)					
Gross profit/(loss) margin	25.0	24.8	25.2	24.8	24.8
Profit/(loss) before tax margin	4.6	4.4	5.6	6.1	5.7
Net margin	3.6	3.5	5.0	4.9	4.6
Liquidity (x)					
Current ratio	2.1	2.2	2.2	2.1	2.1
Quick ratio	1.3	1.3	1.4	1.2	1.3
Interest coverage ratio	8.2	5.9	9.2	12.1	11.6
Net Debt to Equity (%)	14.6	6.8	5.7	18.2	14.4
Valuation (x)					
P/E	12.7	13.5	10.1	8.1	8.5
P/B	1.0	1.0	0.9	0.9	0.8
Returns (%)					
Return on equity	8.9	7.9	10.0	11.8	10.4
Return on asset	5.0	4.6	5.8	6.8	6.1
Dividend payout ratio	45.7	45.1	39.0	34.0	36.0

n.m.: not meaningful

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