

Megachem Limited

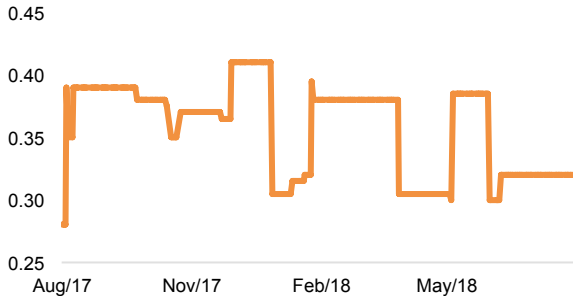
Date: 15 August 2018

BUY
(Maintained)

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

MGCM SP

Price: S\$0.320 (as at 14 August 2018)



Share price	1M	3M	6M	1Y
Megachem Limited	0.0%	0.0%	(15.8)%	14.3%
Catalist Index	(3.4)%	(14.1)%	(18.2)%	(18.8)%

Market capitalisation	S\$42.7m
Current Price	S\$0.320
Shares outstanding	133.3m
Free Float	16%
Major shareholders	Chew Choon Tee (35%) Tan Bock Chia (19%) Chori Co., Ltd (30%)
Recommendation of other brokers	N/A

Source: Company data, Bloomberg, SAC Advisors

Analyst

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Revenue increased 14.8% with stronger gross margins

Megachem reported 1H18 results that saw revenue grew by 14.8% to S\$59.0 million (50.5% of our FY18E revenue forecast) in 1H18. Megachem Limited ("Megachem", or "Group", or, "Company"), an integrated solution provider for specialty chemicals reported 1H18 results that saw revenue accelerated in the 1H18 as broad-based growth across their major market segments saw the Group reporting stronger sales performance.

Gross profit margins improved by 110 basis points from a year ago. The absence of inventory write-down and lower manufacturing overheads also saw the Group reporting stronger gross profit margins of 25.3% in 1H18 vs. 24.2% a year ago. Consequently gross profit grew 19.2% to S\$14.9 million from a year ago.

Net profit before tax excluding receivables impairment and fair value items increased 108.3%. The higher top-line and gross margin translated to a higher headline net profit before tax growth of 29.7%, as this effectively includes the one-off valuation gain from their associate's IPO in 1H17 and the fair value loss from equity investment in 1H18 and the Venezuela receivables impairment. Excluding these items however, net profit before tax growth rose 108.3% to S\$3.3 million from S\$1.6 million (adjusted) a year ago.

Acquisition of C.M.J Anchor ("CMJ") to boost their product offerings. We received more information about the Group's acquisition of CMJ which they announced earlier in the year from the results briefing by the Company. According to management, the acquisition of CMJ will enhance the Group's product portfolio and increase their offerings to their existing customers. The acquisition is expected to widen their industry coverage and strengthen their market position in Thailand.

We maintain our BUY recommendation. Megachem is trading at 9.6x FY19 P/E, more than 50% discount to the sector average of 20x. While some valuation gap is warranted given Megachem's smaller operation size, the spread is too wide, in our opinion. We also like the company's strong corporate governance, prudent management and its presence in a resilient industry. The stock is a proxy to the stronger global economy and offers attractive dividend yield of 4.8% - 5.7%. We value Megachem at S\$0.50, based on DCF valuation. This translates into 14.9x FY19 P/E (~26% discount to the sector average).

Key risks: Deterioration in macroeconomic conditions.

Key Financials

Year ended December (S\$ m)	FY2015	FY2016	FY2017	FY2018F	FY2019F	FY2020F
Revenue	110.6	99.8	108.1	116.8	126.0	135.9
% Growth	-4.6%	-9.8%	8.4%	8.0%	7.9%	7.9%
Gross profit	25.4	25.3	26.6	28.8	31.2	33.7
Gross profit margin	22.9%	25.3%	24.6%	24.7%	24.8%	24.8%
Profit/(loss) before tax	4.4	3.6	5.2	5.1	5.5	6.0
Profit/(loss) before tax margin	4.0%	3.7%	4.8%	4.3%	4.4%	4.4%
Core profit/(loss) attributable to owners	3.0	2.9	3.6	4.1	4.5	4.8
EPS/(LPS) (cents)	2.22	2.21	2.70	3.07	3.35	3.62
P/E (x)	14.4	14.5	11.8	10.4	9.6	8.8
Net Debt/Equity	0.17	0.09	0.16	0.20	0.22	0.22
Dividend (cents)	1.0	1.2	1.2	1.5	1.7	1.8
Dividend yield (%)	3.1%	3.8%	3.8%	4.8%	5.2%	5.7%

Source: Company data, SAC Advisors

Robust demand from North Asia and ASEAN drive 1H18 results

Megachem reported 1H18 results that saw revenue grew by 14.8% to S\$59.0 million (50.5% of our FY18E revenue forecast) in 1H18. Megachem, an integrated solution provider for specialty chemicals, reported 1H18 results that saw revenue accelerated in the 1H18 as broad-based growth across their major market segments saw the Group reporting stronger sales performance.

Revenue breakdown S \$mil	1H18	1H17
Distribution	57.3	50.2
Manufacturing	1.7	1.2
Total	59.0	51.4

Source: SAC Advisors, Company data

Gross profit margins improved by 110 basis points from a year ago. The absence of inventory write-down and lower manufacturing overheads also saw the Group reporting stronger gross profit margins of 25.3% in 1H18 vs. 24.2% a year ago. Consequently gross profit grew 19.2% to S\$14.9 million from a year ago.

Net profit before tax excluding receivables impairment and fair value items increased 108.3%. The higher top-line and gross margin translated to a higher headline net profit before tax growth of 29.7%, as this effectively includes the one-off valuation gain from their associate's IPO in 1H17 and the fair value loss from equity investment in 1H18 and the Venezuela receivables impairment. Excluding these items however, net profit before tax growth rose 108.3% to S\$3.3 million from S\$1.6 million (adjusted) a year ago.

Acquisition of CMJ to boost their product offerings. We received more information about the Group's associated company, Megachem (Thailand) acquisition of CMJ which they announced earlier in the year from the results briefing by the Company. According to management, the acquisition of CMJ (in the business of importing and distributing chemical product, namely ethanol. CMJ imports ethanol from manufacturers abroad and distributes to customers in various spray, perfume and cosmetic industries in Thailand) will enhance the Group's product portfolio and increase their offerings to their existing customers. The acquisition is expected to widen their industry coverage and strengthen their market position in Thailand.

We maintain our BUY recommendation. Megachem is trading at 9.6x FY19 P/E, more than 50% discount to the sector average of 20x. While some valuation gap is warranted given Megachem's smaller operation size, the spread is too wide, in our opinion. We also like the company's strong corporate governance, prudent management and its presence in a resilient industry. The stock is a proxy to the stronger global economy and offers attractive dividend yield of 4.8% - 5.7%. We value Megachem at S\$0.50, based on DCF valuation. This translates into 14.9x FY19 P/E (~26% discount to the sector average).

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 more than 50% 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 FY19 P/E of 14.9x which is a 26% discount to global specialty chemical distributors. Despite the 26% discount, our target price still represents 56% upside over its current price. Hence, we initiate the company with a BUY recommendation.

We like the company's strong corporate governance and prudent management. Megachem is also in an industry with high barriers to entry and resilient pricing and demand. We believe it 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. Megachem is not only the proxy to the improving global economy, the stock also offers attractive dividend yield of 4.8% to 5.7%

Peer comparison

Name	Tkr & Exch	Mkt Cap (\$M)	Last Px (SGD)	Revenue: Latest FY (\$M)	Gross Profit: Latest FY (\$M)	GM: Latest FY	EBITDA: Latest FY (\$M)	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 Equity	11,698.4	75.7	18,301.6	3,883.2	21.2%	1,219.0	562.3	3.1%	22.6	2.41	2.3%	28.6%	12.2%
UNIVAR INC	UNVR US Equity	5,082.8	36.0	11,395.8	2,492.8	21.9%	765.2	165.4	1.5%	26.3	3.2	-	50.5%	12.6%
IMCD NV	IMCD NA Equity	4,758.8	90.5	2,972.6	668.1	22.5%	255.2	120.4	4.1%	35.7	4.10	1.1%	22.2%	10.6%
LAUTAN LUAS TBK PT	LTLS IJ Equity	105.0	0.1	680.8	124.5	18.3%	47.7	15.5	2.3%	5.1	0.6	4.3%	31.7%	9.8%
SAMCHEM HOLDINGS BHD	SAHB MK Equity	92.0	0.3	301.1	31.5	10.5%	14.0	7.2	2.4%	12.5	1.9	3.0%	45.5%	17.8%
UNION PETROCHEMICAL PCL	UKEM TB Equity	43.9	0.0	123.7	20.3	16.4%	10.0	5.1	4.1%	18.2	1.05	5.8%	22.2%	13.2%
MEGACHEM THAILAND PCL	MGT TB Equity	34.4	0.1	23.6	6.7	28.4%	3.0	1.9	8.2%	21.2	2.24	6.7%	1.4%	17.7%
Average		3,116.5	29.0	4,828.4	1,032.5	19.9%	330.6	125.4	3.6%	20.2	2.2	3.9%	28.9%	13.4%

As at 21 June 2018

Source: Bloomberg

Income Statement (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018F	FY2019F	FY2020F
Revenue	99.8	108.1	116.8	126.0	135.9
Less: Cost of sales	-74.5	-81.5	-87.9	-94.7	-102.2
Gross Profit	25.3	26.6	28.8	31.2	33.7
Other operating income	0.7	0.6	0.7	0.8	0.8
Distribution costs	-14.6	-15.8	-17.0	-18.4	-19.8
Administrative expenses	-5.0	-5.1	-5.5	-5.9	-6.4
Other operating expenses	-0.4	-1.0	-1.2	-1.3	-1.4
Depreciation & amortization	-1.5	-1.2	-1.1	-1.2	-1.3
Profit/(loss) from operations	4.5	4.2	4.7	5.2	5.6
Finance expenses	-0.6	-0.5	-0.5	-0.5	-0.5
Interest income	0.1	0.1	0.1	0.1	0.1
Associate	0.6	0.8	0.7	0.8	0.8
Exceptional item	-0.9	0.6	0.0	0.0	0.0
Profit before tax	3.6	5.2	5.1	5.5	6.0
Tax credit/expenses	-1.4	-1.0	-1.0	-1.1	-1.2
Profit after tax	2.2	4.2	4.0	4.4	4.8
Non-controlling interests	-0.2	0.0	0.0	0.0	0.0
Profit/(loss) attributable to owners of company	2.0	4.2	4.1	4.5	4.8
Core Profit/(loss) attributable to owners of company	3.0	2.9	3.6	4.1	4.5
Earnings/(loss) per share (cents)	2.21	2.70	3.07	3.35	3.62

Balance Sheet (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018F	FY2019F	FY2020F
PPE	11.4	10.9	13.3	15.5	14.7
Investment in associates	3.1	5.5	6.3	7.0	7.8
Others	0.1	0.4	0.4	0.4	0.4
Total non-current assets	14.7	16.8	19.9	22.9	22.9
Inventories	20.4	23.9	23.7	25.1	27.1
Trade and other receivables	24.2	27.7	28.0	29.0	31.3
Others	2.4	2.2	2.2	2.2	2.2
Cash and bank balances	11.6	9.3	7.4	5.9	5.3
Total current assets	58.5	63.1	61.4	62.1	65.8
Trade and other payables	13.0	15.6	14.9	16.6	17.9
Borrowings	12.4	14.6	14.6	14.6	14.6
Others	0.1	0.4	0.4	0.4	0.4
Total current liabilities	25.5	30.6	30.0	31.6	32.9
Borrowings	2.9	2.1	2.1	2.1	2.1
Others	0.0	0.0	0.0	0.0	0.0
Total non-current liabilities	2.9	2.1	2.1	2.1	2.1
Share Capital	15.9	15.9	15.9	15.9	15.9
Retained earnings	30.6	33.3	35.3	37.5	40.0
Other reserve	-4.5	-4.5	-4.5	-4.5	-4.5
Total shareholder's equity	42.0	44.6	46.7	48.9	51.3
Non-controlling interests	2.8	2.6	2.5	2.5	2.4
Total equity	44.8	47.2	49.2	51.4	53.7

Cash Flow Statement (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018F	FY2019F	FY2020F
Profit/(Loss) before tax	3.6	5.2	5.1	5.5	6.0
Depreciation & amortisation	1.5	1.2	1.1	1.2	1.3
Change in working capital	-0.1	-4.2	-0.8	-0.7	-3.0
Others	-1.5	-3.3	-1.2	-1.4	-1.5
Net Cash (used in)/ from operations	3.5	-1.1	4.1	4.7	2.8
Purchase of PPE	-0.5	-0.6	-3.5	-3.5	-0.5
Others	2.8	0.4	0.0	0.0	0.0
Net Cash (used in)/ from investing	2.3	-0.2	-3.5	-3.5	-0.5
Net increase in debt	-2.8	1.4	0.0	0.0	0.0
Dividend paid	-1.8	-1.7	-2.0	-2.2	-2.4
Others	-0.6	-0.5	-0.5	-0.5	-0.5
Net Cash (used in)/ from financing	-5.2	-0.8	-2.5	-2.7	-2.9

Ratios

FYE Dec	FY2016	FY2017	FY2018F	FY2019F	FY2020F
Profitability (%)					
Gross margin	25.3%	24.6%	24.7%	24.8%	24.8%
Operating margin	4.5%	3.9%	4.1%	4.1%	4.1%
Pretax margin	3.7%	4.8%	4.3%	4.4%	4.4%
Liquidity (x)					
Current ratio	2.3	2.1	2.0	2.0	2.0
Quick ratio	1.5	1.3	1.3	1.2	1.2
Interest coverage ratio	8.0	7.9	9.5	10.4	11.2
Net Debt to Equity	0.1	0.2	0.2	0.2	0.2
Valuation (x)					
P/E	14.5	11.8	10.4	9.6	8.8
P/B	1.0	0.9	0.9	0.8	0.8
P/NTA	1.0	0.9	0.9	0.8	0.8
Cash Conversion Cycle					
Trade receivable days	91.6	87.6	87.6	84.0	84.0
Inventory days	101.4	99.2	98.6	96.7	96.7
Trade payable days	66.4	64.0	62.1	63.9	63.9
CCC days	126.6	122.8	124.1	116.8	116.8
Returns					
Return on equity	5.0%	9.1%	8.4%	8.8%	9.1%
Return on asset	3.0%	5.5%	5.0%	5.3%	5.5%
Dividend payout ratio	78.4%	37.7%	50.0%	50.0%	50.0%

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Party	Quantum of position
Nil	Nil

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Company	Nature of business relation	Date of business relation
Megachem Limited	Continuing Sponsor	Ongoing relations

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Analyst name	Quantum of position
Nil	Nil

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