

Megachem Limited

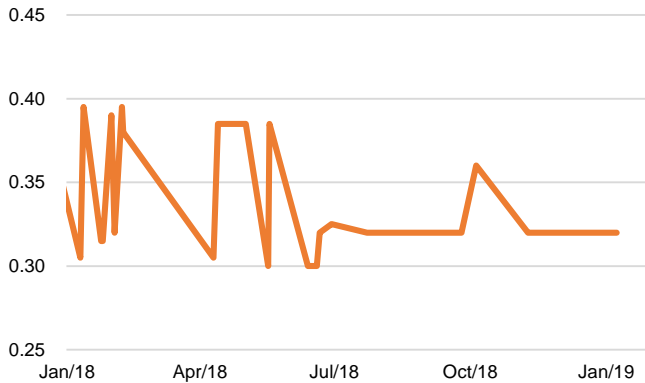
Date: 24 January 2019

BUY
(Maintained)

Target Price: S\$0.50
(+56.3%)

MGCM SP

Price: S\$0.320 (as at 23 January 2019)



Share price	1M	3M	6M	1Y
Megachem	0%	-11%	0%	-22%
Catalist Index	-3%	-12%	-19%	-33%

Market capitalisation	S\$42.7 million
Current Price	S\$0.320
Shares outstanding	133.3 million
Free Float	16%
Top 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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Key Financials

Year ended December (S\$ m)	FY2016	FY2017	FY2018F	FY2019F	FY2020F	FY2021F
Revenue	99.8	108.1	120.0	129.3	139.4	150.7
% Growth	-9.8%	8.4%	11.0%	7.8%	7.8%	8.1%
Gross profit	25.3	26.6	29.6	32.1	34.6	37.4
Gross profit margin	25.3%	24.6%	24.7%	24.8%	24.8%	24.8%
Profit/(loss) before tax	3.6	5.2	6.0	6.1	6.6	7.2
Profit/(loss) before tax margin	3.7%	4.8%	5.0%	4.7%	4.8%	4.8%
Core profit attributable to owners	2.9	3.6	4.8	4.9	5.3	5.8
EPS/(LPS) (cents)	2.21	2.70	3.61	3.69	4.01	4.37
P/E (x)	14.5	11.8	8.9	8.7	7.0	7.3
Net Debt/Equity	0.09	0.16	0.17	0.13	0.13	0.13
Dividend (cent)	1.2	1.2	1.3	1.3	1.4	1.5
Dividend yield (%)	3.8%	3.8%	3.9%	4.0%	4.4%	4.8%

Source: Company data, SAC Advisors

Megachem Site Visit Notes

One factory with Distribution and Contract Manufacturing capabilities. We visited Megachem Limited's ("Megachem", the "Company", or the "Group") factory in Tuas, Singapore. Megachem started its operation in Singapore in 1988, and 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 49,000 square feet manufacturing facility forms the foundations of its daily operations. We were brought to two factory spaces situated back to back and combined, which is ideal for Megachem as it allows for a physical divide between two operating segments yet operate within the same compound. Having an advanced IT and supply chain management system is also a driving force for its timely deliveries and ensuring customers' satisfaction.

One-stop solution provider. Megachem's key advantage lies within its ability to manage a distribution network that has expanded on a global scale. It is also an integrated chemical solutions provider with capabilities in proprietary chemical products manufacturing and contract manufacturing. Megachem has built a network in Asia where there is firm underlying demand for specialty chemicals, allowing the Group to enjoy strong support from suppliers with quality products, competitive pricing and prompt delivery. The Group's experience within the industry led to its diversified customer base and industry reach.

We walk away from the site visit feeling more positive about the Company's outlook. Despite the challenging macro environment, Megachem has seen resiliency in their business and expect a fairly in-line second half with their first half results. The management attributed their stronger portfolio of customers to a broad-based growth across key markets in their distribution and manufacturing business. Moving forward, the management also see the acquisition of C.M.J Anchor ("CMJ") boosting their product offerings, which they can offer to their existing customers. We revise upwards our revenue projections for FY18, FY19 and FY20 by 2.7%, 2.6% and 2.6% respectively. The management also does not foresee any other major impairments moving forward. Consequently, we also revise our earnings forecast for FY18, FY19 and FY20 by 17.6%/10.1% and 10.8% respectively but keep our target price unchanged.

Maintain BUY. Megachem is trading at 8.7x FY19 P/E, which is a 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 in our view, too wide. We like the company's diverse customer profile, prudent management, cheap valuations and a consistent dividend yield. The stock is a proxy to the stronger global economy and offers an attractive dividend yield of 3.9% - 4.8%. We valued Megachem at S\$0.50, based on our DCF valuation. This translates into 14.6x FY19 P/E (a 27% discount to the sector average).

Key risks: Subjected to macroeconomic volatility brought about by the trade war.

Company background¹



Megachem started its operation in Singapore in 1988. Within a year, the Company expanded into Malaysia. Since then, the Company has been actively strategising its global expansion plans. Listed on the Singapore Stock Exchange in 2003, Megachem has become a leading chemical player in Singapore and the region, seen through its presence in 11 countries with a global reach across 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.

Due to competitive reasons, chemical ingredients labeled on machines, formulations and details of the manufacturing process are proprietary and cannot be disclosed. Hence, photography within the manufacturing area was strictly prohibited.

The Group's factory in Tuas, Singapore serves as grounds for operations of its two core businesses:

- 1. Contract Manufacturing**
- 2. Chemical Distribution**



Images sourced from Group's Annual Report, Google and SAC Advisors.

¹ Information extracted from Group's Annual Report.

Office: 11 Tuas Link 1, Singapore



Source: Company data, SAC Advisors

The Office

The office section hosts Megachem's corporate meetings, it is also the office of the administrative staff and management team. All visitors are greeted by the receptionist with an iPad that plays a video that provides a brief introduction to the Company as well as illustrating safety precautions when navigating the factory.

IT system

Megachem strongly believes in investing in an advanced IT infrastructure, which includes the mySAP Business Suite software. This is aimed at enhancing their service efficiency as well as providing seamless information exchange.

Megachem adopts 3 key principals in its IT security management:

- Confidentiality: Information should not be disclosed to unauthoritative individuals or systems.
- Integrity: Important data should not be modified by unauthorized individuals or systems.
- Availability: Information should be readily available when needed even at times of any disruption.

Factory Site: 11 Tuas Link 1, Singapore



Source: Company data, SAC Advisors

Megachem's headquarters is situated in Tuas and has 2 entrances due to the combination of 2 factory unit spaces that it occupies. Visitors would enter via the entrance on 11 Tuas Link 1 which leads directly to the building for guest reception and the administrative office of Megachem located on the upper floors. The ground floor holds much of the machineries, raw materials, containers, drums and vehicles which fuels the operations of its manufacturing segment.



• **Contract Manufacturing**

Stepping into the physical environment of Megachem's factory provided an insight to how Megachem value-adds to the chemical supply chain through its operations, in a tangible manner. This factory supports a wide product portfolio of more than 1,000 types and grades of chemicals.

Within the factory, there were containers of chemicals and materials sent to Megachem from their customers. Megachem then undertakes the process of blending according to their customers' formulation and specified requirements. This is done through a few automated tank mixers in the factory, which were approximately 80% utilised at the point of our visit. The usage of the blending machines varies according to formulas of different chemical products. Hence, we were informed that the period of cycles for manufacturing individual product type differs.



Factory Site: 11 Tuas Link 1, Singapore



Packaging stage

Another section of the factory oversees the repackaging process of products that were packaged in bulk, which are later organised into smaller packaging. This section also fulfils the filling, packaging and labelling of finished chemical products after the manufacturing stage.

A section of the factory on the ground floor is allocated for the use of application laboratories dedicated to provide technical support for Megachem's operations.

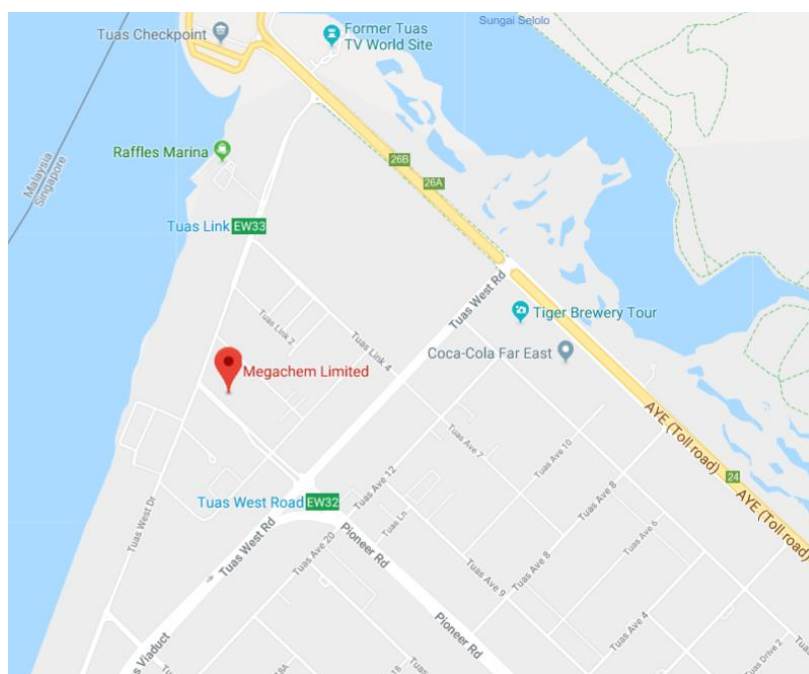


Factory Site: 11 Tuas Link 1, Singapore

In summary, the contract manufacturing segment sources the raw materials, store them in the warehouse, produce the chemical products according to clients' formulations, pack products as per requirements and deliver it directly to the clients.

Singapore

The stability of Singapore's political and economical scene could be seen as a contributing factor for Megachem's success in its operations. The Group's positioning in Singapore is pivotal to its strong presence in Asia. This also allowed several of Megachem's principal suppliers to penetrate key markets, giving Megachem the competitive edge to be appointed as the suppliers' sole distributor and business partner.



At a Glance



7th

largest exporter of chemicals in 2015, ranked by the World Trade Statistical Review 2016¹. Singapore's chemicals and energy industry also ranks among the top 10 globally.

S\$81bil

contributed by the energy and chemicals industry to Singapore's total output in 2015, about a third of Singapore's total manufacturing output.

S\$1.3bil

of fixed asset investments poured into Singapore's chemicals industry in 2016.

1.5mil

barrels of oil refined per day on Jurong Island in 2014, making Singapore one of the top 10 exporters of refined oil products in Asia .

Factory Site: 132 Pioneer Road, Singapore

- **Chemical Distribution**

As we were brought through the factory that faces Tuas Link Road, we reached the other side of the factory facing 132 Pioneer Road. This section is a warehouse that facilitates the distribution business segment. During off-peak hours, returning delivery lorries would line the road path outside the warehouse.



The distribution warehouse contained barrels of chemical products that were on standby for delivery. The shelves holding the barrels were at full capacity. We were told that there is a high turnover rate for these products, falling under the class of fast-moving consumer goods. This bodes well for the Company as it is able to maximise its warehouse space instead of letting products accumulate and stagnate, which would result in incurring extra costs to pay for third party warehouse option.



Factory Site: 132 Pioneer Road, Singapore

Storage space

One key issue faced by the warehouse is the lack of space for storage of goods. Currently, the Company is using a third party warehouse facility in order to cope with the demand for Megachem's warehouse space. In order to maximise utility of its factory space, Megachem has also applied and gotten approval from Jurong Town Corporation to store its containers of chemical products in the yard outdoors.



Income Statement (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018F	FY2019F	FY2020F	FY2021F
Revenue	99.8	108.1	120.0	129.3	139.4	150.7
Less: Cost of sales	-74.5	-81.5	-90.3	-97.2	-104.8	-113.4
Gross Profit	25.3	26.6	29.6	32.1	34.6	37.4
Other operating income	0.7	0.6	0.7	0.8	0.8	0.9
Distribution costs	-14.6	-15.8	-16.8	-18.5	-19.9	-21.6
Administrative expenses	-5.0	-5.1	-5.6	-6.1	-6.6	-7.1
Other operating expenses	-0.4	-1.0	-1.2	-1.3	-1.4	-1.5
Depreciation & amortization	-1.5	-1.2	-1.1	-1.2	-1.2	-1.3
Profit/(loss) from operations	4.5	4.2	5.6	5.8	6.3	6.9
Finance expenses	-0.6	-0.5	-0.5	-0.6	-0.6	-0.6
Interest income	0.1	0.1	0.1	0.1	0.1	0.1
Associate	0.6	0.8	0.7	0.8	0.8	0.8
Exceptional item	-0.9	0.6	0.0	0.0	0.0	0.0
Profit before tax	3.6	5.2	6.0	6.1	6.6	7.2
Tax credit/expenses	-1.4	-1.0	-1.2	-1.2	-1.3	-1.4
Profit after tax	2.2	4.2	4.8	4.9	5.3	5.8
Non-controlling interests	-0.2	0.0	0.0	0.0	0.0	0.0
Profit/(loss) attributable to owners of company	2.0	4.2	4.8	4.9	5.3	5.8
Core Profit/(loss) attributable to owners of company	2.9	3.6	4.8	4.9	5.3	5.8
Earnings/(loss) per share:	2.21	2.70	3.61	3.69	4.01	4.37

Balance Sheet (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018F	FY2019F	FY2020F	FY2021F
PPE	11.4	10.9	12.3	12.6	12.4	12.7
Investment in associates	3.1	5.5	6.3	7.0	7.8	8.7
Others	0.1	0.4	0.4	0.4	0.4	0.4
Total non-current assets	14.7	16.8	18.9	20.0	20.6	21.7
Inventories	20.4	23.9	24.4	25.8	27.8	30.0
Trade and other receivables	24.2	27.7	28.8	29.7	32.1	34.7
Others	2.4	2.2	2.2	2.2	2.2	2.2
Cash and bank balances	11.6	9.3	8.4	11.8	11.6	10.9
Total current assets	58.5	63.1	63.8	69.5	73.7	77.8
Total assets	73.2	79.9	82.8	89.6	94.3	99.6
Trade and other payables	13.0	15.6	15.4	17.0	18.3	19.8
Borrowings	12.4	14.6	14.6	14.6	14.6	14.6
Others	0.1	0.4	0.4	0.4	0.4	0.4
Total current liabilities	25.5	30.6	30.4	32.0	33.4	34.8
Borrowings	2.9	2.1	2.1	4.1	4.1	4.1
Others	0.0	0.0	0.0	0.0	0.0	0.0
Total non-current liabilities	2.9	2.1	2.1	4.1	4.1	4.1
Share Capital	15.9	15.9	15.9	15.9	15.9	15.9
Retained earnings	30.6	33.3	36.4	39.6	43.1	46.9
Other reserve	-4.5	-4.5	-4.5	-4.5	-4.5	-4.5
Total shareholder's equity	42.0	44.6	47.7	50.9	54.4	58.2
Non-controlling interests	2.8	2.6	2.5	2.5	2.4	2.4
Total equity	44.8	47.2	50.3	53.4	56.9	60.6

Cash Flow Statement (\$\$ m)

FYE Dec	FY2016	FY2017	FY2018F	FY2019F	FY2020F	FY2021F
Profit/(Loss) before tax	3.6	5.2	6.0	6.1	6.6	7.2
Depreciation & amortisation	1.5	1.2	1.1	1.2	1.2	1.3
Change in working capital	-0.1	-4.2	-1.8	-0.7	-3.0	-3.4
Others	-1.5	-3.3	-1.4	-1.4	-1.6	-1.7
Net Cash (used in)/ from operations	3.5	-1.1	3.8	5.2	3.2	3.4
Purchase of PPE	-0.5	-0.6	-2.5	-1.5	-1.0	-1.5
Others	2.8	0.4	0.0	0.0	0.0	0.0
Net Cash (used in)/ from investing	2.3	-0.2	-2.5	-1.5	-1.0	-1.5
Net increase in debt	-2.8	1.4	0.0	2.0	0.0	0.0
Dividend paid	-1.8	-1.7	-1.7	-1.7	-1.9	-2.0
Others	-0.6	-0.5	-0.5	-0.6	-0.6	-0.6
Net Cash (used in)/ from financing	-5.2	-0.8	-2.2	-0.3	-2.4	-2.6

Ratios

FYE Dec	FY2016	FY2017	FY2018F	FY2019F	FY2020F	FY2021F
Profitability (%)						
Gross profit/(loss) margin	25.3%	24.6%	24.7%	24.8%	24.8%	24.8%
Operating profit/(loss) margin	4.5%	3.9%	4.1%	4.1%	4.1%	4.2%
Profit/(loss) before tax margin	3.7%	4.8%	4.3%	4.4%	4.4%	4.5%
Liquidity (x)						
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	11.3	10.4	11.3	12.3
Net Debt to Equity	0.1	0.2	0.2	0.1	0.1	0.1
Valuation (x)						
P/E	14.5	11.8	10.4	9.6	8.8	8.0
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
Cash Conversion Cycle						
Trade receivable days	91.6	87.6	87.6	84.0	84.0	84.0
Inventory days	101.4	99.2	98.6	96.7	96.7	96.7
Trade payable days	66.4	64.0	62.1	63.9	63.9	63.9
CCC days	126.6	122.8	124.1	116.8	116.8	116.8
Returns						
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%
Dividend payout ratio	78.4%	37.7%	35.0%	35.0%	35.0%	35.0%

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Analyst name	Quantum of position
Nil	Nil

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