

Megachem Limited

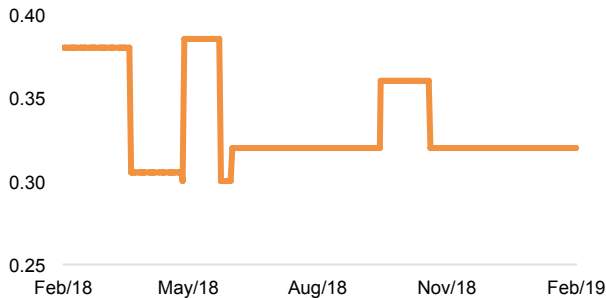
Date: 25 February 2019

BUY
(Maintained)

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

MGCM SP

Price: S\$0.320 (as at 22 February 2019)



Share price	1M	3M	6M	1Y
Megachem Limited	0%	0%	0%	-15.8%
Catalist Index	-2.3%	-6.8%	-21.9%	-51.1%

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

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FY2018 core net profit before tax increased 36.3% led by broad based increase in revenues

Megachem reported FY2018 results that saw revenue grow by 9.0% to S\$117.9 million. Megachem Limited ("Megachem", or "Group, or, "Company"), an integrated solution provider for specialty chemicals reported FY2018 results that saw revenue improve on the back of board based growth across major markets.

Gross profit margins improved by 40 basis points from a year ago. Megachem reported a stronger gross profit margin of 25.0% in FY2018 vs 24.6% in FY2017 due to lower inventory write down and lower depreciation of plant and machinery used in contract manufacturing. Accordingly, gross profit improved by 10.7% to S\$29.4 million year-on-year.

Core net profit before tax improved by 36.3% to S\$5.6 million when we strip out one-off costs. The higher top-line and stronger gross margin led to a higher headline net profit before tax growth of 3.3%. Core net profit however was higher when we strip out the one-time valuation gain from the listing of the associated company recorded in FY2017, changes in fair value of listed equity and Venezuela receivables impairment. In tandem with the growth in net profit before tax, net profit after tax improved by 1.9% to S\$4.3 million.

Boosting product offerings and expanding global footprint. The successful acquisition of C.M.J Anchor, by the Group's associated company, Megachem (Thailand), has helped to enhance the Group's product portfolio and increase its offerings.

Full year dividend payout rises 25% y-y for FY18. Megachem has proposed a final dividend of S\$0.8 cents per share, translating to total dividends of S\$1.5 cents per share for FY18, representing a payout ratio of 49% which is 25% higher on a y-y basis versus last year. The full year dividend payout of S\$1.5 cents represents a respectable dividend yield of 4.7% for FY18.

Maintain BUY. Megachem is trading at 8.7x FY19 P/E, which is a more than 50% discount compared to the sector average of 20x. While some valuation gap is warranted given Megachem's smaller operational 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.

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

Board-based growth from major markets drove FY2018 results

Revenue Breakdown By Segment

Revenue breakdown (S \$mil)	FY18	FY17
Distribution	114.2	105.5
Manufacturing	3.7	2.6
Total	117.9	108.1

Source: SAC Advisors, Company data

Revenue Breakdown By Geography

Revenue breakdown (S \$mil)	FY18	FY17
ASEAN	75.9	73.0
North Asia	16.1	11.9
Europe	8.3	6.9
Middle East	6.4	5.8
South Asia	5.4	4.9
Australia	5.2	5.0
America	0.6	0.6

Source: SAC Advisors, Company data

Megachem reported FY2018 results that saw revenue grow by 9.0% to S\$117.9 million. Improvements in both distribution and manufacturing segments as well as board-based growth across major markets, such as ASEAN, North Asia and Europe helped Megachem achieve stronger sales performance. ASEAN, the Group's largest revenue contributor recorded improvement of 3.9%. North Asia, the Group's second largest market, saw the fastest growth of 35.4% while Europe also recorded a 21.5% improvement in sales.

Gross profit margins improved by 40 basis points from a year ago. Megachem reported a stronger gross profit margin of 25.0% in FY2018 vs 24.6% in FY2017 due to lower inventory write down and lower depreciation of plant and machinery used in contract manufacturing. Accordingly, gross profit improved by 10.7% to S \$29.4 million year-on-year.

Core net profit before tax improved by 36.3% to S\$5.6 million when we strip out one-off costs. The higher top-line and stronger gross margin led to a higher headline net profit before tax growth of 3.3%. Core net profit however was higher when we strip out the one-time valuation gain from the listing of the associated company of S \$1.8 million recorded in FY2017, changes in fair value gain of listed equity of S\$0.4 million and the Venezuela receivables impairment of S\$1.1 million. In tandem with the growth in net profit before tax, net profit after tax improved by 1.9% to S\$4.3 million.

Boosting product offerings and expanding global footprint. The successful acquisition of C.M.J Anchor, by the Group's associated company, Megachem (Thailand), has helped to enhance the Group's product portfolio and increase its offerings. C.M.J Anchor is in the business of importing and distributing chemical product, namely ethanol. C.M.J. Anchor imports ethanol from manufacturers abroad and distributes to customers in various spray, perfume and cosmetic industries in Thailand. The acquisition is expected to widen Megachem's industry coverage and strengthen its market position in Thailand. Megachem has also expanded its global footprint with its establishment of a presence in Myanmar, which helps to bring the Group's presence in Asia to nine markets and grow its presence in the region, in line with its strategy.

Full year dividend payout rises 25% y-y for FY18. Megachem has proposed a final dividend of S\$0.8 cents per share, translating to total dividends of S\$1.5 cents per share for FY18, representing a payout ratio of 49% which is 25% higher on a y-y basis versus last year. The full year dividend payout of S\$1.5 cents is 15% above our expectation and represents a respectable dividend yield of 4.7% for FY18.

Board-based growth from major markets drove FY2018 results

Maintain BUY. Megachem is trading at 8.7x FY19 P/E, which is a more than 50% discount compared to the sector average of 20x. While some valuation gap is warranted given Megachem's smaller operational 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).

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 (\$GD)	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
BRENNTAG AG	BNR GR Equity	11,698.4	75.7	18,301.6	3,883.2	21.2%	1219.0	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	3.20	-	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	0.60	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	1.90	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	2.21	3.9%	28.9%	13.4%

As at 21 June 2018

Source: Bloomberg

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

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

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

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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Party	Quantum of position
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Company	Nature of business relation	Date of business relation
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Analyst name	Quantum of position
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