

Megachem Limited

15 August 2022

BUY (maintained)

| | |
|-----------------------------------|---|
| BBG | MGCM SP |
| Market cap | S\$66.7m |
| Price (15 Aug 2022) | S\$0.50 |
| 52-week range | S\$0.38 – S\$0.50 |
| Target Price | S\$0.58 |
| Shares Outstanding | 133.3m |
| Free Float | 15.1% |
| Major Shareholders | Chew Choon Tee (35.7%) Chori Co Ltd (30.0%) Tan Bock Chia (19.1%) |
| P/BV (06/22) | 1.1x |
| Net Debt to EBITDA (12/21) | 1.9x |

Source: Company data, Bloomberg, SAC Capital

Analysts

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1H22 earnings beat our expectations

Megachem delivered 1H22 revenue and net profit growth of 14.1% and 13.0%, respectively, riding on buoyant crude oil and downstream chemical prices, tighter supply from Europe caused by energy constraints, and uptick in demand from ASEAN re-opening.

Revenue from ASEAN (60.8% of total revenue) rose 16.8% and Europe 13.3%. Robust mining and mineral sectors also drove revenue higher in the Middle East (+48.7%) and Australia (+57.3%). North Asia, however, fell 28.9%, hurt by China's strict Covid lockdowns that affected manufacturing activities. Higher corresponding working capital required have resulted in operating cash outflow of S\$5.7m. We think this should normalize to positive OCF for FY22.

Megachem is involved in high mix/low volume specialty chemical products used in a diverse range of industries, in which the customers prioritize product availability and delivery lead time over prices. About 23% of revenue is contributed by the surface technology applicable to the tech, medical and auto sector. Supply chain bottleneck and step up in near-shoring of manufacturing activities have also contributed to the increase in orders.

We see continued earnings momentum in 2H2022 and FY2023, driven by 1) strong foreign investments in Singapore (1Q22: S\$36.9bn) and Indonesia (2Q22: US\$10.9bn, +39.7% yoy); and 2) recovery in China in 4Q with the lifting of movement restrictions to propel manufacturing activities in these regions.

With the completion of the Malaysia warehouse, Megachem saves on rental costs for third party space, and is able to achieve greater efficiency and operating leverage under one roof. It also plans to acquire a warehouse in Indonesia that is located near its customers, highlighting its confidence in the Indonesian market. A potential risk is a recession in the developed markets that impact demand for products out of Asia.

We have raised our FY22E net profit estimates by 9.5% to S\$8.8m, and FY23E by 13.6% to S\$8.9m, and maintain our DCF-derived TP at S\$0.58 (COE: 10%).

| Year End 31 Dec (S\$m) | FY19A | FY20A | FY21A | FY22E | FY23E |
|------------------------|-------|-------|--------|--------|--------|
| Revenue | 113.8 | 105.2 | 138.9 | 151.7 | 154.7 |
| EBIT | 6.0 | 6.7 | 10.0 | 12.6 | 12.9 |
| Net profit | 3.8 | 5.1 | 7.8 | 8.8 | 8.9 |
| EPS (S cents) | 2.9 | 3.8 | 5.8 | 6.6 | 6.6 |
| DPS (S cents) | 1.2 | 1.5 | 2.0 | 2.0 | 2.0 |
| Net cash / (debt) | (3.5) | (3.1) | (17.4) | (22.8) | (20.4) |
| Valuation | | | | | |
| EBIT margin (%) | 5.3 | 6.3 | 7.2 | 8.3 | 8.3 |
| ROIC (%) | 11.4 | 13.0 | 15.9 | 14.6 | 14.0 |
| EV/EBITDA (x) | 11.5 | 13.5 | 9.1 | 7.1 | 6.6 |
| P/E (x) | 17.3 | 13.0 | 8.6 | 7.6 | 7.5 |
| Dividend yield (%) | 2.4 | 3.0 | 4.0 | 4.0 | 4.0 |

Income Statement

| FYE 31 Dec (\$m) | FY20A | FY21A | FY22E | FY23E |
|---------------------|--------------|--------------|--------------|--------------|
| Revenue | 105.2 | 138.9 | 151.7 | 154.7 |
| Cost of sales | (77.5) | (103.6) | (112.2) | (114.5) |
| Gross profit | 27.7 | 35.3 | 39.4 | 40.2 |
| Other income | 0.8 | 0.8 | 0.8 | 1.0 |
| Operating expenses | (23.4) | (26.9) | (27.6) | (28.1) |
| EBITDA | 5.2 | 9.3 | 12.7 | 13.2 |
| Depreciation | (1.2) | (1.2) | (1.3) | (1.5) |
| Associates & JV | 1.6 | 1.6 | 1.2 | 1.2 |
| Exceptional items | 1.2 | 0.3 | 0.1 | - |
| EBIT | 6.7 | 10.0 | 12.6 | 12.9 |
| Finance costs | (0.7) | (0.8) | (0.8) | (0.8) |
| Pretax profit | 5.9 | 9.2 | 11.8 | 12.0 |
| Tax expense | (0.7) | (1.2) | (2.5) | (2.6) |
| Minority interests | (0.1) | (0.2) | (0.5) | (0.6) |
| Net profit | 5.1 | 7.8 | 8.8 | 8.9 |

Balance Sheet

| FYE 31 Dec (\$m) | FY20A | FY21A | FY22E | FY23E |
|--------------------------------|-------------|--------------|--------------|--------------|
| Assets | | | | |
| Fixed assets | 12.7 | 15.2 | 17.4 | 19.5 |
| Associates & JV | 7.6 | 8.0 | 8.7 | 9.4 |
| Investment properties | 0.1 | 0.1 | 0.1 | 0.1 |
| Others | 3.2 | 3.4 | 3.4 | 3.3 |
| Non-current assets | 23.6 | 26.7 | 29.6 | 32.3 |
| Inventories | 24.4 | 36.5 | 45.5 | 46.4 |
| Trade receivables | 24.2 | 31.1 | 31.6 | 32.2 |
| Other current assets | 2.9 | 5.1 | 5.1 | 5.1 |
| Cash | 16.2 | 11.5 | 6.1 | 8.6 |
| Current assets | 67.7 | 84.2 | 88.3 | 92.3 |
| Total assets | 91.3 | 110.9 | 117.9 | 124.6 |
| Liabilities | | | | |
| Bank loans | 16.8 | 27.5 | 27.5 | 27.5 |
| Trade payables | 13.5 | 18.0 | 16.9 | 17.2 |
| Lease liabilities | 0.2 | 0.4 | 0.4 | 0.4 |
| Tax payable | 0.2 | 0.6 | 2.5 | 2.6 |
| Others | 0.2 | 0.0 | 0.0 | 0.0 |
| Current liabilities | 30.9 | 46.5 | 47.3 | 47.7 |
| Bank loans | 2.6 | 1.4 | 1.4 | 1.4 |
| Lease liabilities | 2.6 | 2.6 | 2.6 | 2.6 |
| Non-current liabilities | 5.1 | 4.0 | 4.0 | 4.0 |
| Net assets | 55.3 | 60.4 | 66.5 | 72.9 |
| Equity | | | | |
| Share capital | 15.9 | 15.9 | 15.9 | 15.9 |
| Other reserves | (4.2) | (4.7) | (4.7) | (4.7) |
| Retained earnings | 40.7 | 46.1 | 51.8 | 57.5 |
| | 52.4 | 57.3 | 63.0 | 68.7 |
| Minority interests | 2.9 | 3.1 | 3.6 | 4.2 |
| Total equity | 55.3 | 60.4 | 66.6 | 72.9 |

Cash Flow

| FYE 31 Dec (\$m) | FY20A | FY21A | FY22E | FY23E |
|-----------------------------|--------------|---------------|--------------|--------------|
| Pretax profit | 5.9 | 9.2 | 11.8 | 12.0 |
| Depreciation & amortisation | 1.2 | 1.2 | 1.3 | 1.5 |
| Associates & JV | (1.6) | (1.6) | (1.2) | (1.2) |
| Net finance expense | 0.5 | 1.1 | 0.8 | 0.9 |
| Non-fund items | - | (0.2) | - | - |
| Working capital changes | 0.6 | (16.3) | (10.6) | (1.2) |
| Interest paid | (0.4) | (0.5) | (0.8) | (0.9) |
| Dividend from associates | 0.4 | 0.6 | 0.5 | 0.5 |
| Tax paid | (0.8) | (0.9) | (0.6) | (2.5) |
| Operating cash flow | 5.9 | (7.4) | 1.2 | 9.1 |
| Capex | (2.8) | (3.5) | (3.5) | (3.5) |
| Net investments | - | - | - | -- |
| Fixed assets disposal | - | - | - | - |
| Others | - | - | - | - |
| Investing cash flow | (2.8) | (3.5) | (3.5) | (3.5) |
| Free cash flow | 3.1 | (10.9) | (2.3) | 5.6 |
| Dividend paid | (2.1) | (2.4) | (3.1) | (3.1) |
| Borrowings | (0.1) | 8.8 | - | - |
| Equity | - | - | - | - |
| Financing cash flow | (2.2) | 6.4 | (3.1) | (3.1) |
| Net change | 1.0 | (4.5) | (5.4) | 2.5 |

Ratios

| FYE 31 Dec | FY20A | FY21A | FY22E | FY23E |
|------------------------------|-------|-------|-------|-------|
| Profitability (%) | | | | |
| Gross margin | 25.2 | 24.6 | 25.1 | 25.0 |
| EBIT margin | 6.3 | 7.2 | 8.3 | 8.3 |
| Liquidity (x) | | | | |
| Current ratio | 2.2 | 1.8 | 1.9 | 1.9 |
| Net Debt/EBITDA | 0.6 | 1.9 | 1.8 | 1.5 |
| Interest coverage ratio | 7.1 | 11.5 | 15.6 | 15.2 |
| Net Debt to Equity (%) | 5.7 | 28.8 | 34.3 | 27.9 |
| Valuation (x) | | | | |
| P/E | 13.0 | 8.6 | 7.6 | 7.5 |
| P/B | 1.3 | 1.2 | 1.1 | 1.0 |
| EV/EBITDA | 13.5 | 9.1 | 7.1 | 6.6 |
| Cash Conversion Cycle | | | | |
| Trade receivable days | 81 | 93 | 76 | 76 |
| Inventory days | 110 | 147 | 148 | 148 |
| Trade payable days | 61 | 73 | 55 | 55 |

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