

**GICS:** Industrials/Trading Companies & Distributors

**Business Summary:** Listed on SGX in 2003, MegaChem is a leading chemical player in Singapore and the region. The company positions itself as a global one-stop specialty chemical solutions provider, offering services including manufacturing of proprietary chemicals, customized contract manufacturing and distribution of specialty chemicals.

**Country of Incorporation:** Singapore

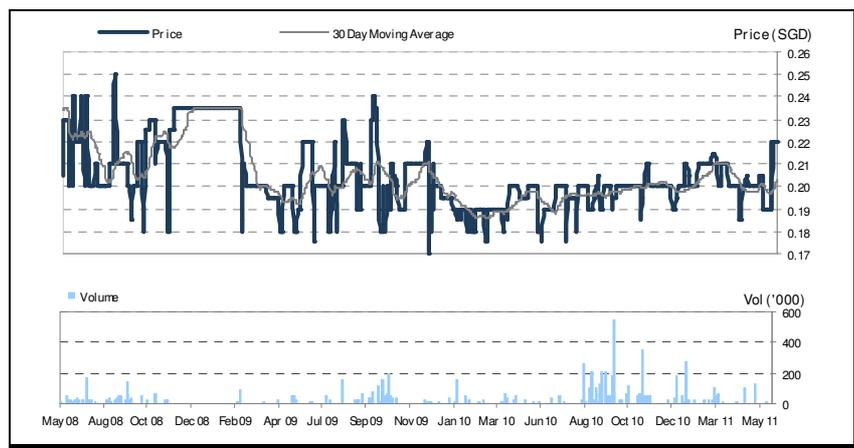
**Head Office Location:** No 132, Pioneer Road, Singapore 639588

**Place of Operations:** Singapore

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**Recent Developments**

- We view positively the SGD5.6-mln proposed acquisition of a factory unit for Megachem, as this will almost double the factory floorspace, and significantly increase the capacity of Megachem's manufacturing business. Megachem expects to spend a further SGD2 mln on machinery and warehouse design.
- By end 2H11, we expect Megachem's manufacturing business (currently undertaken at the Pioneer Road factory) will be shifted to the new premise in adjacent Tuas Link 1, hence minimizing work disruptions and clearing up space for the distribution business. Currently, Megachem has to source warehouse space for its distribution arm from third parties. Recent meetings with management indicate that rental costs are projected to increase. Megachem spent some SGD1.4 mln on rental expenses in 2010.
- Overall margins should also be enhanced by the expansion of the higher-margin manufacturing business (40% gross margin, vs. 20% for distribution). Megachem expects to grow the net profit contribution of the manufacturing business to 15% by 2013, from 7% in 2010.
- We tweak our 2011 capex assumption up slightly to SGD8 mln (from SGD7 mln), following the announcement.

**Earnings Outlook / Estimates Revision**

- Our earnings forecast remains unchanged, pending completion of the acquisition. We expect little impact on 2011 earnings, but there is upside risk to our 2012 forecasts, primarily on better group margins on expansion of the manufacturing business. Still, downside risk exists from prolonged elevated crude prices, which could derail the global economic recovery and reduce demand for Megachem's specialty chemical products.
- For now, we expect revenue growth to track regional economic growth as well as petrochemical prices. Margins, however, should come off slightly, especially in 1H11 vs. 2H10, on the global increase in fuel costs and expansion into new, lower margin markets: we maintain our 2011 gross margin assumption at about 20%, from 21% in 2010.

**Investment Risks**

- Distribution business has relatively low barriers to entry and margins that may make profit more sensitive to competition and cost swings.
- The group is subject to volatile raw material costs and forex risks.
- Slowing recovery in the global economy will affect demand for manufactured products, and in turn, for specialty chemicals.

**Key Stock Statistics**

52-week Share Price Range (SGD)	0.18 - 0.22
Avg Vol - 12 months ('000 shares)	69.6
Price Performance (%)	
- 1 month	10.0
- 3 month	4.8
- 12 month	22.2
No. of Outstanding Shares (mln)	133.3
Free Float (%)	19.1
Market Cap (SGD mln)	29.3
Enterprise Value (SGD mln)	32.3
Major Shareholders (%)	
Chew Choon Tee	34.3
Lim Yee Hoe	30.0
Tan Bock Chia	16.8

**Per Share Data**

FY Dec.	2009	2010	2011E	2012E
Book Value (SG cents)	25.00	27.07	30.22	34.48
Cash Flow (SG cents)	1.6	0.0	0.0	2.0
Reported Earnings (SG cents)	2.0	3.5	4.4	5.0
Dividend (SG cents)	1.0	1.2	1.5	2.0
Payout Ratio (%)	22.1	38.8	27.6	30.3
PER (x)	11.1	6.3	5.1	4.4
P/Cash Flow (x)	13.3	NM	NM	11.0
P/Book Value (x)	0.9	0.8	0.7	0.6
Dividend Yield (%)	4.5	5.5	6.9	9.1
ROE (%)	7.5	14.9	15.2	15.6
Net Gearing (%)	0.5	8.2	26.2	17.9

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**Profit & Loss**

FY Dec. / SGD mln	2009	2010	2011E	2012E
Reported Revenue	70.6	95.0	109.2	120.2
Reported Operating Profit	2.8	5.7	6.8	8.1
Depreciation & Amortization	-0.6	-0.6	-0.8	-1.0
Net Interest Income / (Expense)	-0.2	-0.1	-0.4	-0.5
Reported Pre-tax Profit	3.4	6.2	7.6	8.7
Effective Tax Rate (%)	21.6	21.7	20.0	20.0
Reported Net Profit	2.6	4.6	5.8	6.7
Reported Operating Margin (%)	3.9	6.0	6.3	6.7
Reported Pre-tax Margin (%)	4.9	6.5	6.9	7.3
Reported Net Margin (%)	3.7	4.9	5.3	5.6

Source: Company data, S&amp;P Equity Research

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