MPAC Group plc

EQUITY DEVELOPMENT

Resetting the bar

18th July 2018

Selling high-value packaging machinery to large corporates can sometimes feel like 'threading the needle'. For the vast majority of the time everything runs like clockwork - however occasionally unforeseen problems crop up. Indeed, at this morning's pre-close trading statement MPAC revealed it had encountered some **technical challenges on two legacy contracts which would result in "*material*" cost over-runs this year**.

Moreover, despite the positive start in Q1, **overall business sentiment has since "*softened*" due to "*general economic as well as Brexit related uncertainty*"** - leading to extended customer purchasing decisions and weighing down on pipeline conversion.

Clearly this is not ideal and illustrates once again the importance of the firm's strategy to reduce its exposure to 'lumpy hardware' bookings, shift more towards recurring service revenues and migrate further up the value chain. In fact, we were encouraged to hear there **are no more onerous contracts**, and the **current order book is of a "*higher quality and lower project complexity*"**.

Elsewhere, **the company has also undertaken a number of extra cost saving measures** on top of its group-wide efficiency drive. This has already borne fruit albeit partly offset by anticipated relocation expenses from transferring Canadian production to a new facility in Mississauga, Ontario.

So, what does this all mean?

Well, in terms of the numbers, **we have reduced our 2018 EBIT forecast by £1.3m to £1.5m on sales of £57m** and trimmed the 2019 LFL growth rate from 10% to 6% - consistent with the broader market. Similarly, **the valuation drops from 225p to 170p/share**.

CEO Tony Steels, concluding, "*I am disappointed that the momentum built in the previous year has been slowed due to the current business environment and investment decisions taking longer to conclude. We continue to put in place the strategic objectives to deliver long term revenue growth.* ***The fundamentals of our business remain strong, we are well capitalised and are fully focused on resolving the current issues and continuing with our strategic plan***"

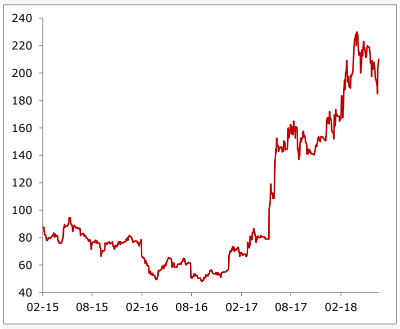
Considerable upside if strategy can be delivered

That said, **we see significant upside to our projections in the event the Board's strategy can be successfully implemented** in terms of achieving 10% organic topline growth alongside 10% EBIT margins (vs Est 2.8% 2018). And, with a healthy cash pile of circa £24m (or 119p/share) to boot, we note there is plenty of firepower left to execute the plan and find the right acquisitions.

Company Data

EPIC	**AIM:MPAC**
Price (last close)	215p
52 week Hi/Lo	230p/137p
Market cap	£43.4m
ED valuation	170p/share
Avg. daily volume	50,000

Share Price, p



Source: Web Financial

Description

MPAC (formerly Molins) is a specialist provider of high speed packaging machines (76% of sales) and complementary services (24%, eg spares/maintenance) with c. 350 staff.

The group was rebranded MPAC in Jan'18, encompassing the design / manufacture of cartoning equipment, case packers, end-of-line and robotic packaging solutions, as well as undertaking turnkey projects involving the design/integration of packaging systems. Here it has sites in Canada and the Netherlands, plus service engineers based throughout the world.

On top in Coventry (UK), the firm develops innovative technology and associated production / packaging machinery. Core clients include Nestlé, GSK, AstraZeneca, Unilever, Kellogg's, Diageo, Ferrero, Hollister and CooperVision.

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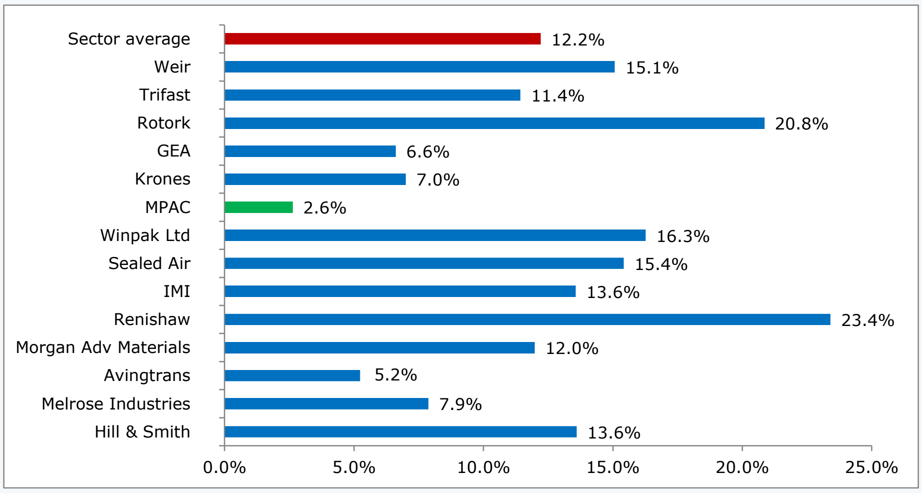
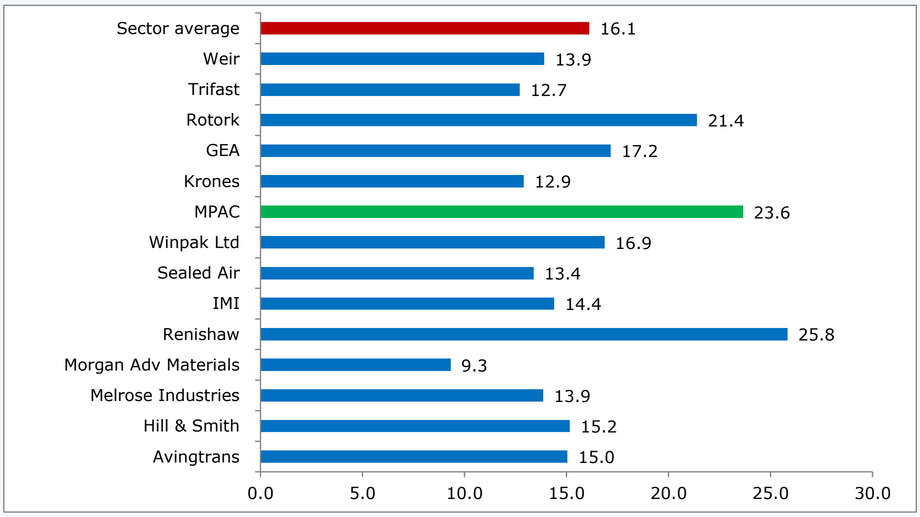
Current year (CY) peer group EBIT margins



Source: Equity Development, various – prices as at 17th July 2018

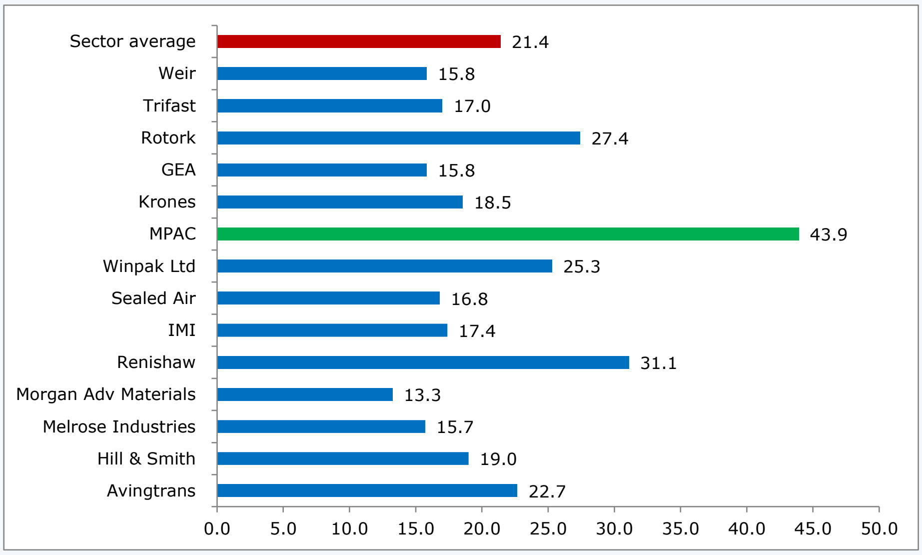
Interestingly too, comparable stocks today trade on multiples of 12x-18x EV/EBIT and 15x-25x PER (see below), which **hypothetically would imply a valuation range of 330p-490p/share for MPAC by 2021** vs 215p today.

CY EV/EBIT multiples for industry peers



Source: Equity Development, various – prices as at 17th July 2018

CY PER multiples for industry peers



Source: Equity Development, various – prices as at 17th July 2018

Key risks

- As demonstrated in past recessions, capital equipment volumes are typically exposed to the cyclical nature of the global economy.
- The large size of the UK (£397m of liabilities) & US (£23m of liabilities) defined benefit pension schemes compared to MPAC's market capitalisation.
- Currency exposure and greater competition.
- MPAC is smaller than its rivals/clients (eg German and Italian) and could see margins squeezed.
- Slower than expected growth, higher costs and/or lower cash generation.
- Industry suffers occasionally from lumpy orders, protracted customer purchasing decisions and irregular cashflows over the period end.
- Long term trend towards clients outsourcing production to 'low cost' contract manufacturers.
- Continued industry consolidation could impact on pricing and margins.
- Difficulties passing on cost inflation, such as salaries and raw materials.

Adjusted financial projections

MPAC plc - continuing (December year end)	2016 Act £'000s	2017 Act £'000s	2018 Est £'000s	2019 Est £'000s	2020 Est £'000s	2021 Est £'000s
Closing orderbook	**25,500**	**34,400**				
Equipment	28,800	40,400	45,000	47,700	50,562	53,596
Service	12,700	13,000	12,000	12,720	13,483	14,292
Turnover	**41,500**	**53,400**	**57,000**	**60,420**	**64,045**	**67,888**
Equipment		*40.3%*	*11.4%*	*6.0%*	*6.0%*	*6.0%*
Service		*2.4%*	*-7.7%*	*6.0%*	*6.0%*	*6.0%*
Total % YoY growth		*28.7%*	*6.7%*	*6.0%*	*6.0%*	*6.0%*
Equipment	5,400	9,200	10,345	11,925	12,893	13,935
Service	5,600	5,300	4,800	5,088	5,393	5,717
Total gross margin	**11,000**	**14,500**	**15,145**	**17,013**	**18,287**	**19,652**
Equipment	*18.8%*	*22.8%*	*23.0%*	*25.0%*	*25.5%*	*26.0%*
Service	*44.1%*	*40.8%*	*40.0%*	*40.0%*	*40.0%*	*40.0%*
% Margin	*26.5%*	*27.2%*	*26.6%*	*28.2%*	*28.6%*	*28.9%*
EBITDA	**500**	**2,200**	**2,441**	**3,938**	**4,830**	**5,804**
% Margin	*1.2%*	*4.1%*	*4.3%*	*6.5%*	*7.5%*	*8.5%*
Distribution	-5,300	-5,400	-5,582	-5,749	-5,922	-6,100
Administration	-6,600	-7,300	-7,546	-7,772	-8,006	-8,246
Other	-300	-500	-517	-532	-548	-565
Adjusted EBIT	**-1,200**	**1,300**	**1,500**	**2,959**	**3,811**	**4,742**
% Operating Margin	***-2.9%***	***2.4%***	***2.6%***	***4.9%***	***5.9%***	***7.0%***
Underlying interest charge	-330	-170	-200	-200	-200	-200
Adjusted Profit before Tax	**-1,530**	**1,130**	**1,300**	**2,759**	**3,611**	**4,542**
Adjusted EPS (p)	**-6.0**	**4.2**	**4.9**	**10.3**	**13.5**	**16.9**
EPS growth rate			*16.9%*	*111.1%*	*30.2%*	*25.5%*
Dividend (pence)	***1.25***	***0.00***	***0.00***	***0.00***	***0.00***	***0.00***
Reported sharecount (Ks - incl Treasury)	20,172	20,172	20,172	20,172	20,172	20,172
Valuation benchmarks						
P/E ratio		*51.4*	*43.9*	*20.8*	*16.0*	*12.7*
PER (adjusted for pension recovery payments)					*98.3*	*33.3*
EV/Sales (pension adjusted)	*0.85*	*0.66*	*0.62*	*0.59*	*0.55*	*0.52*
EV/EBITDA (pension adjusted)		*16.1*	*14.5*	*9.0*	*7.3*	*6.1*
EV/EBIT (pension adjusted)		*27.3*	*23.6*	*12.0*	*9.3*	*7.5*
PEG ratio			*2.60*	*0.19*	*0.53*	*0.50*
EBITDA drop through rate			*6.7%*	*43.8%*	*24.6%*	*25.3%*
Return on equity (%)		*1.9%*	*2.2%*	*4.4%*	*5.5%*	*6.5%*
Net cash/(debt)	**800**	**29,400**	**23,778**	**21,257**	**19,557**	**18,735**
Estimated non-underlying Pension charges						
UK pension recovery payments		-1,847	-1,886	-1,925	-1,966	-2,007
UK tax shield		369	377	385	393	401
US pension recovery payments			-1,100	-900	-700	-500
Cashflow effect		**-1,478**	**-2,609**	**-2,440**	**-2,273**	**-2,106**
Net cash/(debt) - pence per share		**146**	**118**	**105**	**97**	**93**
Net assets / diluted share (p)	175	216	221	231	245	262
Shareprice (p)	**215**					

Source: Equity Development. MPAC's EV has been adjusted for pension/spare land. The cost of UK PPF levy is included within EBIT.

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