MPAC Group plc

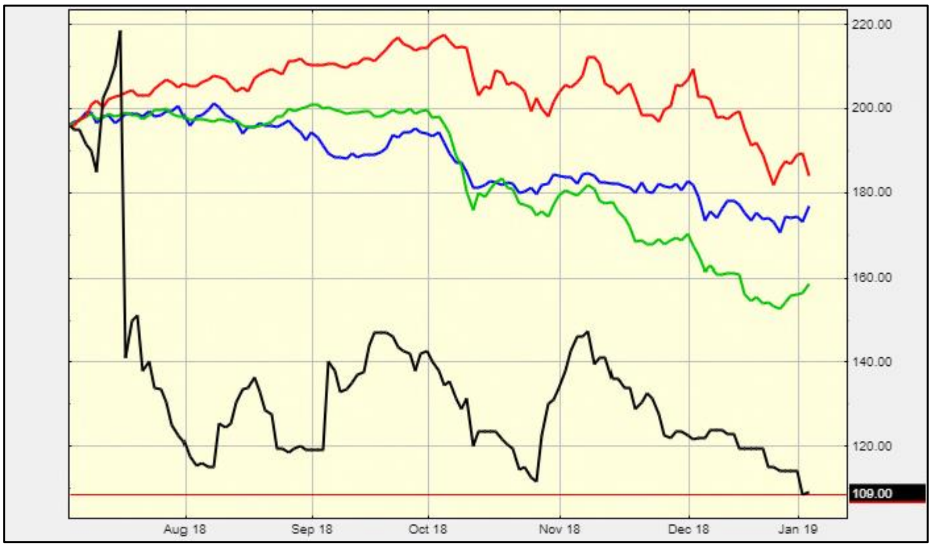
Wrapping up 2018 in fine fettle

7th January 2019

So after Friday's storming US jobs report, augmented by dovish comments from Federal Reserve Chairman Jerome Powell and extra stimulus measures in China – are we out of the woods? Nobody knows for sure. The equity rebound could simply be a 'dead cat bounce' or 'relief rally'. Either way, with the AIM Index in bear market territory, future returns should at least be better than 4 months ago.

Here we suspect the richest rewards will be earned by investors who are prepared to 'cherry pick' those 'fallen angles' that have declined the most. Step forward MPAC, a specialist provider of hi-speed packaging machines and related services. Generating **c.85% of revenues from outside the UK** - where it should not only be a **beneficiary of the lower £**, but also insulated somewhat against any Hard Brexit.

6 month MPAC chart vs Dow Jones, FTSE 100 & AIM indices



Source: ADVFN - Black MPAC, Red Dow Jones, Blue FTSE100 and Green AIM

Solid growth platform for 2019

What's more, **this morning's positive trading update said "*2018 sales (ED est £57m vs £53.4m LY) and PBT (ED est £1.3m vs £1.13m) [were] in line with expectations*,** *supported by a* ***strong closing orderbook****, which will provide a platform for continued growth in 2019*." Confirming the soft patch experienced in H1 was a temporary blip, and **order flow has now returned to normal levels**.

Additionally, the £1m of cost-overruns relating to two legacy contracts, have been contained. The UK machinery project is "*resolved*", whilst the "*Canadian agreement should be [fully settled] during 2019"*. Tony steels adding "*H2 saw us* ***secure a number of new contract wins*** *that support our strategic objectives. We are well on the way to finalising the remaining legacy contract and* ***I am confident that we are back on track with a good platform for growth.***"

In terms of the balance sheet, we estimate **the group ended Dec'18 sporting a net cash pile of £25m, equivalent to 124p/share**, and net assets of 263p/share.

Company Data

EPIC	**AIM:MPAC**
Price (last close)	109p
52 week Hi/Lo	230p/109p
Market cap	£22m
ED valuation/ share	170p
Avg. daily volume	35,000

Share Price, p

Source: Web Financial

Description

MPAC 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.

In Coventry (UK), the firm develops innovative technology and associated production / packaging machinery. Core verticals are Pharmaceutical (12% sales), Healthcare (30%) and Food/Beverage (58%), supporting the likes of Nestlé, GSK, AstraZeneca, Unilever, Kellogg's, Diageo, Ferrero, Hollister and CooperVision.

Next news: Prelims in March 2019

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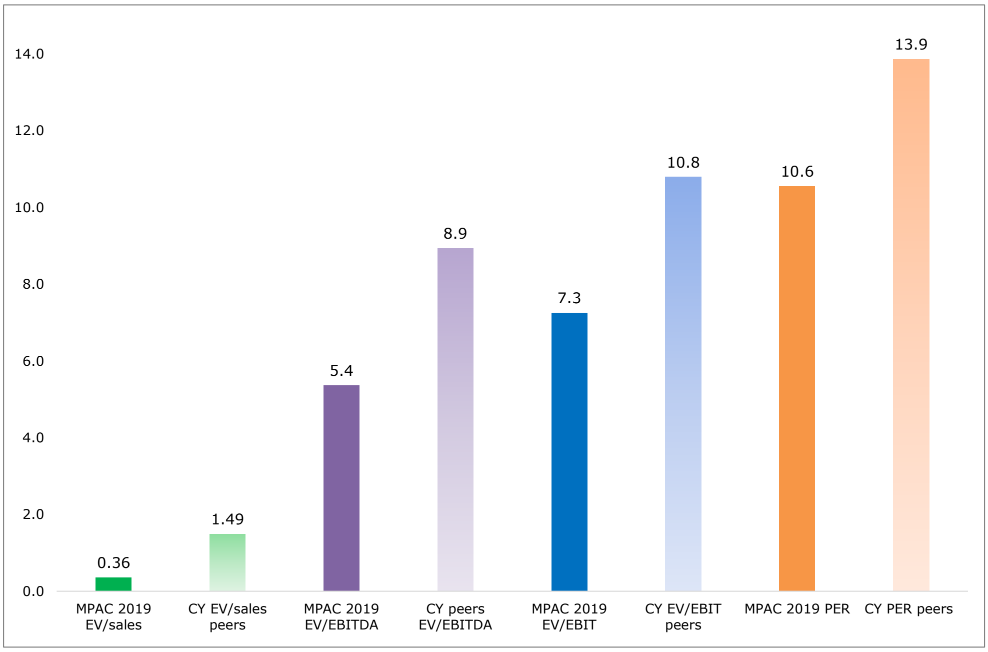
On the front foot, offering plenty of upside

Elsewhere, there seems to be little impact either from commodity price pressures (eg steel & aluminium) and/or the Trump trade tariffs. Plus, we look forward in hearing how the cost cutting measures that were implemented post June are set to bear fruit in 2019. Meaning at this stage, **we make no change to our financial projections, or 170p/share valuation**.

Longer term, there may even be scope to exceed our top (est. 6% pa) and bottom line forecasts – predicated on delivering enhanced service revenues, product innovation, x/up-selling, economies of scale and 'end-to-end' solutions.

In fact, if the Board's target of 10% LFL revenue growth alongside rising EBIT margins (est. 2.6% 2018) can be achieved, then we could see the shares push above 250p. Particularly given the wide discount the stock trades vs engineering/packaging peers (see below).

MPAC 2019 valuation benchmarks vs peers

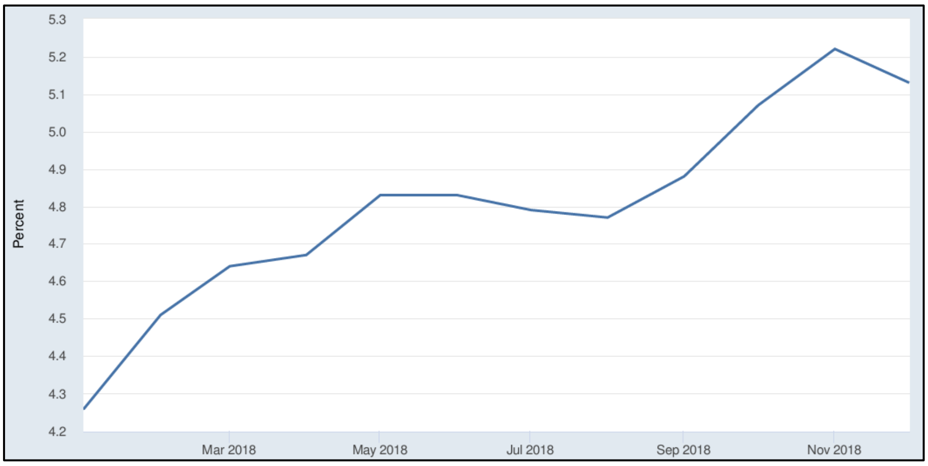


Source: Equity Development

Pension position being re-assessed

That is not to say everything is totally smelling of roses. MPAC's pension position ***may*** have deteriorated since 30th June, reflecting weaker equity prices (see next table) – albeit partly offset by higher corporate bond yields which should have similarly reduced liabilities.

Moody's Seasoned Baa Corporate Bond Yield



Source: Federal Reserve Bank of St Louis

Going forward though, the main driver of UK deficit recovery payments will be the outcome of the June 2018 triennial review (£70m deficit in Jun'15 with a 14 year recovery period) – which employs more conservative actuarial assumptions and lower gilt yields (1.3% Dec'18 vs 1.5% Jun'18: see below).

MPAC is paying around £1.9m pa (gross) into the UK scheme, with the company's advisors currently "*evaluating the extent to which the recent Lloyds Banking Group's High Court ruling on the equalisation of guaranteed minimum pensions between men and women will crystallise additional liabilities*".

UK 10 year Gilt yield

Source: Financial Times

In the event there is a significant shortfall, there may be a chance of filling some of the gap by injecting proceeds from the possible disposal of MPAC's 10 acres of spare land in Monks Risborough, Buckinghamshire (NBV £0.8m) - which is seeking planning permission after being rejected twice before. Alternatively, it might also be possible to transfer part/all of these pension obligations to an insurance company, if interest rates were ever to return to historical levels.

Lastly, with regards to M&A we understand the Board continues to actively look at opportunities - although nothing is thought to be imminent.

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 (£375.3m of liabilities) & US (£21.8m of liabilities) defined benefit pension schemes compared to MPAC's market capitalisation.
- Currency exposure, trade tariffs, raw material price increases (eg steel, aluminium) and 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 pricing and margins.

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**	**2022 Est £'000s**	**2023 Est £'000s**	**2024 Est £'000s**
Closing orderbook	**25,500**	**34,400**							
Equipment	28,800	40,400	46,000	48,760	51,686	54,787	58,074	61,558	65,252
Service	12,700	13,000	11,000	11,660	12,360	13,101	13,887	14,720	15,604
Turnover	**41,500**	**53,400**	**57,000**	**60,420**	**64,045**	**67,888**	**71,961**	**76,279**	**80,856**
Equipment		*40.3%*	*13.9%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*
Service		*2.4%*	*-15.4%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*
Total % YoY growth		*28.7%*	*6.7%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*
Equipment	5,400	9,200	10,718	12,322	13,319	14,392	15,546	16,787	18,120
Service	5,600	5,300	4,400	4,664	4,944	5,240	5,555	5,888	6,241
Total gross margin	**11,000**	**14,500**	**15,118**	**16,986**	**18,263**	**19,633**	**21,101**	**22,675**	**24,362**
Equipment	*18.8%*	*22.8%*	*23.3%*	*25.3%*	*25.8%*	*26.3%*	*26.8%*	*27.3%*	*27.8%*
Service	*44.1%*	*40.8%*	*40.0%*	*40.0%*	*40.0%*	*40.0%*	*40.0%*	*40.0%*	*40.0%*
% Margin	*26.5%*	*27.2%*	*26.5%*	*28.1%*	*28.5%*	*28.9%*	*29.3%*	*29.7%*	*30.1%*
EBITDA	**450**	**2,200**	**2,500**	**4,007**	**4,915**	**5,905**	**6,984**	**8,159**	**9,436**
% Margin	*1.1%*	*4.1%*	*4.4%*	*6.6%*	*7.7%*	*8.7%*	*9.7%*	*10.7%*	*11.7%*
Distribution	-5,300	-5,400	-5,582	-5,749	-5,922	-6,100	-6,283	-6,471	-6,665
Administration	-6,600	-7,300	-7,546	-7,772	-8,006	-8,246	-8,493	-8,748	-9,010
Other	-300	-500	-490	-505	-520	-535	-551	-568	-585
Adjusted EBIT	**-1,200**	**1,300**	**1,500**	**2,959**	**3,816**	**4,752**	**5,774**	**6,888**	**8,101**
% Operating Margin	***-2.9%***	***2.4%***	***2.6%***	***4.9%***	***6.0%***	***7.0%***	***8.0%***	***9.0%***	***10.0%***
Underlying interest charge	-330	-170	-200	-200	-200	-200	-200	-200	-200
Adjusted Profit before Tax	**-1,530**	**1,130**	**1,300**	**2,759**	**3,616**	**4,552**	**5,574**	**6,688**	**7,901**
Adjusted EPS (p)	**-6.0**	**4.2**	**4.9**	**10.3**	**13.5**	**16.9**	**20.6**	**24.9**	**29.4**
EPS growth rate			*16.9%*	*111.2%*	*30.4%*	*25.6%*	*21.8%*	*20.6%*	*18.1%*
Dividend (pence)	***1.25***	***0.00***	***0.00***	***0.00***	***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	20,172	20,172	20,172
Valuation benchmarks									
P/E ratio		*26.0*	*22.3*	*10.6*	*8.1*	*6.4*	*5.3*	*4.4*	*3.7*
PER (adjusted for pension recovery payments)					*194.0*	*23.7*	*12.3*	*8.0*	*5.8*
EV/Sales (pension adjusted)	*0.52*	*0.40*	*0.38*	*0.36*	*0.34*	*0.32*	*0.30*	*0.28*	*0.27*
EV/EBITDA (pension adjusted)		*9.8*	*8.6*	*5.4*	*4.4*	*3.6*	*3.1*	*2.6*	*2.3*
EV/EBIT (pension adjusted)		*16.5*	*14.3*	*7.3*	*5.6*	*4.5*	*3.7*	*3.1*	*2.7*
PEG ratio			*1.32*	*0.09*	*0.27*	*0.25*	*0.24*	*0.21*	*0.20*
EBITDA drop through rate			*8.3%*	*44.1%*	*25.0%*	*25.8%*	*26.5%*	*27.2%*	*27.9%*
Return on equity (%)		*1.9%*	*1.8%*	*3.8%*	*4.7%*	*5.6%*	*6.4%*	*7.1%*	*7.8%*
Net cash/(debt)	**800**	**29,400**	**25,000**	**22,604**	**20,998**	**20,242**	**20,403**	**21,551**	**23,760**
Estimated non-underlying Pension charges									
UK pension recovery payments			-1,900	-1,940	-1,981	-2,022	-2,065	-2,108	-2,152
UK tax shield			361	369	376	384	392	401	409
US pension recovery payments			-1,300	-1,150	-1,000	-850	-700	-550	-400
Cashflow effect			**-2,839**	**-2,721**	**-2,604**	**-2,488**	**-2,372**	**-2,258**	**-2,143**
Net cash/(debt) - pence per share		**146**	**124**	**112**	**104**	**100**	**101**	**107**	**118**
Net assets / diluted share (p)	175	216	263	273	287	304	324	349	379
Shareprice (p)	**109**								

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

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