

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

Paul Hill (Analyst)

0207 065 2690
paul.hill@equitydevelopment.co.uk

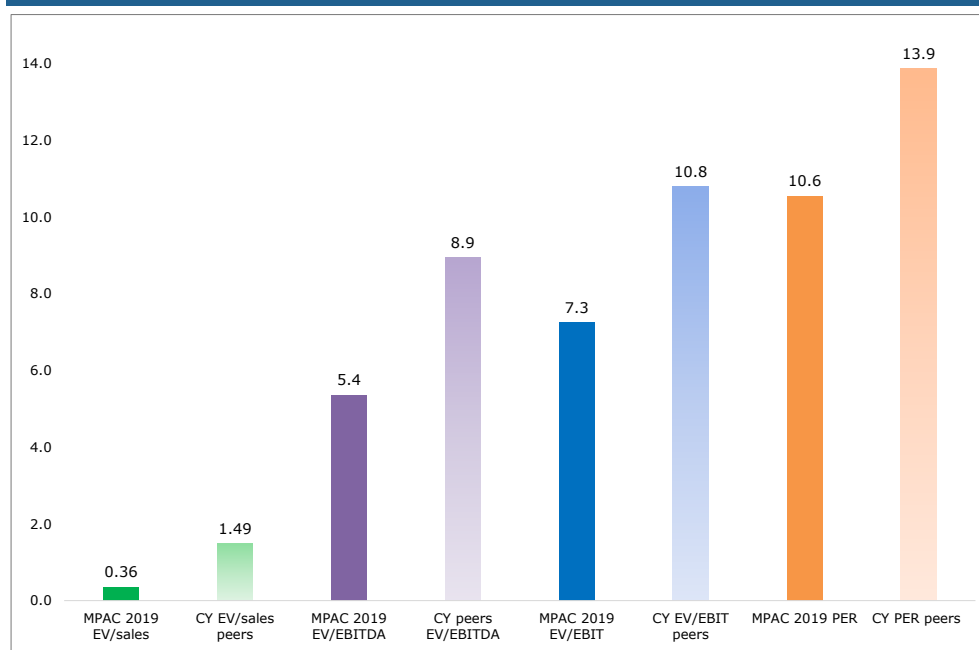
On the front foot, offering plenty of upside

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% | 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% |
| % Margin | | 26.5% | 27.2% | 26.5% | 28.1% | 28.5% | 28.9% | 29.3% | 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% | 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.



Investor Access

Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

hannah@equitydevelopment.co.uk

Felix Grant-Rennick

Direct: 0207 065 2693

Tel: 0207 065 2690

felix@equitydevelopment.co.uk

Equity Development Limited is regulated by the Financial Conduct Authority

Equity Development Limited ('ED') is retained to act as financial adviser for various clients, some or all of whom may now or in the future have an interest in the contents of this document and/or in the Company. In the preparation of this report ED has taken professional efforts to ensure that the facts stated herein are clear, fair and not misleading, but make no guarantee as to the accuracy or completeness of the information or opinions contained herein.

The research in this document has been produced in accordance with COBS 12.3 as Non-Independent Research and is a marketing communication. This document is not directed at, may not be suitable for and should not be relied on by anyone who is not an investment professional including retail clients. It does not constitute a personal investment recommendation and recipients must satisfy themselves that any dealing is appropriate in the light of their own understanding, appraisal of risk and reward, objectives, experience, and financial and operational resources. Research on its client companies produced and distributed by ED is normally commissioned and paid for by those companies themselves ('issuer financed research') and as such is deemed to be 'non-independent research' but is 'objective' in that the authors are stating their own opinions. This report has not been produced under legal requirements designed for independent research.

ED may in the future provide, or may have in the past provided, investment banking services to its client companies. For ED's employees and consultants there are rules to prevent dealing in the shares of client companies whilst notes are being prepared, or immediately after the note's release. Publication is achieved by a new note being freely available from the ED website. ED's engagement with corporate clients is governed by the laws of England & Wales. In the UK, companies quoted on AIM are subject to lighter due diligence than shares quoted on the main market and are therefore more likely to carry a higher degree of risk than main market companies.

This report is being provided to relevant persons by ED to provide background information about MPAC Group plc. This document does not constitute, nor form part of, and should not be construed as, any offer for sale or purchase of (or solicitation of, or invitation to make any offer to buy or sell) any Securities (which may rise and fall in value). Nor shall it, or any part of it, form the basis of, or be relied on in connection with, any contract or commitment whatsoever. Self-certification by investors can be completed free of charge at www.fisma.org

More information is available on our website

www.equitydevelopment.co.uk

Equity Development, 15 Eldon Street, London, EC2M 7LD. Contact: info@equitydevelopment.co.uk 0207 065 2690