

Strong start to H2 as demand returns

COVID-19 has impacted businesses in many different ways. However for specialist high speed packaging & automation solutions provider Mpac, **we think the pandemic will prove to be a long-term positive**. Why?

Well the lockdowns have already started to **accelerate both the reshoring of US production back from China** (re supply chain disruption & US tariffs), and the **adoption of the company's expanding suite of Industry 4.0 solutions**, such as remote diagnostics, virtual machine testing/commissioning & augmented reality training.

Excellent cash generation with resilient margins

Sure H1'20 turnover fell 20% (-32% LFL) to £36.6m YoY, due to deferred shipments, tough comparatives (record H1'19 of £45.8m) and difficulties accessing client sites. Yet equally **no orders have been cancelled**, whilst **operating margins came in at a healthy 7.1%** (adjusted EBIT £2.6m), thanks to favourable mix. Reflecting **higher spare part volumes**, driving **service revenues up +30% YoY** - equivalent to 26% sales vs 17% LY. Moreover order intake declined by only -6% to £30.5m (£32.6m LY), underlining the **natural resilience of their core markets**: namely Healthcare (eg GSK, CooperVision, Bausch+Lomb), Food/Beverage (Ice-cream, popcorn) and pharmaceuticals.

Elsewhere, **net funds closed June up £4.5m to £22.5m** (or 112p/share vs £18.0m Dec'19), benefitting from tight working capital control (£3.5m inflow) and cash collection (re debtor days at pre CV19 levels). All told, **providing plenty of fire-power in the event suitable M&A opportunities become available** at attractive prices

Solid H1'20 results despite the coronavirus

Summary Financials (£'000s)	FY18	H1'19	H2'19	Act FY19	H1'20	Est H2'20	Est FY20
Closing orderbook (ED Est)	53,100	39,900		52,200	45,400		52,000
Equipment	46,200	38,200	31,200	69,400	27,100	32,900	60,000
Service	12,100	7,600	11,800	19,400	9,700	10,300	20,000
Revenues	58,300	45,800	43,000	88,800	36,800	43,200	80,000
Reported % growth rate	9.2%	62.4%	42.9%	52.3%	-19.7%	0.5%	-9.9%
Equipment	9,300	10,400	7,800	18,200	6,911	8,690	15,600
Service	4,700	2,700	5,100	7,800	4,365	3,835	8,200
Gross Profit	14,000	13,100	12,900	26,000	11,300	12,500	23,800
% margin	24.0%	28.6%	30.0%	29.3%	30.7%	28.9%	29.8%
Operating expenses (excl D&A)	-11,800	-7,700	-8,500	-16,200	-8,000	-8,700	-16,700
Adjusted EBITDA (post SBPs)	2,200	5,400	4,400	9,800	3,300	3,800	7,100
% margin	3.8%	11.8%	10.2%	11.0%	9.0%	8.8%	8.9%
Depreciation	-600	-700	-1,200	-1,900	-600	-1,000	-1,600
Amortisation of intangibles (non acqn)	-200	-100	-100	-200	-100	-100	-200
Adjusted EBIT (post SBPs)	1,400	4,600	3,100	7,700	2,600	2,700	5,300
% margin	2.4%	10.0%	7.2%	8.7%	7.1%	6.3%	6.6%
Net interest	0	-100	-100	-200	-100	0	-100
Adjusted PBT	1,400	4,500	3,000	7,500	2,500	2,700	5,200
Tax	-503	-300	687	387	-300	-428	-728
Adjusted earnings	897	4,200	3,687	7,887	2,200	2,272	4,472
Adjusted EPS (pence)	4.5p	21.0p	18.5p	39.5p	11.0p	11.3p	22.3p
EPS growth %	7.5%			777.7%			-43.6%
Dividend	0.0p	0.0p	1.5p	1.5p	0.0p	0.0p	0.0p
Net cash / (debt) - Ex IFRS16	27,000	9,600	18,000	18,000	22,500	19,500	19,500
Net cash per share	134p	48p	89p	89p	112p	97p	97p

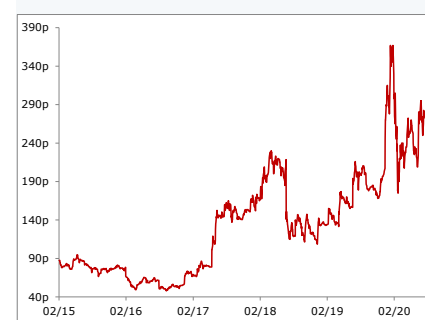
Source: Equity Development

3rd September 2020

Company Data

EPIC	AIM:MPAC
Price (last close)	310p
52 week Hi/Lo	367p/167p
Market cap	£62.5m
Net cash Jun'20	£22.5m
Share count (incl Treasury)	20.172m
ED valuation/share	350p/share
Avg. daily volume	450,000

Share Price, p



Source: Share Cast

Description

Mpac is a specialist provider of **full line, high speed packaging & automation solutions**, employing c. 510 staff.

The group not only develops & manufactures niche factory equipment and robotics, but also undertakes turnkey projects involving the design & integration of such systems. More than 80% of revenues are generated outside of the UK, hence providing a natural hedge against sterling weakness.

Core verticals are Healthcare, Pharmaceutical and Food/Beverage, supporting the likes of 3M, J&J, Nestlé, GSK, P&G, Philips Advent, ConvaTec, AstraZeneca, Unilever, Kellogg's, Diageo, Ferrero, Bausch + Lomb & CooperVision.

Next news: Interims 3rd September 2020

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Reinstating forecasts with a 350p/share valuation

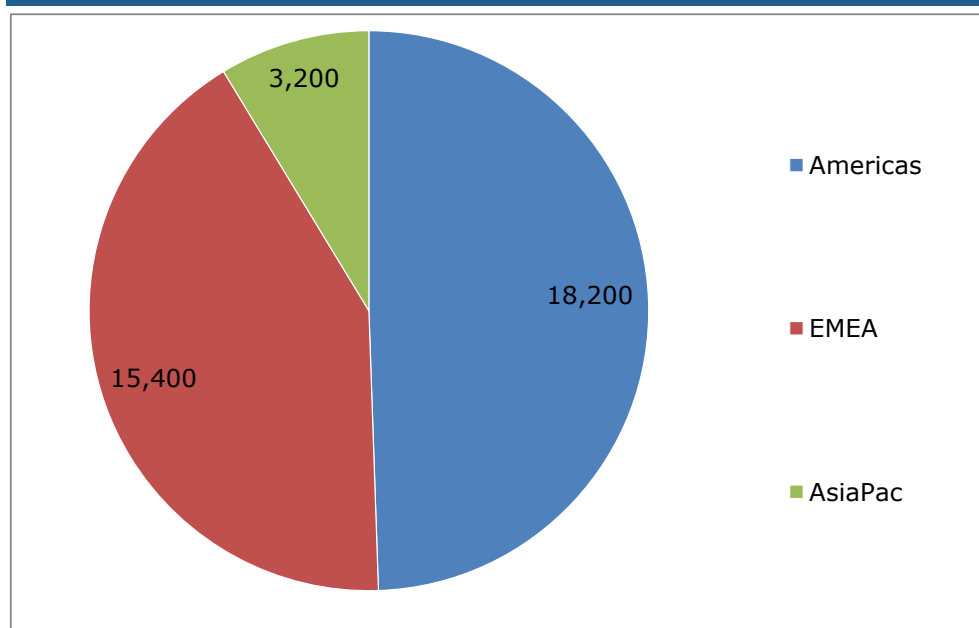
Looking ahead, **H2 has begun well**, with un-seasonally strong July bookings, especially in North America & Healthcare, with Food & Beverage not far behind. Indeed more broadly, US durable goods orders rose 11.2% (+7.7% June) in the month, significantly above economist expectations of 4.8%. The 3rd straight increase, implying manufacturing is continuing to recover, partly attributed to the vast amounts fiscal/monetary stimulus.

Hence putting all this together, alongside Mpac's robust June backlog of £45.5m (+14% vs £39.9m LY & £52.2m Dec'19), **we have reintroduced 'conservative' 2020 revenue and adjusted EBIT forecasts of £80m and £5.3m** (margin 6.6%) respectively.

Best-in-class products and services

Further out, there is even **scope for the group to win market share**, as clients standardise on best-in-class OEMs offering worldwide service (see below) and fully integrated smart factory technologies.

H1'20 geographical sales (£36.8m) split (£'000s)



Source: Equity Development

There are still risks though

That's not to say, the coast is totally clear. November's US Presidential elections could throw a mini spanner in C-suite investment works, particularly if Donald Trump weaponizes trade negotiations with the likes of China & Europe. Whilst Brexit also carries uncertainties, in the event the UK & Brussels fail to strike an agreement by Dec'20. Additionally, there can be some contract lumpiness over period ends.

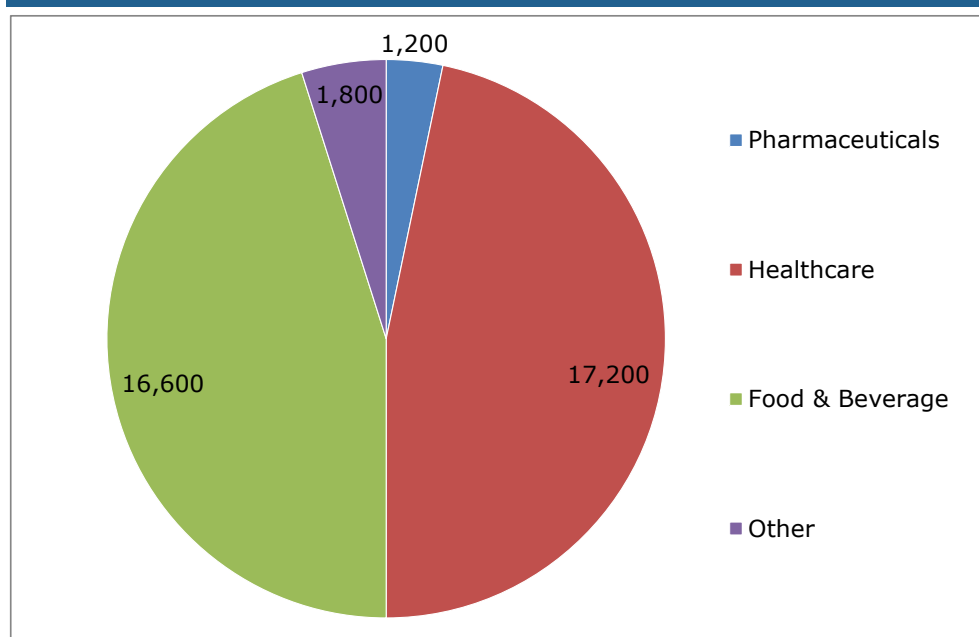
"Long term prospects remain positive"

Tony Steels adding *"I am really pleased with the way in which the business responded to the COVID-19 pandemic, **demonstrating agility, ingenuity and resilience which contributed to positive financial results and excellent cash generation in H1'20.** It*

further demonstrates the good progress and, in some cases, accelerated the positive impact and value of the strategic objectives we have been working on.

During the pandemic we have taken steps to preserve cash, to reduce discretionary spend and focus on our digital marketing presence and on new product development. These measures will place the Group in a strong position going into H2'20 to leverage the essential and **COVID-19 resilient Healthcare and Food and Beverage growth markets** which we supply. We are well placed, serving markets (see below) with good underlying demand. **Long-term prospects remain positive."**

H1'20 sales sector (£36.8m) split (£'000s)



Source: Equity Development

Organic growth complemented by synergistic M&A

In terms of M&A, **Lambert** (acquired in May '19 for £15m) **has now been successfully integrated**. Generating significant economies of scale, alongside back office, property, supply chain, procurement and overhead savings.

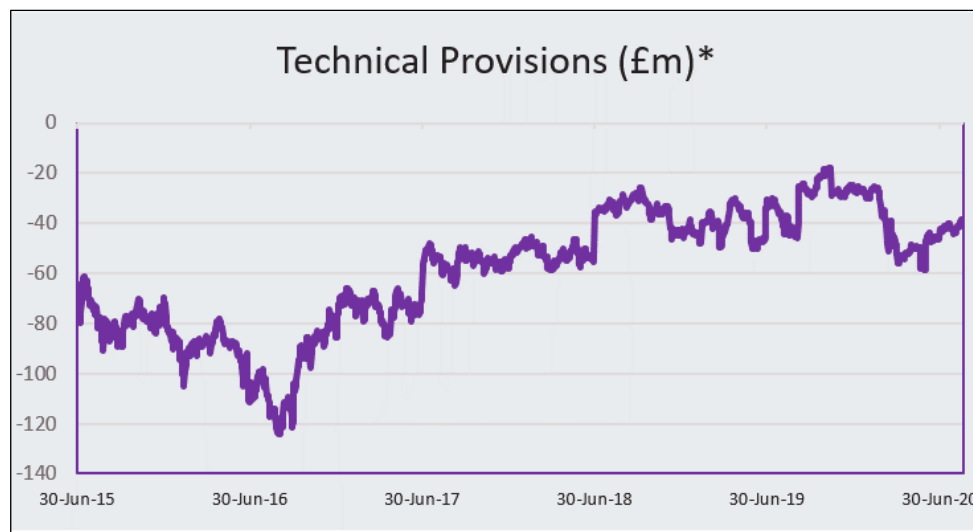
To us, it makes perfect strategic to temporarily pass the interim dividend, with the aim of redeploying some of the group's surplus cash to find another Lambert. Delivering we suspect ROCEs way above the Board's own M&A hurdle rates (ED est 12%-15% marginal IRRs).

UK actuarial deficit to be eliminated by July 2024

With regards to the pension, the UK scheme's actuarial deficit stood at around £40m on 30th June (see below), and is on track to be completely eliminated by July 2024.

This is key because it puts a line in the sand, after which the company should not have to make any more recovery contributions. In fact our projections model an extra £4m pa of positive cashflow (net of tax) in 2025, aided by a drop in the PFI levy (circa £0.5m pa - ED Est).

Actuarial deficit of UK pension scheme



Source: Company

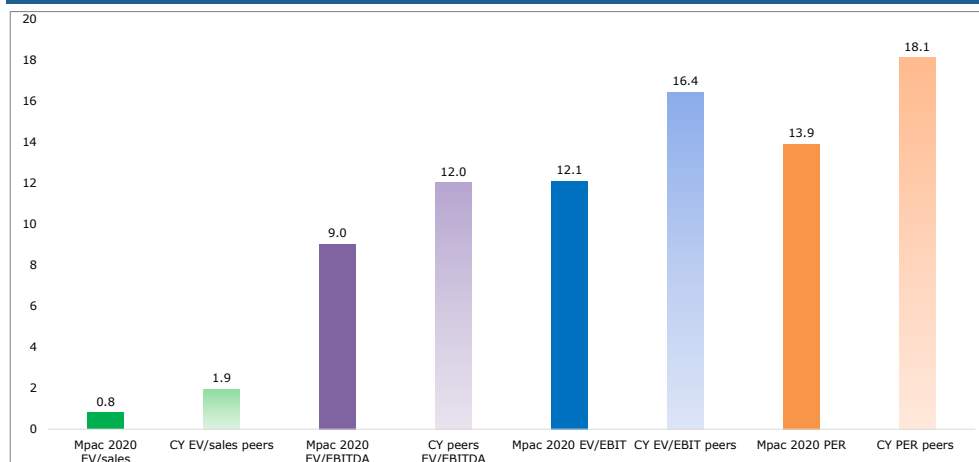
On an accounting basis, the UK pension scheme (IAS 19: pre-tax) ended June 2020 in surplus at £25.7m (£20.4m Dec'19), with the US deficit at £4.9m (£3.1m). Both were sheltered from the worst of the crisis by clever liability matching (equities <10% of assets), offset by lower yields on AA corporate bonds.

Brexit resilient with >85% of sales outside UK

Finally moving to valuation, **the stock at 310p remains attractively priced** - trading on a 2020 EV/EBIT multiple of 12.1x (see below) vs 16.4x for peers. Offering **material potential upside for investors** - particularly if Covid jumpstarts adoption of Mpac's recently launched industry 4.0 solutions, lifts profit margins (re mix/service) and increases repeat/recurring revenues.

With >85% of turnover generated overseas, there's a natural hedge too against UK currency depreciation (£:\$ 1.33), say in the event of a 'no-deal' Brexit.

MPAC valuation benchmarks vs peers



Source: Equity Development (MPAC metrics have been pension adjusted, except for PER)

Historical results

Mpac Group plc - continuing (December year end)	2016 Act £'000s	2017 Act £'000s	2018 Act £'000s	2019 Act £'000s	2020 Est £'000s
Closing orderbook	25,500	34,400	53,100	52,200	50,000
<i>Growth</i>		34.9%	54.4%	-1.7%	-4.2%
Equipment	28,800	40,400	46,200	69,400	60,000
Service	12,700	13,000	12,100	19,400	20,000
Turnover	41,500	53,400	58,300	88,800	80,000
<i>Equipment</i>		40.3%	14.4%	50.2%	-13.5%
<i>Service</i>		2.4%	-6.9%	60.3%	3.1%
Total % YoY growth		28.7%	9.2%	52.3%	-9.9%
Equipment	5,400	9,200	9,300	18,200	15,600
Service	5,600	5,300	4,700	7,800	8,200
Total gross margin	11,000	14,500	14,000	26,000	23,800
<i>Equipment</i>	18.8%	22.8%	20.1%	26.2%	26.0%
<i>Service</i>	44.1%	40.8%	38.8%	40.2%	41.0%
% gross margin	26.5%	27.2%	24.0%	29.3%	29.8%
EBITDA	450	2,200	2,200	9,800	7,100
<i>% Margin</i>	1.1%	4.1%	3.8%	11.0%	8.9%
Distribution	-5,300	-5,400	-5,000	-7,200	-6,763
Administration	-6,600	-7,300	-7,200	-10,300	-11,000
Other	-300	-500	-400	-800	-737
Adjusted EBIT	-1,200	1,300	1,400	7,700	5,300
<i>% Operating Margin</i>	-2.9%	2.4%	2.4%	8.7%	6.6%
Underlying interest charge	-330	-170	0	-200	-100
Adjusted Profit before Tax	-1,530	1,130	1,400	7,500	5,200
Adjusted EPS (p)	-6.0p	4.2p	4.5p	39.5p	22.3p
<i>EPS growth rate</i>			7.5%	777.7%	-43.6%
Dividend (p)	1.3p	0.0p	0.0p	1.5p	0.0p
<i>Yield</i>	0.4%	0.0%	0.0%	0.5%	0.0%
Reported sharecount (Ks - incl Treasury)	20,172	20,172	20,172	20,172	20,172
Valuation benchmarks					
<i>P/E ratio</i>		74.1	68.9	7.8	13.9
<i>PER (adjusted for pension recovery payments)</i>					43.5
<i>EV/Sales (pension adjusted)</i>	1.55	1.20	1.10	0.72	0.80
<i>EV/EBITDA (pension adjusted)</i>		29.2	29.2	6.5	9.0
<i>EV/EBIT (pension adjusted)</i>		49.3	45.8	8.3	12.1
<i>PEG ratio</i>					
<i>Corporate tax rate</i>	-20.0%	-26.5%	-35.9%	5.2%	-14.0%
<i>EBITDA drop through rate</i>			0.0%	24.9%	30.7%
<i>Return on equity (%)</i>		1.9%	2.2%	16.6%	8.6%
Net cash/(debt)	800	29,400	27,000	18,000	19,500
Information only - Estimated non-underlying Pension charges					
UK pension recovery payments			-1,900	-1,940	-1,981
Topup UK pension payments above £5.5m EBIT			0	-726	66
UK pension admin costs			-900	-1,200	-1,224
UK tax shield			532	735	596
US pension recovery payments (net tax shield)			-790	-790	-514
Cashflow effect			-3,058	-3,921	-3,057
Net cash per share		146	134	89	97
Net assets / diluted share (p)	175	212	201	235	258
Shareprice (p)	310p				

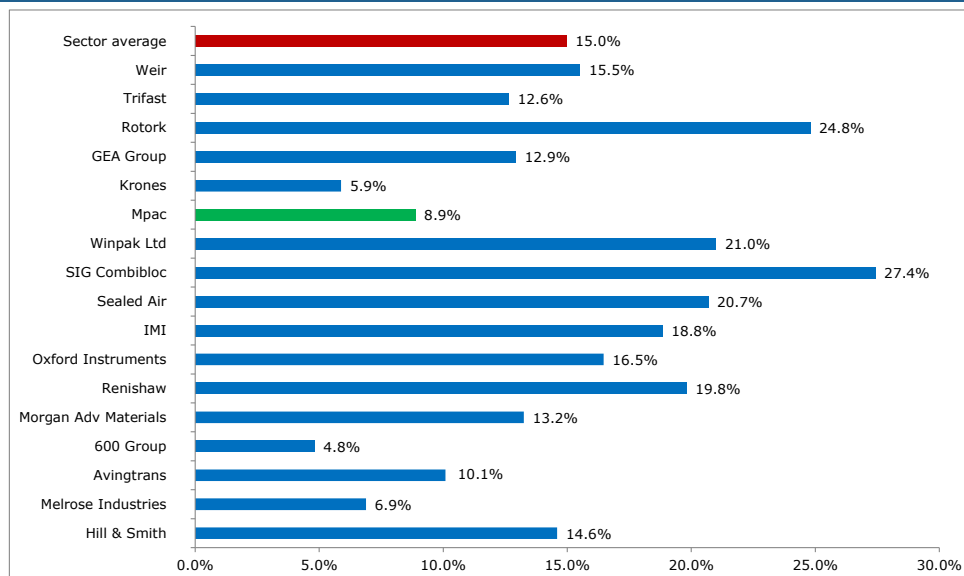
Source: Equity Development. Mpac's EV has been adjusted for pension. The cost of UK PPF levy is included within EBIT.

Key risks

- COVID-19 impacts last longer than expected. Plus in past recessions, capital equipment volumes are typically exposed to the cyclical nature of the global economy.
- The large size of the UK (£403.2m of liabilities as at December 2019) & US (£13.5m 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.

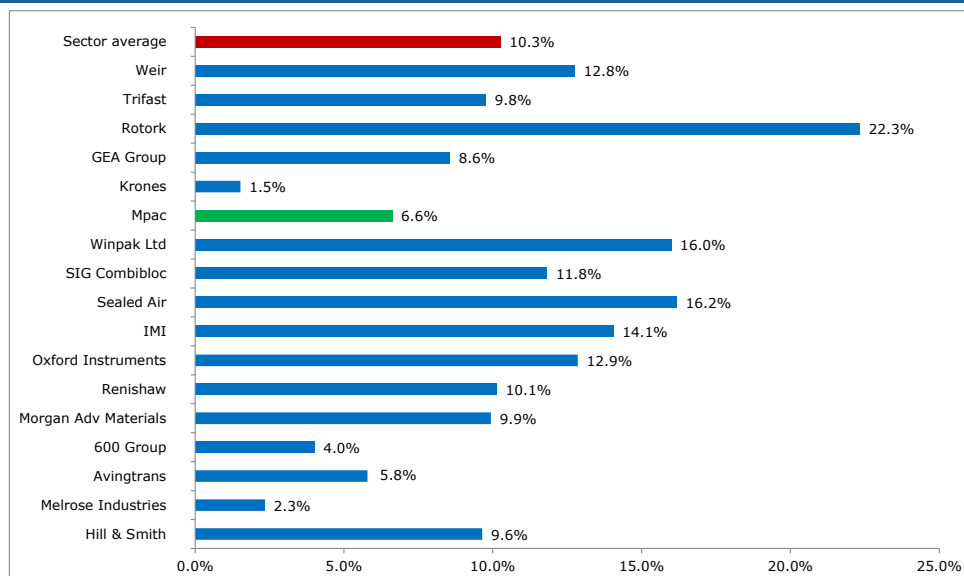
Appendix - Valuation benchmarks & industry KPIs

CY EBITDA margins



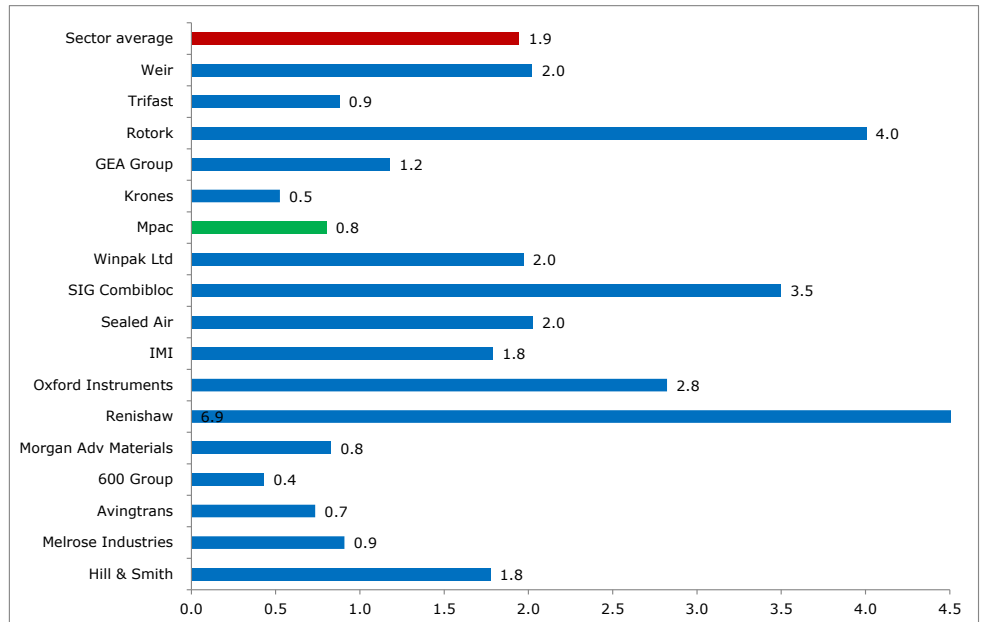
Source: Equity Development

CY EBIT margins



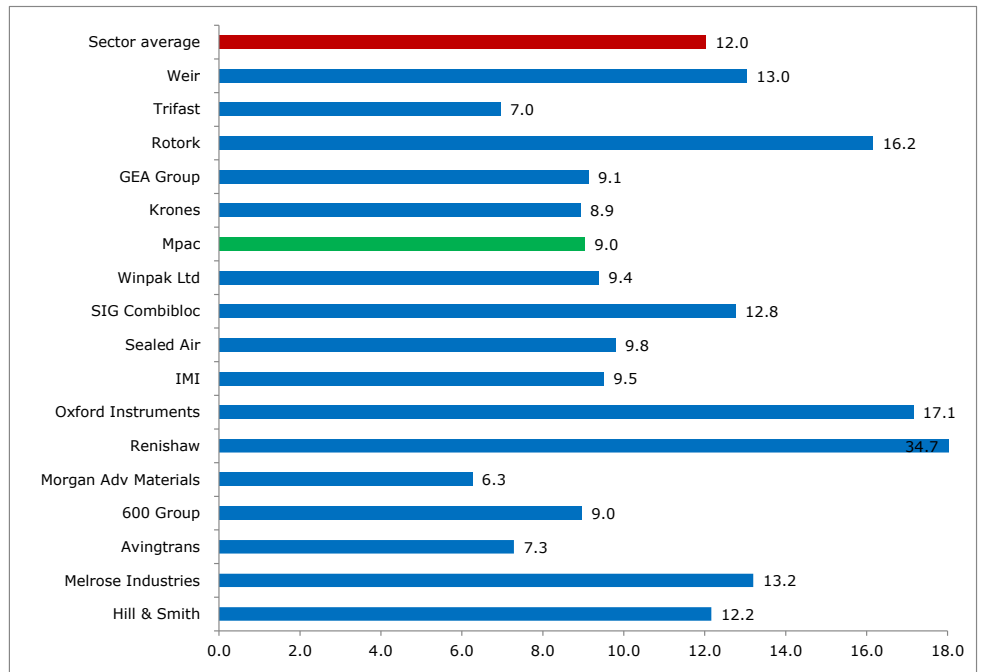
Source: Equity Development

CY EV/Sales multiples



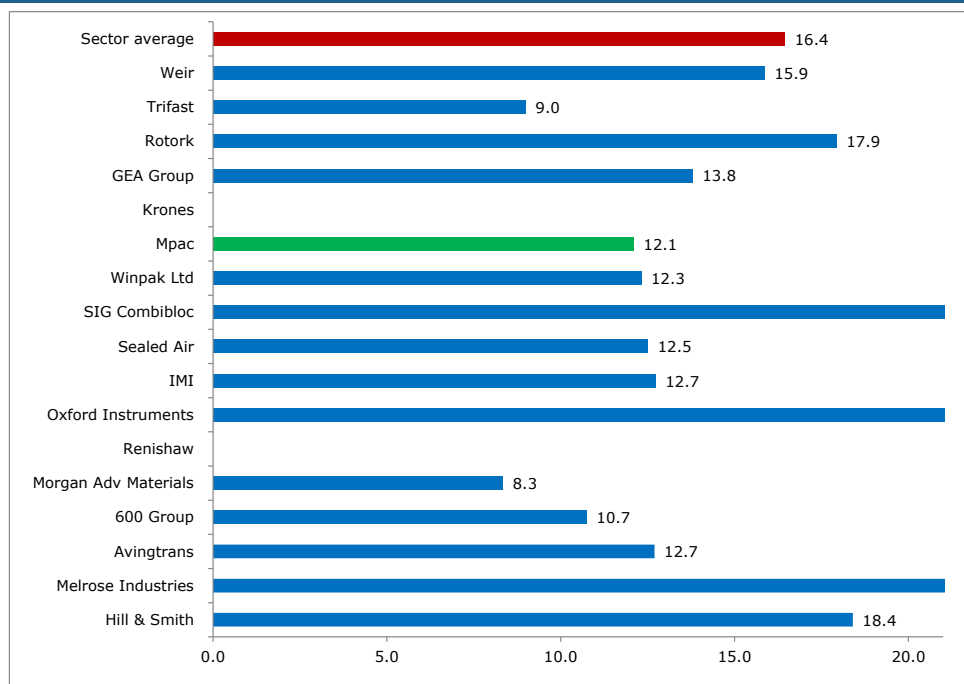
Source: Equity Development. Mpac pension adjusted

CY EV/EBITDA multiples



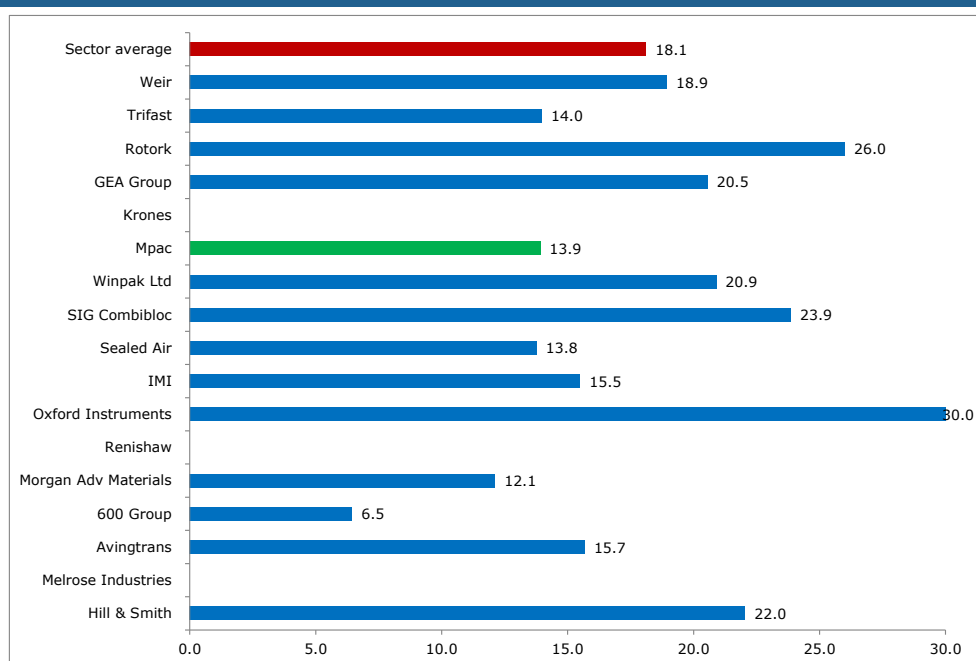
Source: Equity Development. Mpac pension adjusted

CY EV/EBIT multiples



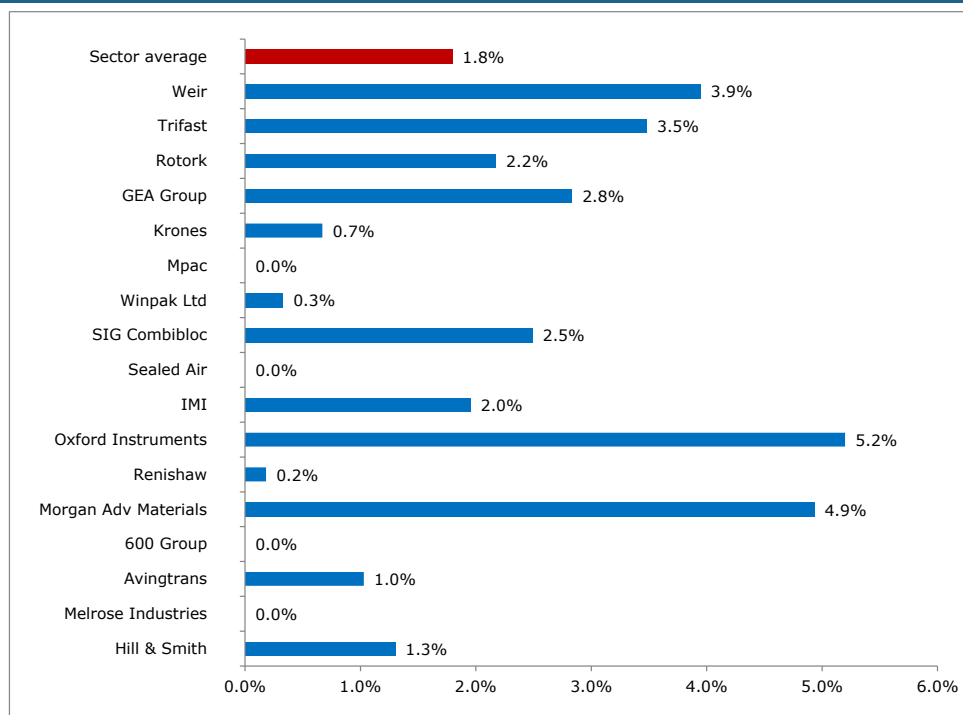
Source: Equity Development. Mpac pension adjusted

CY PE ratios



Source: Equity Development.

CY dividend yields vs peers



Source: Equity Development

Market capitalisation of peers

	Shareprice	Mrk Cap (Millions)	CY net cash / (debt) Millions	Enterprise Value (Millions)
Hill & Smith	1,230p	£977.9	-£174.0	£1,151.9
Melrose Industries	100p	£4,858	-£2,915	£7,773
Avingtrans	243p	£76.3	-£7.5	£83.8
600 Group	8p	£9.4	-£12.1	£21.5
Morgan Adv Materials	223p	£635.6	-£130.0	£765.6
Renishaw	4,950p	£3,604	£96	£3,508
Oxford Instruments	1,580p	£907	£77	£830
IMI	1,060p	£2,883	-£246	£3,129
Sealed Air	\$40.20	\$6,271	-\$3,411	\$9,682
SIG Combibloc	€ 16.46	€ 5,268	-€ 1,239	€ 6,507
Wipak Ltd	\$33.44	\$2,174	\$483	\$1,691
Mpac	310p	£62.5	£22.5	£40.0
Krones	€ 55.20	€ 1,744	-€ 14	€ 1,758
GEA Group	€ 30.00	€ 5,415	-€ 5	€ 5,420
Rotork	299p	£2,604	£165	£2,439
Trifast	102p	£137.7	-£15.2	£152.9
Weir	1,290p	£3,354	-£1,262	£4,616

Source: Equity Development



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