Mpac Group plc

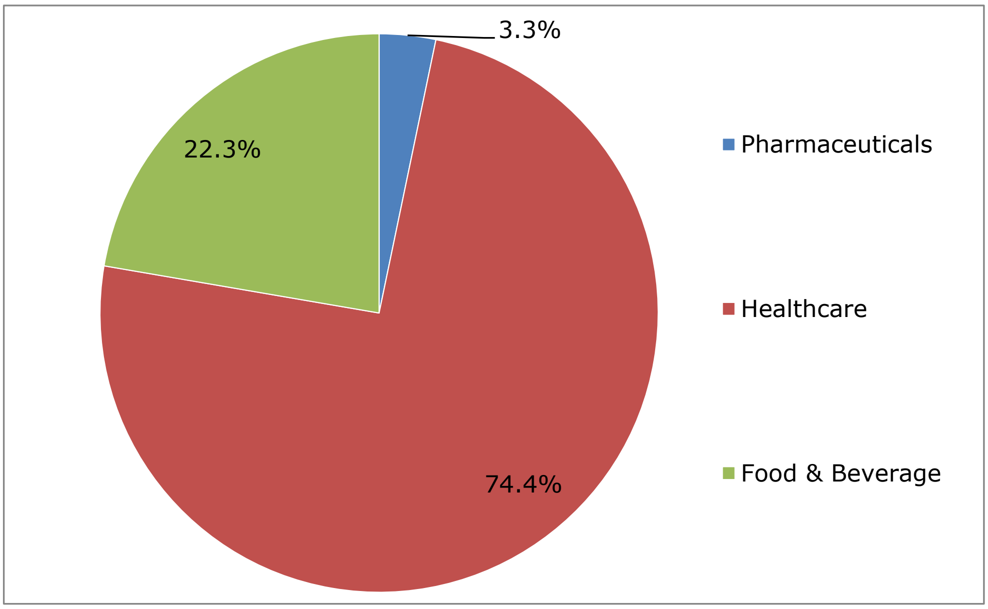
COVID-19 induced demand pause

26th March 2020

3 weeks ago, we thought the coronavirus would be a Chinese/Italian phenomena impacting global supply chains, but not triggering full/partial lockdowns across large swathes of the planet. How things have changed.

Indeed since then just about every country has been affected, with many industries literally at a standstill. **Mpac** is certainly not in this camp, since it **provides machinery, spares & engineering expertise to strategically important sectors** like healthcare, pharmaceuticals and food/beverage (see below) that will keep us all alive through this challenging period.

2019 revenue (£88.8m) break-down by customer segment



Source: Equity Development

Long term fundamentals remain intact

Nevertheless, **Mpac** is also **beginning to experience slowing activity levels** and **difficulties accessing client premises to fulfil shipments** (re social distancing).

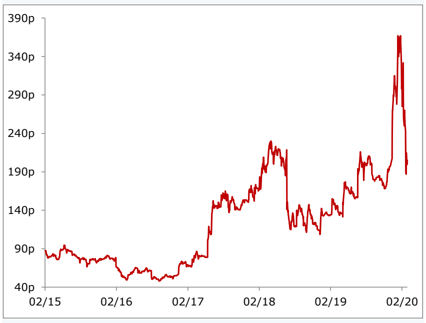
Sure this is frustrating, however we reckon the majority of its orderbook (£52.2m Dec'19) should be completed at a later date. Yes, delays will undoubtedly hit 2020 results – probably more so in Q2 than H2. Yet the **longer term fundamentals of Industry 4.0, direct to consumer deliveries and the shift towards more environmentally friendly packaging, continue to play to Mpac's strengths**. On top, there's **repeat service/aftermarket revenue** which should keep things ticking over.

Elsewhere **the balance sheet is strong**, sporting **£18.1m of net cash** (89p/share) **as at Feb'20** (ie £19m less £0.9m of preference shares), alongside a fully undrawn £10m credit line. Moreover the group has come through these types of short, sharp, economic shock before. And besides, there are **other levers to pull if things were to significantly deteriorate**. Not least, reducing capex (£2.3m 2019), discretionary spend and non-essential purchases.

Company Data

EPIC	**AIM:MPAC**
Price (last close)	205p
52 week Hi/Lo	375p/130p
Market cap	£41.4m
Net cash Dec '19	£18.0m
Share count (incl Treasury)	20.172m
ED valuation/ share	Withdrawn
Avg. daily volume	250,000

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: AGM 6th May 2020

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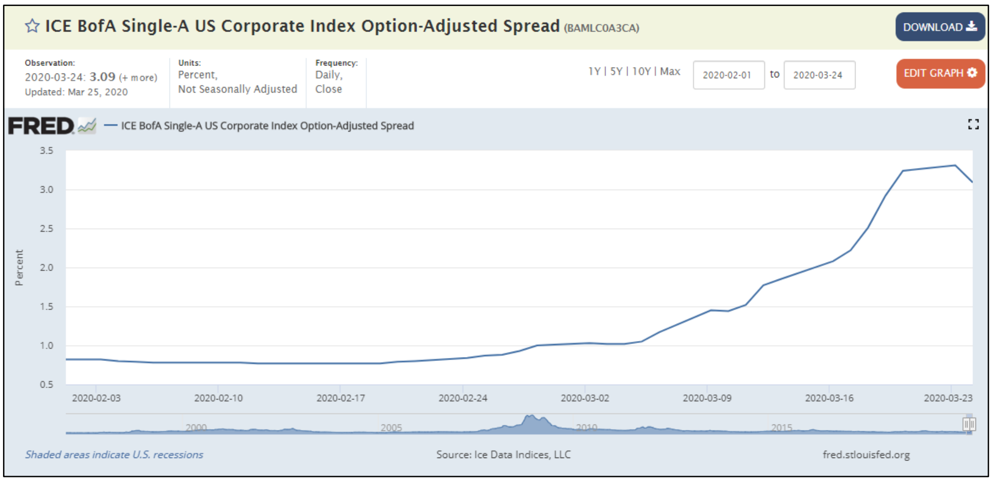
Temporary withdrawal of our forecasts

All of these options are presently being explored, albeit equally mindful not to harm the firm's 1st class design and operational capability. In fact to get ahead of the curve, the **Board has decided to cancel the previously recommended final dividend of 1.5p**. Whilst also evaluating government support measures available across various jurisdictions.

Similarly, we have temporarily withdrawn our forecasts until there's greater clarity surrounding COVID-19. But **believe at 205p, the stock is attractively priced**, trading on trailing 5.2x PE and 6.6x EV/EBIT (pension adjusted) multiples.

In terms of marking-to-market the UK pension scheme, we suspect the actuarial deficit (re £35.2m as at the June 2018 triennial valuation) may have increased over the past month (in paper terms) – reflecting lower gilt yields, higher spreads on corporate bonds (see below) and the recent equity rout.

Single-A US Corporate bond spreads (ie vs Treasuries)



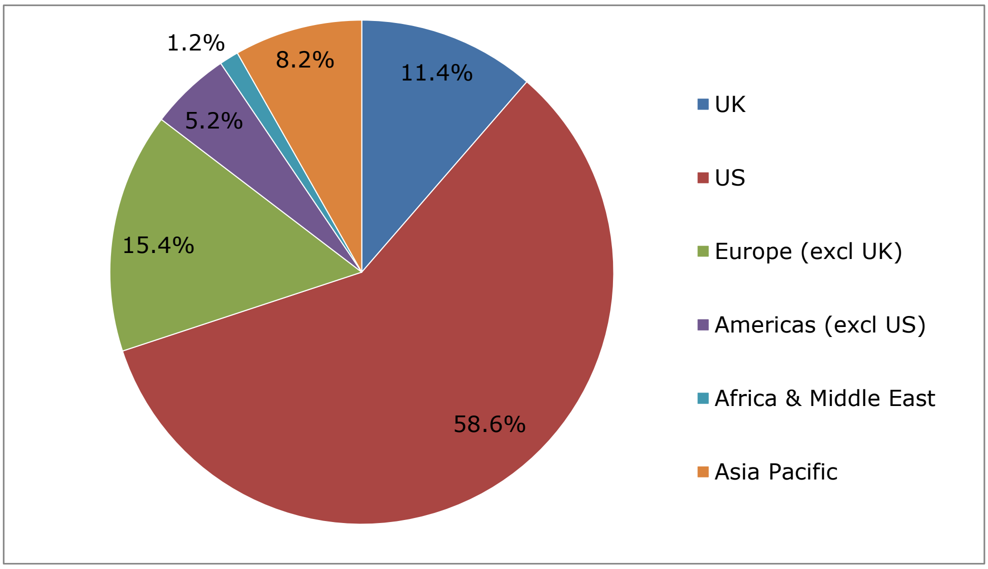
Source: Federal Reserve Bank of St Louis

Trump is hoping to 'open up' the US again by Easter

How much is anyone's guess, although as central banks pour $trillions of liquidity into the financial system - spearheaded by the US Federal Reserve going 'all in on QE infinity' (ie Helicopter money, Chinook style), involving unlimited purchases of Treasuries, mortgage-backed securities & investment grade corporate bonds. Then we imagine it is only a matter of time before market volatility quietens down.

Additionally, the political mood music in Washington seems to be now questioning whether 'the cure is worse than the disease'. With **President Trump stating he <u>ideally</u> wants to 'reopen' the US economy by the 12th April Easter holiday**. Maybe a little premature, but an aspirational target nonetheless. North America of course is Mpac's largest market.

2019 regional sales (£88.8m) split



Source: Equity Development

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.

Historical results

Mpac plc - continuing (December year end)	**2016 Act £'000s**	**2017 Act £'000s**	**2018 Act £'000s**	**2019 Act £'000s**
Closing orderbook	**25,500**	**34,400**	**53,100**	**52,200**
Growth		*34.9%*	*54.4%*	*-1.7%*
Equipment	28,800	40,400	46,200	69,400
Service	12,700	13,000	12,100	19,400
Turnover	**41,500**	**53,400**	**58,300**	**88,800**
Equipment		*40.3%*	*14.4%*	*50.2%*
Service		*2.4%*	*-6.9%*	*60.3%*
Total % YoY growth		***28.7%***	***9.2%***	***52.3%***
Equipment	5,400	9,200	9,300	18,200
Service	5,600	5,300	4,700	7,800
Total gross margin	**11,000**	**14,500**	**14,000**	**26,000**
Equipment	*18.8%*	*22.8%*	*20.1%*	*26.2%*
Service	*44.1%*	*40.8%*	*38.8%*	*40.2%*
% gross margin	***26.5%***	***27.2%***	***24.0%***	***29.3%***
EBITDA	**450**	**2,200**	**2,200**	**9,800**
% Margin	*1.1%*	*4.1%*	*3.8%*	*11.0%*
Distribution	-5,300	-5,400	-5,000	-7,200
Administration	-6,600	-7,300	-7,200	-10,300
Other	-300	-500	-400	-800
Adjusted EBIT	**-1,200**	**1,300**	**1,400**	**7,700**
% Operating Margin	*-2.9%*	*2.4%*	*2.4%*	*8.7%*
Underlying interest charge	-330	-170	0	-200
Adjusted Profit before Tax	**-1,530**	**1,130**	**1,400**	**7,500**
Adjusted EPS (p)	**-6.0p**	**4.2p**	**4.5p**	**39.5p**
EPS growth rate			*7.5%*	*777.7%*
Dividend (p)	***1.3p***	***0.0p***	***0.0p***	***1.5p***
Yield	*0.6%*	*0.0%*	*0.0%*	*0.7%*
Reported sharecount (Ks - incl Treasury)	20,172	20,172	20,172	20,172
Valuation benchmarks				
P/E ratio		*49.0*	*45.6*	*5.2*
PER (adjusted for pension recovery payments)				
EV/Sales (pension adjusted)	*1.22*	*0.95*	*0.87*	*0.57*
EV/EBITDA (pension adjusted)		*23.0*	*23.0*	*5.2*
EV/EBIT (pension adjusted)		*38.9*	*36.2*	*6.6*
PEG ratio				
Corporate tax rate	*-20.0%*	*-26.5%*	*-35.9%*	*5.2%*
EBITDA drop through rate			*0.0%*	*24.9%*
Return on equity (%)		*1.9%*	*2.2%*	*16.6%*
Net cash/(debt)	**800**	**29,400**	**27,000**	**18,000**
Information only - Estimated non-underlying Pension charges				
UK pension recovery payments			-1,900	-1,940
Topup UK pension payments above £5.5m EBIT			0	-726
UK pension admin costs			-900	-1,200
UK tax shield			532	735
US pension recovery payments (net tax shield)			-790	-790
Cashflow effect			**-3,058**	**-3,921**
Net cash per share		**146**	**134**	**89**
Net assets / diluted share (p)	175	212	201	235
Shareprice (p)	**205p**			

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

Investor Access

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