MPAC plc (formerly Molins)

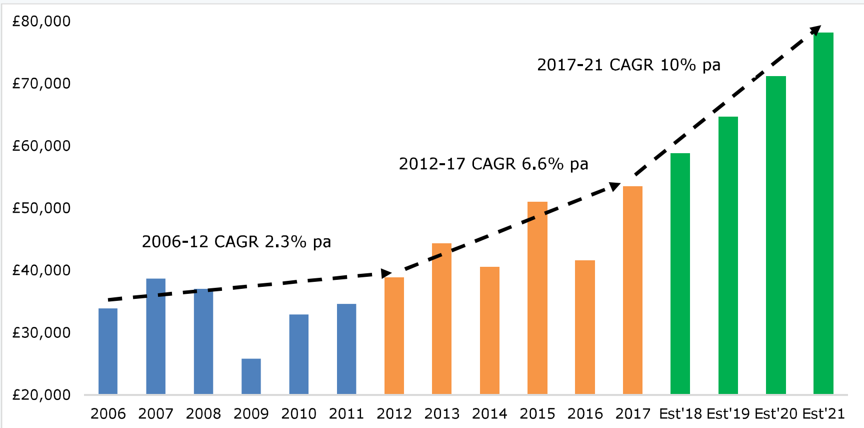
Packing a powerful punch

6th March 2018

Since taking the helm in June'16, CEO Tony Steels has engineered a meteoric turnaround at MPAC. Firstly, disposing of the sub-scale tobacco division to GD Spa for gross proceeds of £30m (£23.5m net) in August 2017. Then refocusing the business entirely on **niche, high-speed packaging solutions** within the 'sweet-spot verticals' of pharmaceuticals (eg powders), healthcare (contact lenses) and food/beverages. All benefitting from the shifts towards urbanisation, convenience, recycling and nutrition – whilst also expanding at 4%-5% pa (vs global GDP ~3.5%).

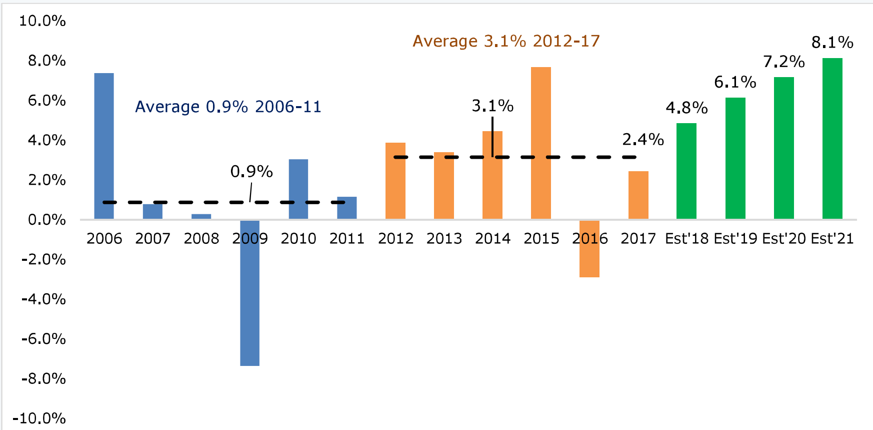
What's more, **the company believes it can double this growth rate** over the economic cycle – thanks to greater market penetration, higher attachment rates between original equipment (76% sales) and services (24%), new product launches (eg incorporating advanced soft/firmware), x/up-selling and end-to-end solutions. Which combined with favourable operating leverage and tight cost control, should enable MPAC to meet its 'ambitious' (vs past performance – see below) and 'industry leading' **goals of delivering 10% pa LFL top-line growth alongside 10% EBIT margins.**

Accelerating organic revenue (£'000s) growth



Source: Equity Development

Higher and more predictable EBIT margins

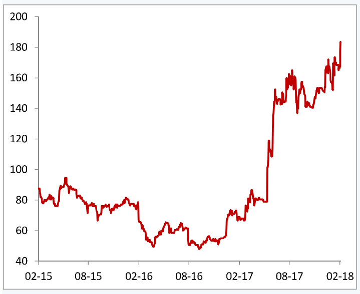


Source: Equity Development

Company Data

EPIC	**AIM:MPAC**
Price (last close)	180p
52 week Hi/Lo	183p/67p
Market cap	£36m
ED valuation	225p/share
Avg. daily volume	50,000

Share Price, p



Source: DigitalLook

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.

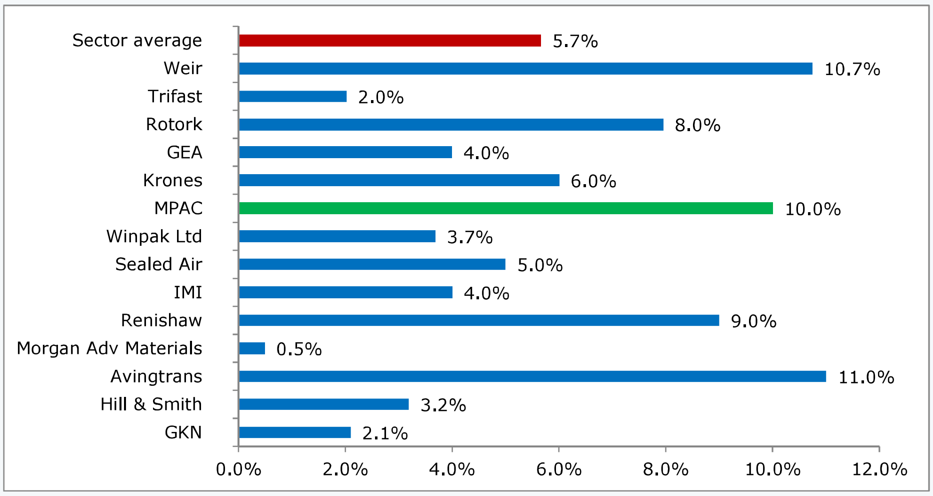
On top in Coventry (UK), the firm develops innovative technology and associated production / packaging machinery. Core clients include Nestlé, GSK, Unilever, Kellogg's, Diageo, Ferrero and CooperVision.

Paul Hill (Analyst)
0207 065 2690
paul.hill@equitydevelopment.co.uk

Hannah Crowe
0207 065 2692
hannah@equitydevelopment.co.uk

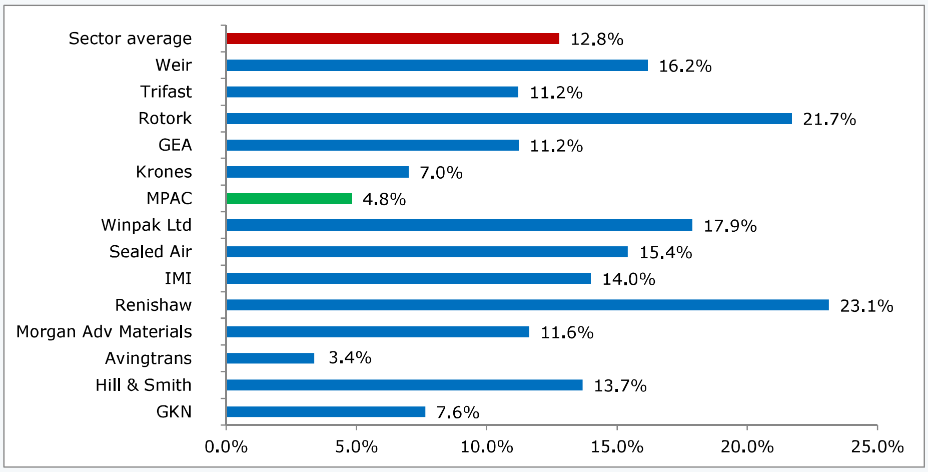
Elsewhere within the assumptions is a natural catch-up, since historically the Packaging division was run as an independent entity and generally underperformed its peers. **Meanwhile considerable upside is offered by the ongoing switch to 'smart manufacturing' (or Production 4.0), augmented by the popularity of online deliveries**, requiring smaller pack sizes, more frequent deliveries, greater supply chain flexibility and much faster distribution.

CY +1 sales growth rates for packaging/engineering peers



Source: Equity Development : CY = Current Year, arithmetic average for sector

CY EBIT margins



Source: Equity Development, arithmetic average for sector

£29.4m cash pile to be invested internally

However, in order to convert these plans into reality, more investment is required with the firm's **£29.4m cash-pile (as at Dec'17) being ear-marked for a step-change in both organic (eg R&D) and acquisitive growth.** For instance, developing/launching innovative new machines (eg integrating remote diagnostics, data analytics and artificial intelligence), further expanding the Service proposition and selective M&A. The latter probably involving the purchase of **specialist know-how, smart factory technology and/or solutions capability,** whilst being within the £10-£30m price range and offering IRRs above 15%.

Strict capital discipline

Hence, the Board's decision today to **temporarily suspend the dividend** – and instead allocate the capital to internal (primarily) and corporate development. Albeit if the situation changes - say no M&A candidates are found of the desired quality, calibre or at an acceptable valuation – then we envisage this income stream would be reinstated.

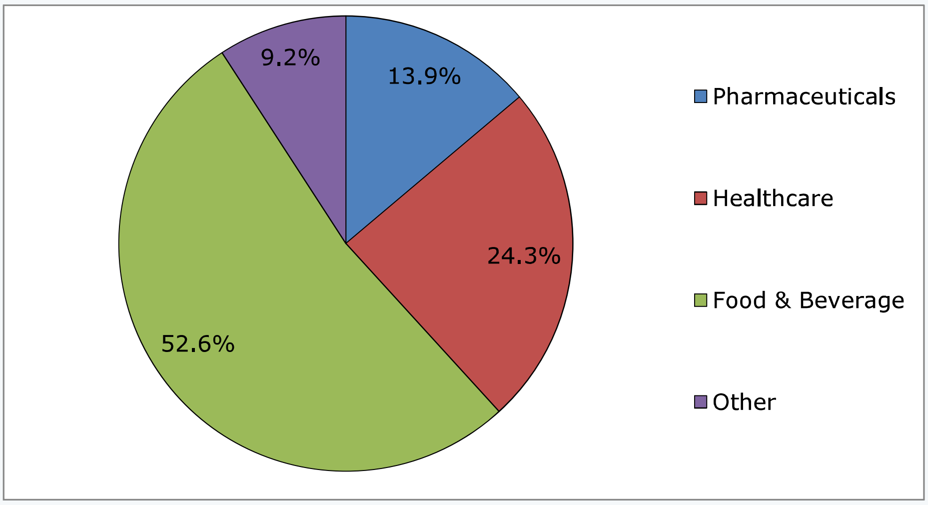
Ok, so what else came out of this morning's prelims?

Buoyant demand with more to come

Well, undoubtedly the #1 takeaway for investors was the "**excellent" LFL growth**, with **order intake (£61.1m) and turnover (£53.4m) climbing 21% and 29%** respectively – on top of a **1.14x Book:Bill ratio**. In turn, **exceeding our estimates**, with revenue growth broadly split volume (ED Est +21%), forex (+6%) and price (+2%). Divisionally, Original Equipment jumped +40.3% to £40.3m, which was complemented by a small uptick in Service +2.4% (£13m) – although we expect the latter to materially improve in 2018 helped by the July appointment of an experienced Services exec.

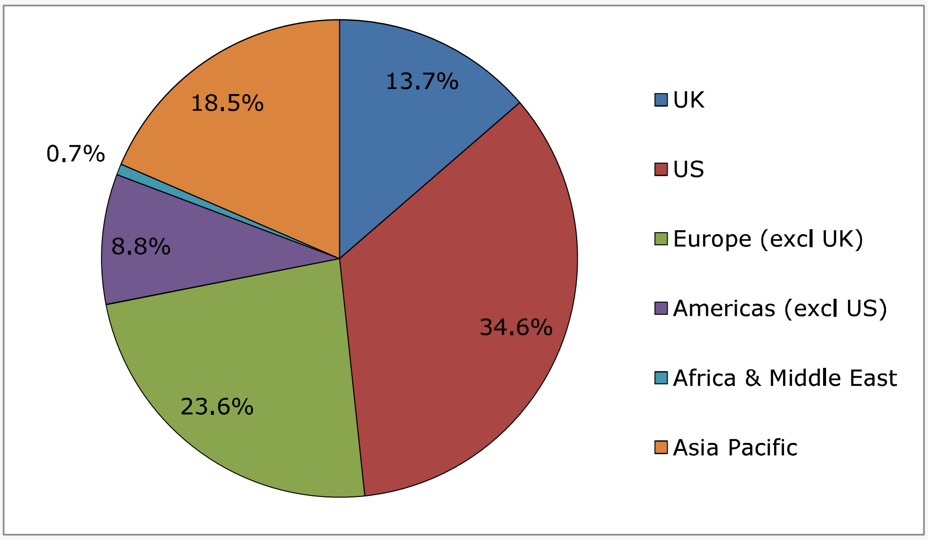
In terms of target verticals, pharmaceuticals posted a 7% gain (to £7.4m), healthcare +25% (£13.0m) and food/beverages +31% (£28.1m) – while geographically the US contributed 35% of the group with the UK chipping in at 14% (see below):

2017 revenue (£53.4m) break-down by target market



Source: Equity Development

2017 Geographical sales (£54.3m) split



Source: Equity Development

Looking ahead, **we see this momentum being maintained into 2018 and beyond** – assisted by the **£34.4m (+35%) opening orderbook** – although, as always, there can be some lumpiness of bookings/shipments over period ends.

Profitability and cashflow set to improve too

That said, the transition towards stronger **EBIT margins (2.4%) and cash conversion is still work-in-progress**, with the latter impacted by a net £2.7m working capital outflow in 2017, mainly caused by timing effects and a rebalancing of trade debtors after a 2016 y/e collection squeeze.

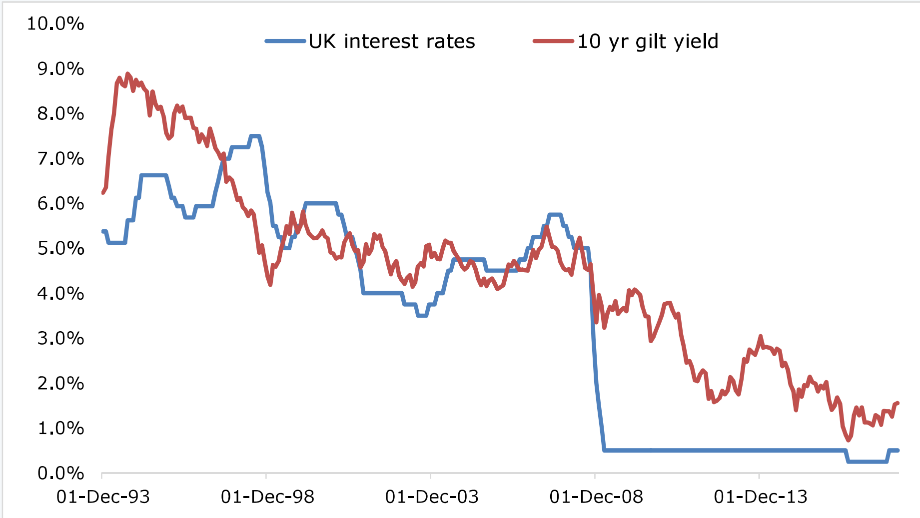
Nonetheless, we believe profitability and cashflow should improve markedly as the business scales, new tech-rich products are introduced and pension recovery payments (Est'18 £3.0m vs £4.9m LY) become less significant – partly offset by extra capex (£2.6m Est'18 vs £1.7m LY). In relation to the balance sheet, net assets closed Dec'17 at 216p/share, of which **cash accounted for 146p** (or £29.4m).

No change to 2018 PBT, but valuation rises to 225p

With regards to this year, revenues are forecast to rise +10% to £58.7m, with **adjusted EBIT and EPS coming in at £2.8m** (vs £1.3m LY) **and 9.9p** (4.2p) **respectively** – supported by further operational efficiencies and 30% EBITDA drop through rates. LY's improvement in gross margins (28.4% vs 27.2% LY) was tempered slightly due to a fall in Service, reflecting adverse mix from spare parts to new equipment.

Nevertheless, given the "*excellent*" strategic progress made over the past 12-18 months and enhanced pension position (re robust investment returns), **we have upgraded our valuation from 180p to 225p/share.** The **UK DB scheme sporting a net accounting surplus of £17.6m** (vs £4.6m), offset by a £6.2m (vs £6.8m) US deficit. Interestingly, if interest rates were ever to return to past norms (see below) from the present ultra-low levels, then there may be scope to offload part, or all of these liabilities to an insurance company.

UK interest rates and 10 year gilt yield

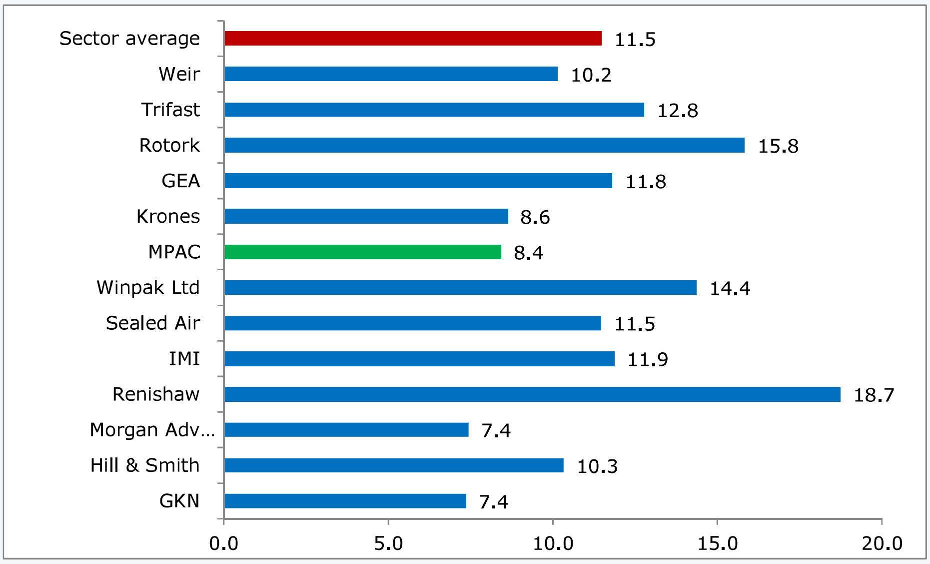


Source: Equity Development, Bank of England

Stock trades at a discount to its peers

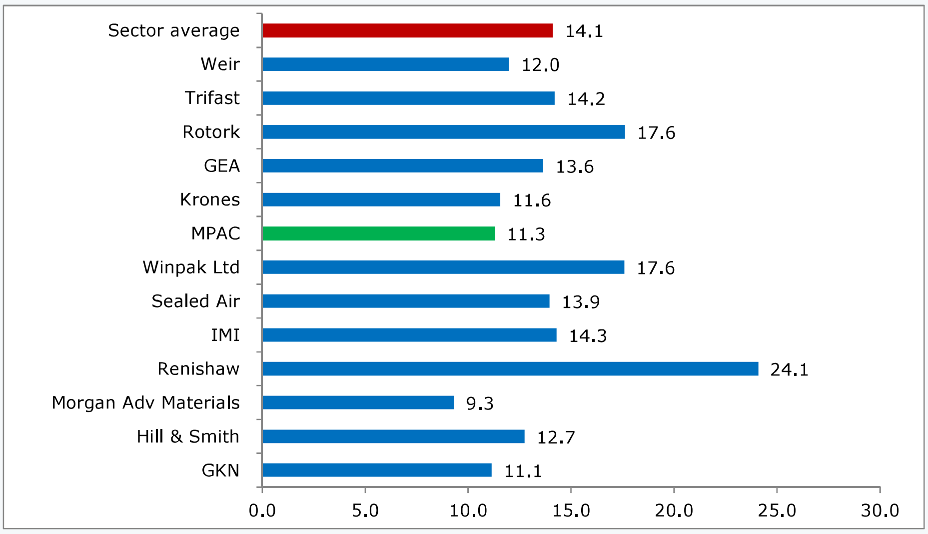
Finally, **we think the stock (at 180p) offers good value to patient investors** - trading at a discount to the broader packaging/engineering sector based on current year (CY) EV/BITDA, EV/EBIT, PER and EV/sales multiples (see below). Moreover, profits are artificially depressed at the moment, and should rebound in the fullness of time.

CY EV / EBITDA (pension adjusted) vs sector peers



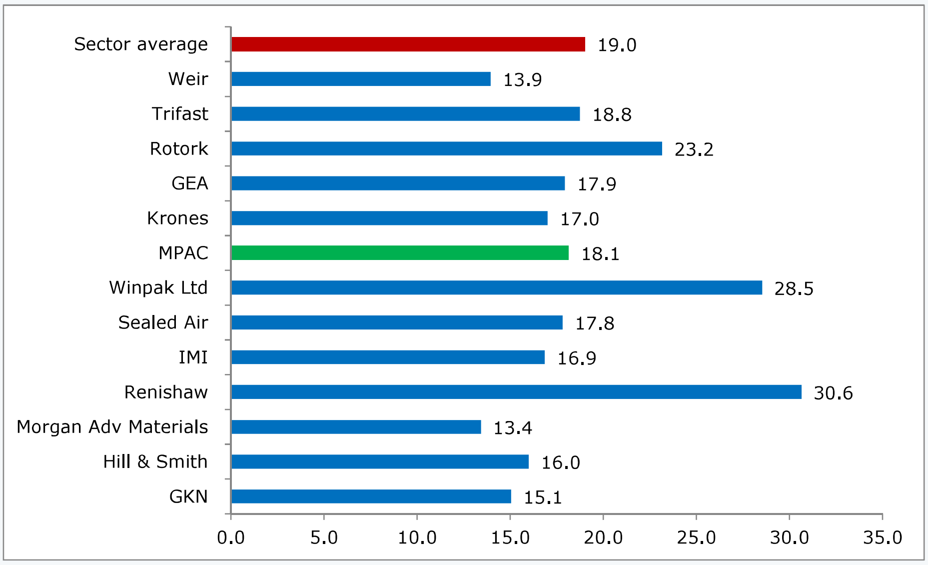
Source: Equity Development; arithmetic average for sector. MPAC has been EV adjusted for pension/spare land

CY EV / EBIT (pension adjusted)



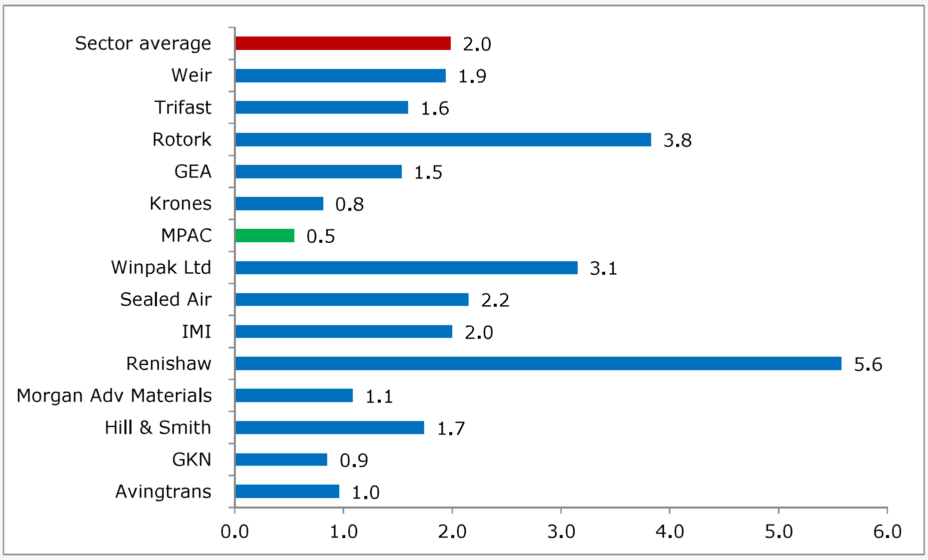
Source: Equity Development, arithmetic average for sector. MPAC has been EV adjusted for pension/spare land

CY PERs



Source: Equity Development, arithmetic average for sector. Closing prices as per 5th March 2018.

CY EV/sales (pension adjusted)



Source: Equity Development, closing prices at 5th Mar'18. MPAC has been EV adjusted for pension/spare land

Transformational year

CEO Tony Steels adding, "***The business made excellent progress on its strategic initiatives following the sale of the I&TM division****. The strategy is now focused on the growth markets in which it currently operates, in the Pharmaceutical, Healthcare and Food and Beverage sectors. The Group has both the financial and managerial resources available to develop the business, with the* ***prime focus being on organic growth****. This will be delivered through the leveraging of its global position, development of its products and an improved services offering to its customers.* ***Suitable complementary acquisition targets will also be considered when identified****.*

The Company entered 2018 with a stronger order book *than a year before, and with a greater focus, progress continues in the development of the continuing operations, with order intake and sales both strongly ahead of last year the* ***Group's future prospects remain positive*** ".

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	44,440	48,884	53,772	59,150
Service	12,700	13,000	14,300	15,730	17,303	19,033
Turnover	**41,500**	**53,400**	**58,740**	**64,614**	**71,075**	**78,183**
Equipment		*40.3%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*
Service		*2.4%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*
Total % YoY growth		*28.7%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*
Equipment	5,400	9,200	10,977	12,221	13,443	14,787
Service	5,600	5,300	5,720	6,292	6,921	7,613
Total gross margin	**11,000**	**14,500**	**16,697**	**18,513**	**20,364**	**22,401**
Equipment	*18.8%*	*22.8%*	*24.7%*	*25.0%*	*25.0%*	*25.0%*
Service	*44.1%*	*40.8%*	*40.0%*	*40.0%*	*40.0%*	*40.0%*
% Margin	*26.5%*	*27.2%*	*28.4%*	*28.7%*	*28.7%*	*28.7%*
EBITDA	**500**	**2,200**	**3,797**	**4,986**	**6,182**	**7,535**
% Margin	*1.2%*	*4.1%*	*6.5%*	*7.7%*	*8.7%*	*9.6%*
Distribution	-5,300	-5,400	-5,670	-5,954	-6,251	-6,564
Administration	-6,600	-7,300	-7,665	-8,048	-8,451	-8,873
Other	-300	-500	-525	-551	-579	-608
Adjusted EBIT	**-1,200**	**1,300**	**2,837**	**3,960**	**5,084**	**6,356**
% Operating Margin	***-2.9%***	***2.4%***	***4.8%***	***6.1%***	***7.2%***	***8.1%***
Underlying interest charge	-330	-170	-200	-200	-200	-200
Adjusted Profit before Tax	**-1,530**	**1,130**	**2,637**	**3,760**	**4,884**	**6,156**
Adjusted EPS (p)	**-6.0**	**4.2**	**9.9**	**14.1**	**18.2**	**22.9**
EPS growth rate			*137.1%*	*41.9%*	*29.2%*	*25.8%*
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		*43.0*	*18.1*	*12.8*	*9.9*	*7.9*
PER (adjusted for pension recovery payments)					*26.0*	*14.5*
EV/Sales (pension adjusted)	*0.77*	*0.60*	*0.54*	*0.50*	*0.45*	*0.41*
EV/EBITDA (pension adjusted)		*14.5*	*8.4*	*6.4*	*5.2*	*4.2*
EV/EBIT (pension adjusted)		*24.6*	*11.3*	*8.1*	*6.3*	*5.0*
PEG ratio			*0.13*	*0.31*	*0.34*	*0.30*
EBITDA drop through rate			*29.9%*	*20.2%*	*18.5%*	*19.0%*
Return on equity (%)		*1.9%*	*4.3%*	*5.8%*	*7.0%*	*8.1%*
Net cash/(debt)	**800**	**29,400**	**24,800**	**22,832**	**21,881**	**22,060**
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**	**123**	**113**	**108**	**109**
Net assets / diluted share (p)	175	216	226	240	258	281
Shareprice (p)	**180**					

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

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.
- Occasionally lumpy orders and cashflow over the period end.
- Long term trend towards clients outsourcing production to 'low cost' contract manufacturers.
- Continued industry consolidation could impact pricing and margins.
- Difficulties passing on cost inflation, such as salaries and raw materials.

Head of Corporate

Gilbert Ellacombe
Direct: 0207 065 2698
Tel: 0207 065 2690
gilbert@equitydevelopment.co.uk

Investor Access

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk

Justin Langen
Direct: 0207 065 2693
Tel: 0207 065 2690
justin@equitydevelopment.co.uk

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