

Fourth consecutive upgrade this year

August was brutal for UK investors, with the FTSE100 and AIM indices declining 6% and 12% respectively. Triggered by fears over a deteriorating world economy, manufacturing Armageddon, sliding business confidence, Brexit and a protracted US-Chinese trade war. Worse still, there is presently more than \$15 trillion of negative earning debt, with several pundits warning of an imminent recession (not our view) after both the US & UK yield curves briefly inverted last month.

The good news is that this rhetoric appears misplaced (at least to us), since many quality businesses are still **firing on all cylinders**. Take MPAC, who this morning reported **strong interims**, with **FY19 results likewise anticipated to be "significantly above expectations"**.

H1'19 revenues climb 43% LFL to £45.8m

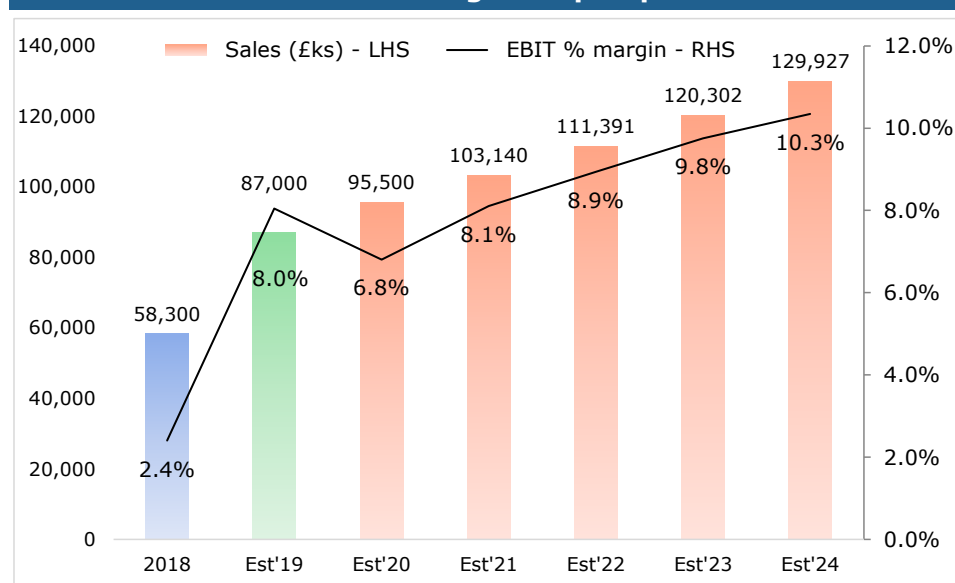
Here, not only did **H1 turnover and EBIT climb to £45.8m** (+62% vs £28.2m LY & 43% LFL) and **£4.6m** (£0m LY), but also the firm reported a **54% jump in bookings** (Services +75%) alongside **12% EBITDA margins**. The latter reflecting **operational efficiencies** and **improved product mix**, after shipping more 'repeat' (vs one-off) orders. Thus reducing upfront customisation, commissioning and implementation costs.

Better still, the **outlook for the rest of the year is positive too**, thanks to **the approx £35m** (ED Est) **June closing orderbook** (flat vs 12 months' ago) and increasing proportion of recurring revenues (c. 10%-15% of group).

Valuation raised to 275p/share from 260p

As such, **we've lifted our FY19 sales** (+2.4% to £87m vs £58.3m LY), **profit margin** (8.0% vs 2.4% LY), **EBIT** (£7.0m vs £1.4m) and **adjusted EPS** (26.2p vs 4.5p) projections, on top of nudging up the **valuation from 260p to 275p/share**.

Secular trends set to drive long term prospects



Source: Equity Development

5th September 2019

Company Data

EPIC	AIM:MPAC
Price (last close)	204p
52 week Hi/Lo	224p/104p
Market cap	£41.2m
Net cash (Est. Dec '19)	£11.0m
Share count (incl Treasury)	20.172m
ED valuation/ share	275p
Avg. daily volume	25,000

Share Price, p



Source: Web Financial

Description

MPAC is a specialist provider of **high speed production, packaging & automation machines**, and complementary services employing c. 510 staff.

Here the group not only develops & manufactures niche factory equipment and robotic solutions, 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 further sterling weakness.

Core verticals are Pharmaceutical, Medical, Healthcare and Food/Beverage, supporting the likes of Nestlé, GSK, P&G, Philips, ConvaTec, AstraZeneca, Unilever, Kellogg's, Diageo, Ferrero and CooperVision.

Next news: Trading update early Jan'20

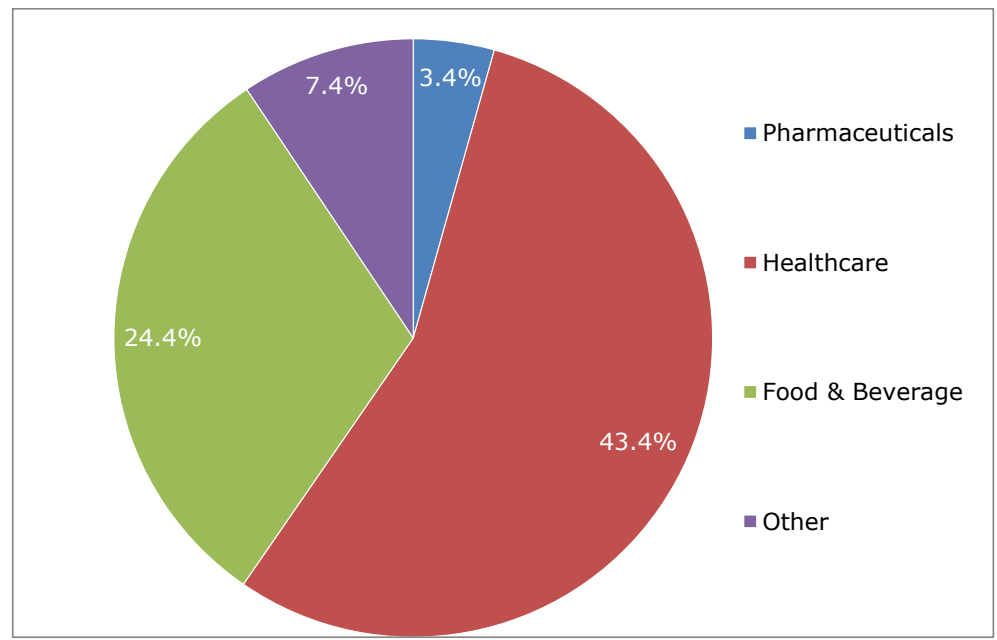
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Demand coming from 'economically stable' areas

A **large chunk of this growth is coming from the healthcare sector** (see below), where a substantial contract was secured in 2018. Offering both **favourable near-term visibility** and **multi-year expansion opportunities**, incorporating design, configuration, hardware, service, spares and remote diagnostics.

H1'19 revenue (£45.8m) break-down by target market



Source: Equity Development

2020 numbers conservatively biased

Equally though, we are aware of the ongoing challenges facing the wider environment, and recognise that MPAC's prospects are not totally immune to the health of the capital goods industry, where orderflow tends to lag corporate confidence by 6-12 months.

Plus **the mix of 'repeat vs bespoke' machine orders is envisaged to return to more normal levels next year**. Meaning that overall, despite upgrading our FY19 numbers, **we've chosen at this stage to hold the 2020 turnover & EBIT forecasts** at £95.5m and £6.5m (margin 6.8%) - at least until some of the macro headwinds begin to clear. Additionally, investors should bear in mind that there can be some contract lumpiness over period ends.

"Orderbook and future prospects remain strong"

Tony Steels adding **"I am really pleased with the results for H1'19, which demonstrate the value of the strategic objectives we have been working hard to implement. The recent acquisition of Lambert is progressing to plan and has been well received by our current and potential new customers, increasing our prospects to provide full turnkey solutions."**

"The Group is in an excellent position to benefit from further commercial successes in H2'19. [That said further out], "general market uncertainty has increased with global FMCG companies under pressure to eliminate plastic in consumer products leading to investment delays whilst they develop new solutions. Order intake is also

variable and sensitive to geo-political events, and recent signs of slowing growth resulting in delayed investment decisions."

Ok, so what else came out of today's RNS?

Well getting more granular, **the integration of Lambert Automation** (purchased in May '19 for £15m) **is progressing to plan**. Generating economies of scale, and augmenting the group's key medical, healthcare and food/beverage verticals - whilst further delivering back office, property, supply chain, procurement and overhead savings, as the 2 firms are merged over the next 12-24 months.

What's more, the Board has adopted a **dual track expansion strategy**. First & foremost aiming to achieve **double digit LFLs and 10% profit margins** by resetting the competitive bar with regards to technical innovation (eg integrating remote diagnostics, data analytics and artificial intelligence), service and client flexibility. This organic centric approach being complemented by selective M&A - perhaps involving the purchase of **proprietary know-how, smart factory expertise and/or solutions capability**.

£9.6m of cash ear-marked for expansion strategy

Hence, the decision to not reinstate the dividend just yet - but instead 'keep some fire power' for internal and corporate development purposes. Moreover, in the event there was a 'hard/messy Brexit', the ensuing disruption could crimp vendor price expectations and provide the ideal backdrop to snap-up deep-value opportunities. Albeit if no M&A candidates materialise, then we suspect shareholder payouts will recommence in due course.

There is no shortage of financial muscle to execute these initiatives either, with **net cash closing June 2018 at £9.6m** (post £900k of preference shares), equivalent to 47p/share. Which together with the 245p/share of net assets, should in theory **help put a floor under the stock**.

Similarly, there seems to be **little adverse effect from commodity price volatility** (eg steel & aluminium) **and/or the Trump trade tariffs**. Granted, there was a £9.0m increase in working capital due to the much higher revenues and unwinding of customer deposits received in Q4'18. Hopefully though this should largely reverse by y/e.

Light at the end of the pension tunnel

Elsewhere, the **actuarial deficit** relating to MPAC's **UK pension scheme almost halved from £69.9m in Jun'15 to £35.2m as at Jun'18** - and importantly is expected to be completely eliminated by Jul'24. **5 years earlier than previously envisaged and for £9.7m less**.

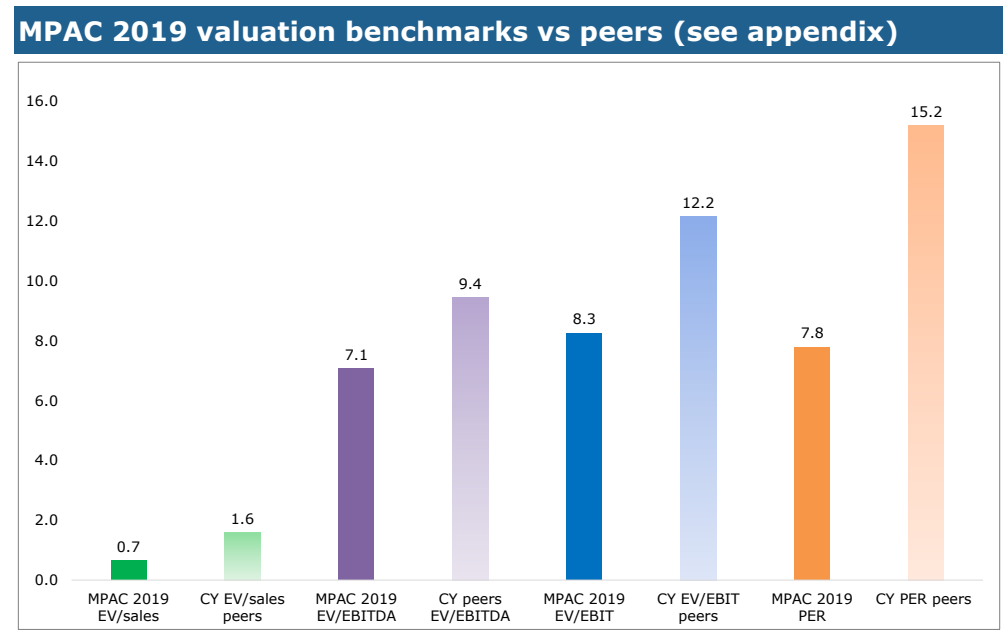
This is key because it puts a line in the sand, after which the company should not have to make any more recovery contributions. Indeed our projections model an extra £4m pa of positive cashflow (net of tax) in 2025, aided by a drop in the PFI levy (circa £0.5m pa - ED Est).

On an accounting basis, the UK pension scheme (IAS 19: pre-tax) ended June in surplus at £29.3m (£20.5m Dec'18), with the US deficit flat at £6.2m. Both schemes benefitted from robust asset gains, partly offset by lower yields on AA corporate bonds.

Finally the timescales relating to the possible disposal of MPAC’s 10 acres of spare land in Monks Risborough, Buckinghamshire (NBV £0.8m) remains on the ‘back-burner’ - ie following the rejection of planning permission for the 2nd time last year. Longer term, it might be possible to sell this plot to a specialist property developer.

Brexit resilient with >80% of sales from overseas

Consequently, putting all this together, **we believe there’s significant upside for investors** - particularly given the unjustified discount the stock trades vs engineering/packaging peers (see below). Plus with >80% of revenues generated overseas, there’s a natural hedge against additional currency depreciation (£:\$ 1.22 spot), say in the event of a ‘no-deal’ Brexit.



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

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 (£398.1m of liabilities as at June 2019) & US (£23.8m 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.

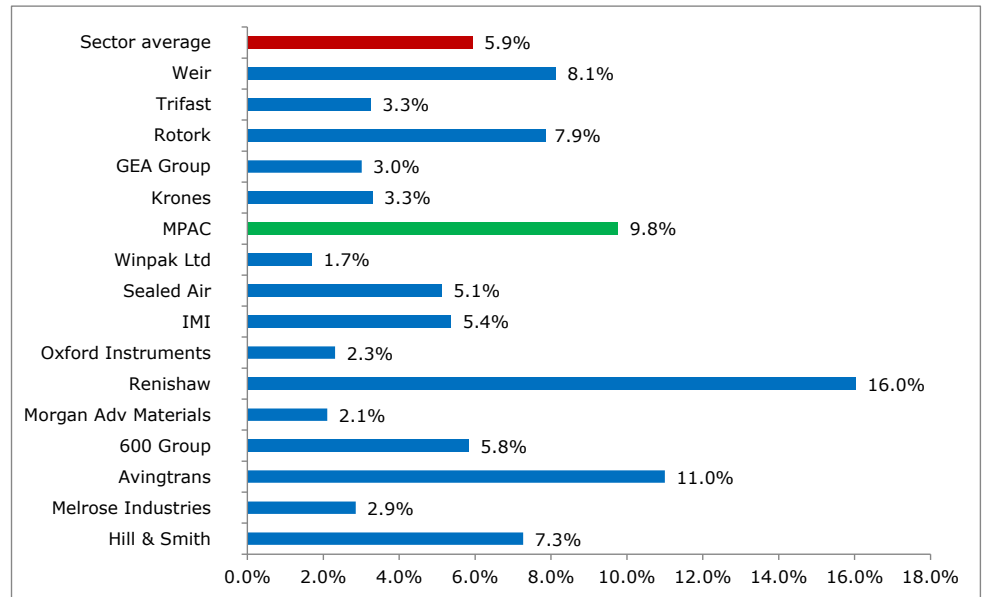
Adjusted financial projections

MPAC plc - continuing (December year end)	2016 Act £'000s	2017 Act £'000s	2018 Act £'000s	2019 Est £'000s	2020 Est £'000s	2021 Est £'000s	2022 Est £'000s	2023 Est £'000s	2024 Est £'000s	2025 Est £'000s
Closing orderbook	25,500	34,400	39,800	40,000						
<i>Growth</i>		35%	16%	1%						
Equipment	28,800	40,400	46,200	58,000	58,000	62,640	67,651	73,063	78,908	85,221
Service	12,700	13,000	12,100	14,000	15,200	16,416	17,729	19,148	20,679	22,334
Lambert Automation				15,000	22,300	24,084	26,011	28,092	30,339	32,766
Turnover	41,500	53,400	58,300	87,000	95,500	103,140	111,391	120,302	129,927	140,321
<i>Equipment</i>		40.3%	14.4%	25.5%	0.0%	8.0%	8.0%	8.0%	8.0%	8.0%
<i>Service</i>		2.4%	-6.9%	15.7%	8.6%	8.0%	8.0%	8.0%	8.0%	8.0%
<i>Lambert Automation</i>					48.7%	8.0%	8.0%	8.0%	8.0%	8.0%
Total % YoY growth		28.7%	9.2%	49.2%	9.8%	8.0%	8.0%	8.0%	8.0%	8.0%
Equipment	5,400	9,200	9,300	13,432	12,760	14,157	15,627	17,243	18,741	20,368
Service	5,600	5,300	4,700	5,390	5,852	6,484	7,003	7,563	8,168	8,822
Lambert Automation				5,775	8,586	9,513	10,274	11,096	11,984	12,943
Total gross margin	11,000	14,500	14,000	24,597	27,198	30,154	32,905	35,902	38,893	42,132
<i>Equipment</i>	18.8%	22.8%	20.1%	23.2%	22.0%	22.6%	23.1%	23.6%	23.8%	23.9%
<i>Service</i>	44.1%	40.8%	38.8%	38.5%	38.5%	39.5%	39.5%	39.5%	39.5%	39.5%
<i>Lambert Automation</i>				38.5%	38.5%	39.5%	39.5%	39.5%	39.5%	39.5%
% Margin	26.5%	27.2%	24.0%	28.3%	28.5%	29.2%	29.5%	29.8%	29.9%	30.0%
EBITDA	450	2,200	2,200	8,171	7,766	9,712	11,399	13,277	15,089	17,088
<i>% Margin</i>	1.1%	4.1%	3.8%	9.4%	8.1%	9.4%	10.2%	11.0%	11.6%	12.2%
Distribution	-5,300	-5,400	-5,000	-6,797	-8,500	-9,044	-9,623	-10,239	-10,894	-11,591
Administration	-6,600	-7,300	-7,200	-10,000	-11,198	-11,710	-12,245	-12,805	-13,390	-14,003
Other	-300	-500	-400	-800	-1,000	-1,040	-1,082	-1,125	-1,170	-1,217
Adjusted EBIT	-1,200	1,300	1,400	7,000	6,500	8,360	9,955	11,734	13,439	15,322
<i>% Operating Margin</i>	-2.9%	2.4%	2.4%	8.0%	6.8%	8.1%	8.9%	9.8%	10.3%	10.9%
Underlying interest charge	-330	-170	0	0	0	0	0	0	0	0
Adjusted Profit before Tax	-1,530	1,130	1,400	7,000	6,500	8,360	9,955	11,734	13,439	15,322
Adjusted EPS (p)	-6.0	4.2	4.5	26.2	24.2	31.1	36.8	43.6	50.0	57.0
<i>EPS growth rate</i>			7.8%	480.4%	-7.6%	28.4%	18.5%	18.5%	14.5%	14.0%
Dividend (pence)	1.25	0.00	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	20,172
Valuation benchmarks										
<i>P/E ratio</i>		48.7	45.2	7.8	8.4	6.6	5.5	4.7	4.1	3.6
<i>PER (adjusted for pension recovery payments)</i>					26.3	16.7	12.9	10.1	8.4	4.0
<i>EV/Sales (pension adjusted)</i>	1.39	1.08	0.99	0.66	0.61	0.56	0.52	0.48	0.44	0.41
<i>EV/EBITDA (pension adjusted)</i>		26.3	26.3	7.1	7.4	6.0	5.1	4.4	3.8	3.4
<i>EV/EBIT (pension adjusted)</i>		44.5	41.3	8.3	8.9	6.9	5.8	4.9	4.3	3.8
<i>PEG ratio</i>			5.76	0.02	-1.11	0.23	0.30	0.25	0.28	0.26
<i>Corporate tax rate</i>	20.0%	26.5%	35.7%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
<i>EBITDA drop through rate</i>			0.0%	20.8%	-4.8%	25.5%	20.4%	21.1%	18.8%	19.2%
<i>Return on equity (%)</i>		1.9%	2.2%	11.4%	9.6%	11.0%	11.6%	12.0%	12.1%	12.1%
Net cash/(debt)	800	29,400	27,000	11,000	10,912	11,619	12,854	14,683	17,060	25,069
Information only - Estimated non-underlying Pension charges										
UK pension recovery payments			-1,900	-1,940	-1,981	-2,022	-2,065	-2,108	-2,152	0
Topup UK pension payments above £5.5m EBIT			0	-495	-330	-944	-1,470	-2,057	-2,620	0
UK pension admin costs			-900	-900	-918	-936	-955	-974	-994	-1,014
UK tax shield			532	634	613	741	853	976	1,096	193
US pension recovery payments (net tax shield)			-790	-751	-701	-651	-601	-551	-501	-451
Cashflow effect			-3,058	-3,452	-3,316	-3,811	-4,237	-4,713	-5,171	-1,271
Net cash/(debt) - pence per share		146	134	55	54	58	64	73	85	124
Net assets / diluted share (p)	175	212	201	227	251	283	320	363	413	470
Shareprice (p)	204									

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

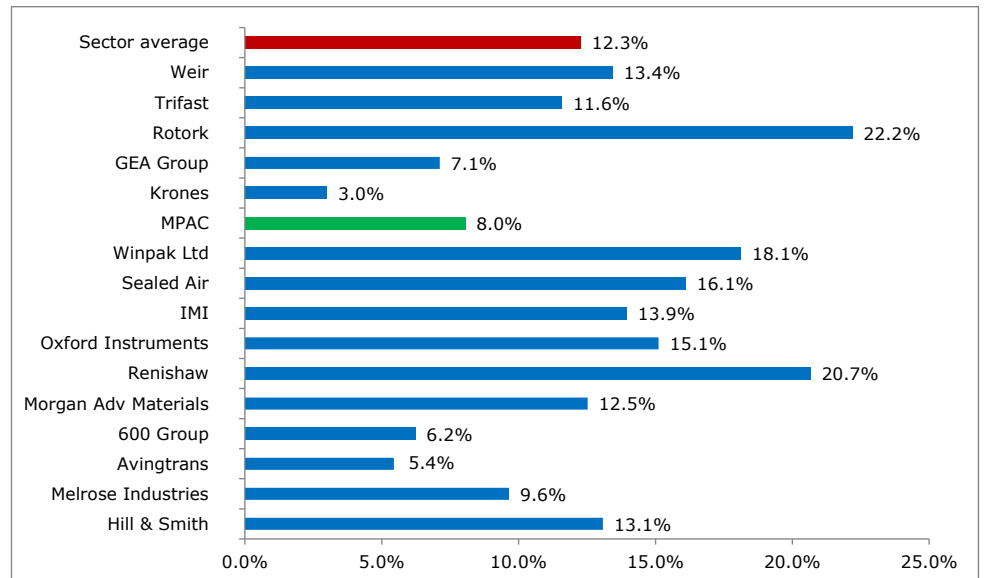
Appendix - Valuation benchmarks & industry KPIs

Current year (CY) + 1, sales growth rates



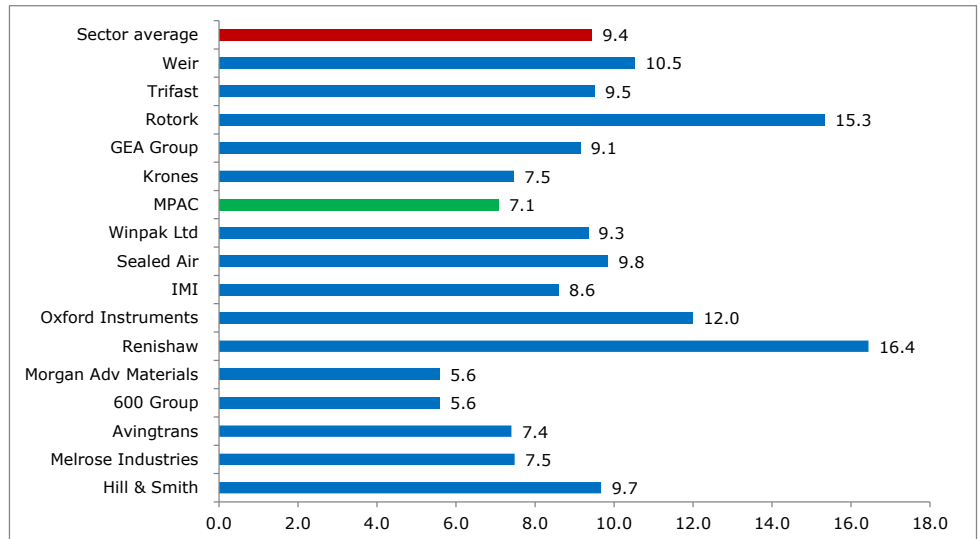
Source: Equity Development

CY EBIT margins



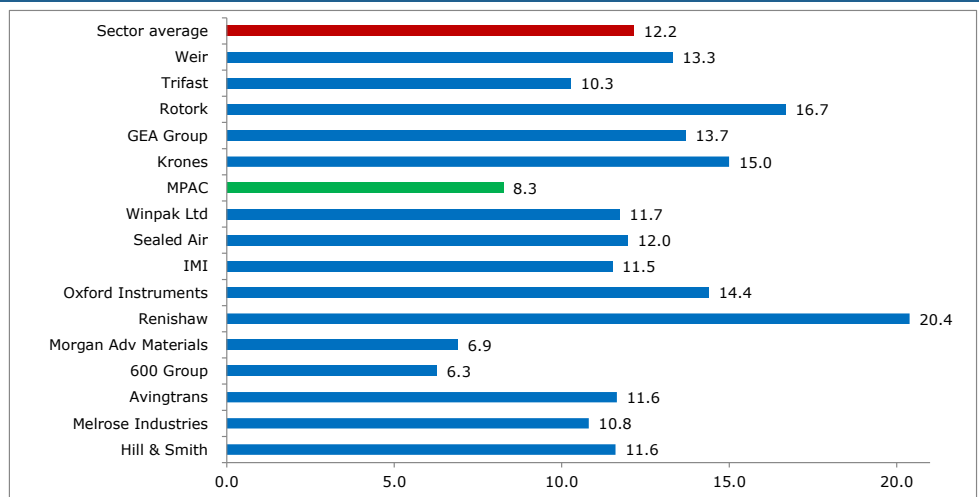
Source: Equity Development

CY EV/EBITDA multiples



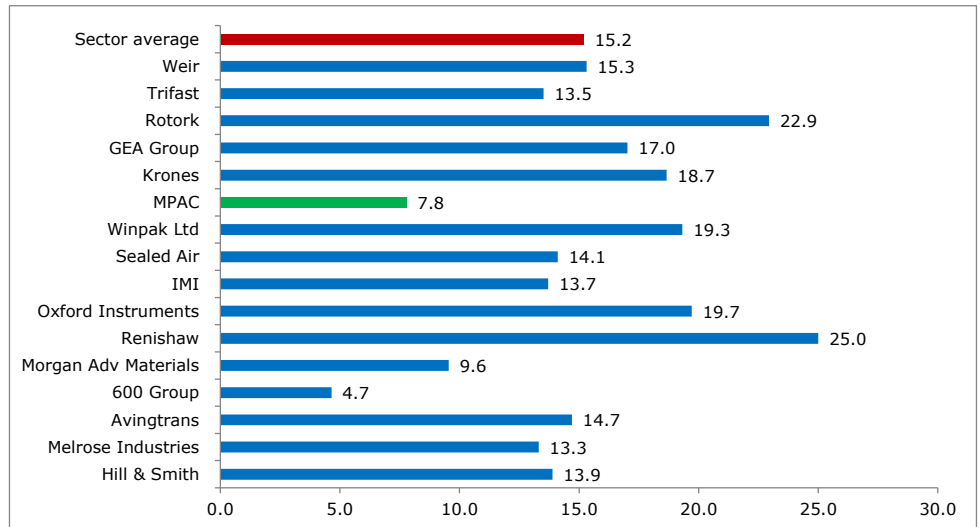
Source: Equity Development. MPAC pension adjusted

CY EV/EBIT multiples



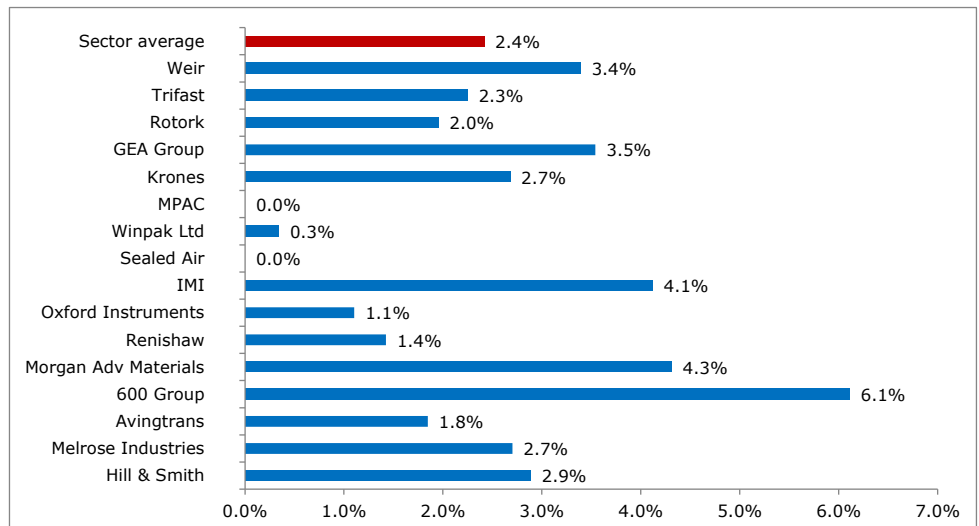
Source: Equity Development. MPAC pension adjusted

CY PE ratios



Source: Equity Development.

CY dividend yields vs peers



Source: Equity Development



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