

Crafting a £100m+ factory solutions firm

As legendary investor Warren Buffet succinctly puts it: "it is better to buy great companies at fair prices, rather than fair companies at great prices". Today, we think Mpac has done exactly that by acquiring Ohio based [Switchback Group, Inc.](#) for a maximum of \$15m in cash (£11.4m). Equivalent to **modest takeover multiples of 7.1x EV/EBIT and 1.1x EV/sales** – with \$13m of the consideration paid upfront, and the rest structured as a \$2m earnout depending on EBITDA performance over the next 24 months.

Highly synergistic & lower risk \$15m acquisition

Better still, we believe **the strategic logic is compelling**. Why? Well the beauty of the deal is that the **firms' products are complementary and have little (or no) direct overlap** within the same packaging machinery & automation solutions hierarchy. Both organisations serving a wide range of food, beverage and healthcare clients, with **Switchback possessing further bench strength in the expanding US craft beers segment** (+3.6% organic – see overleaf).

Switchback's high speed cartoner for canning lines



Source: Switchback website

Immediately earnings enhancing

Consequently Switchback's \$14.2m 2019 turnover (\$2.1m PBT) should be incremental and highly synergistic in terms of future cross selling, geographical expansion & cost saving opportunities.

In particular, Switchback has no presence in Europe, possesses minimal aftermarket support & is already bumping up against capacity constraints. Thus potentially benefitting quickly from Mpac's broader international footprint, existing infrastructure and service proposition. Similarly Switchback's product range provides additional "breadth and depth" to Mpac's cartoning & end of line solutions.

9th September 2020

Company Data

	AIM:MPAC
EPIC	
Price (last close)	280p
52 week Hi/Lo	367p/167p
Market cap	£56.5m
Est net cash Dec'20	£9.5m
Share count (incl Treasury)	20.172m
ED valuation/share	380p/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 9th September 2020

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Mpac already knows Switchback well

On top, there should be further supply chain efficiencies (re design, procurement, assembly, warehousing, etc), with Switchback also able to leverage Mpac’s leading Industry 4.0 products, such as remote diagnostics, virtual machine testing/commissioning & augmented reality training.



Source: Internet

Impressively too, in spite of CV19 disruptions, **we understand Switchback’s 2020 YTD results are tracking LY’s levels**, implying robust underlying demand and downside resilience.

Elsewhere, Mpac already has a comprehensive understanding of these operations, which should help smooth the planned 12-18 month integration, alongside scaling up the enlarged group’s US footprint. Plus Switchback President Dave Shepherd is staying with the firm to accelerate the next phase of the growth strategy.

Raising valuation from 350p to 380p/share

With regards to the numbers, **we have increased our 2020 revenue (+5%) and adjusted EBIT (+9%) forecasts (see below) to £83.6m and £5.8m** (margin 7.0%) respectively. Which in turn has lifted the valuation by 8.5% to 380p/share.

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		55,000
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
Switchback						3,586	3,586
Revenues	58,300	45,800	43,000	88,800	36,800	46,786	83,586
Reported % growth rate	9.2%	62.4%	42.9%	52.3%	-19.7%	8.8%	-5.9%
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
Switchback						1,076	1,076
Gross Profit	14,000	13,100	12,900	26,000	11,300	13,600	24,876
% margin	24.0%	28.6%	30.0%	29.3%	30.7%	29.1%	29.8%
Operating expenses (excl D&A)	-11,800	-7,700	-8,500	-16,200	-8,000	-9,188	-17,163
Adjusted EBITDA (post SBPs)	2,200	5,400	4,400	9,800	3,300	4,412	7,712
% margin	3.8%	11.8%	10.2%	11.0%	9.0%	9.4%	9.2%
Depreciation	-600	-700	-1,200	-1,900	-600	-1,100	-1,700
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	3,212	5,812
% margin	2.4%	10.0%	7.2%	8.7%	7.1%	6.9%	7.0%
Net interest	0	-100	-100	-200	-100	-100	-200
Adjusted PBT	1,400	4,500	3,000	7,500	2,500	3,112	5,612
Tax	-503	-300	687	387	-300	-486	-786
Adjusted earnings	897	4,200	3,687	7,887	2,200	2,627	4,827
Adjusted EPS (pence)	4.5p	21.0p	18.5p	39.5p	11.0p	13.1p	24.1p
EPS growth %	7.5%			777.7%			-39.1%
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	9,513	9,513
Net cash per share	134p	48p	89p	89p	112p	47p	47p

Source: Equity Development

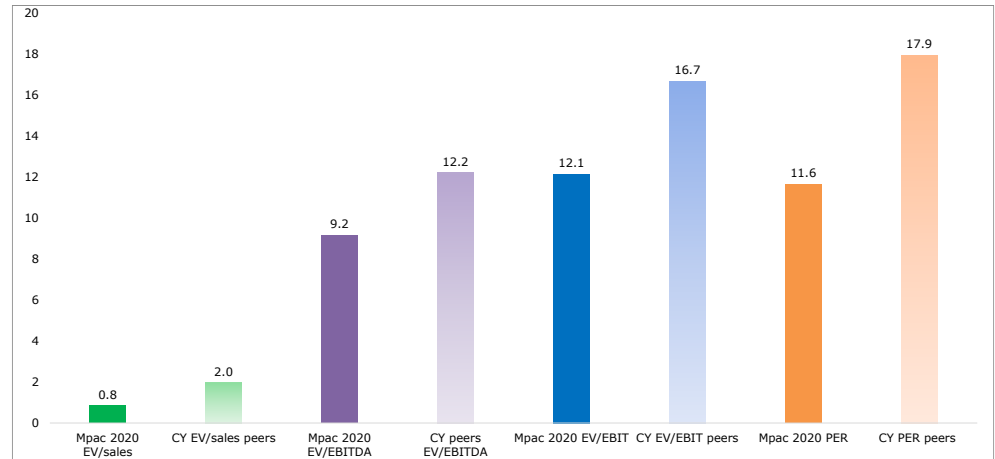
Transaction gets the thumbs up

Tony Steels commenting: ***"The acquisition of Switchback represents another key stage in the strategic development of Mpac, providing a strong US footprint, together with a great range of products, talented employees that have demonstrated entrepreneurial growth to become market leaders with embedded customer relationships."***

*I am very excited by the opportunities presented by bringing Switchback into the Mpac Group, providing the resources to support the continued growth and the improved overall Mpac customer proposition. **Switchback's performance during the COVID pandemic has been strong with a good orderbook, demonstrating the high quality of the business."***

Finally at 280p, **the stock continues to be attractively priced** - trading on a 2020 EV/EBIT multiple of 12.1x (see below) vs 16.7x for peers. Offering **material potential upside for patient investors** - particularly if Covid speeds up the adoption of Mpac's industry 4.0 solutions, lifts profit margins (re mix/service) and increases the mix of repeat/recurring revenues.

MPAC valuation benchmarks vs peers



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

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.

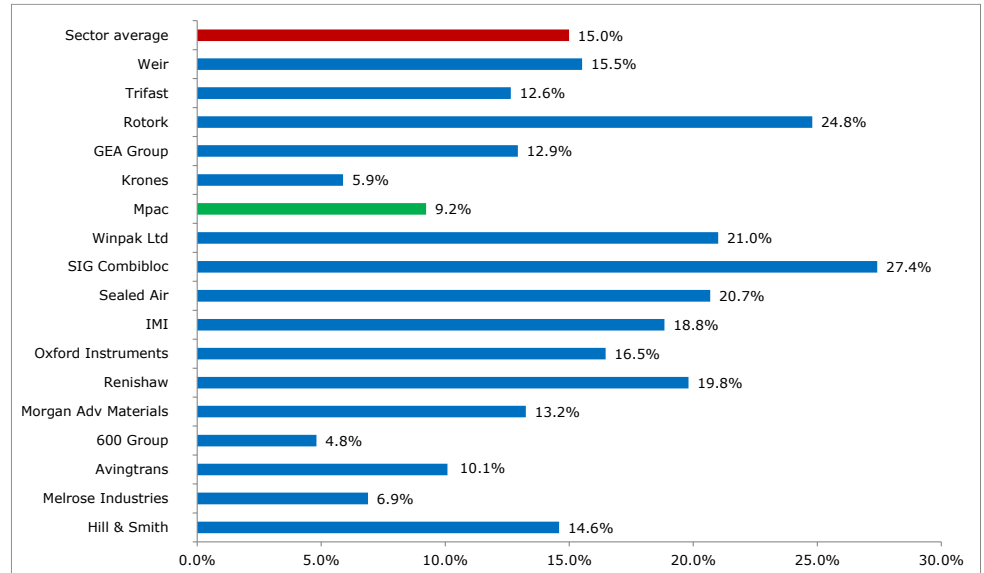
Historical & estimated 2020 results

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	55,000
<i>Growth</i>		34.9%	54.4%	-1.7%	5.4%
Equipment	28,800	40,400	46,200	69,400	60,000
Service	12,700	13,000	12,100	19,400	20,000
Switchback					3,586
Turnover	41,500	53,400	58,300	88,800	83,586
<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%	-5.9%
Equipment	5,400	9,200	9,300	18,200	15,600
Service	5,600	5,300	4,700	7,800	8,200
Switchback					1,076
Total gross margin	11,000	14,500	14,000	26,000	24,876
<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	7,712
<i>% Margin</i>	1.1%	4.1%	3.8%	11.0%	9.2%
Distribution	-5,300	-5,400	-5,000	-7,200	-6,763
Administration	-6,600	-7,300	-7,200	-10,300	-11,000
Switchback					-538
Other	-300	-500	-400	-800	-762
Adjusted EBIT	-1,200	1,300	1,400	7,700	5,812
<i>% Operating Margin</i>	-2.9%	2.4%	2.4%	8.7%	7.0%
Underlying interest charge	-330	-170	0	-200	-200
Adjusted Profit before Tax	-1,530	1,130	1,400	7,500	5,612
Adjusted EPS (p)	-6.0p	4.2p	4.5p	39.5p	24.1p
<i>EPS growth rate</i>			7.5%	777.7%	-39.1%
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>		66.9	62.2	7.1	11.6
<i>PER (adjusted for pension recovery payments)</i>					34.1
<i>EV/Sales (pension adjusted)</i>	1.70	1.32	1.21	0.80	0.84
<i>EV/EBITDA (pension adjusted)</i>		32.1	32.1	7.2	9.2
<i>EV/EBIT (pension adjusted)</i>		54.3	50.4	9.2	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%	40.0%
<i>Return on equity (%)</i>		1.9%	2.2%	16.6%	9.2%
Net cash/(debt)	800	29,400	27,000	18,000	9,513
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	-103
UK pension admin costs			-900	-1,200	-1,224
UK tax shield			532	735	628
US pension recovery payments (net tax shield)			-790	-790	-514
Cashflow effect			-3,058	-3,921	-3,194
Net cash per share		146	134	89	47
Net assets / diluted share (p)	175	212	201	235	259
Shareprice (p)		280p			

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

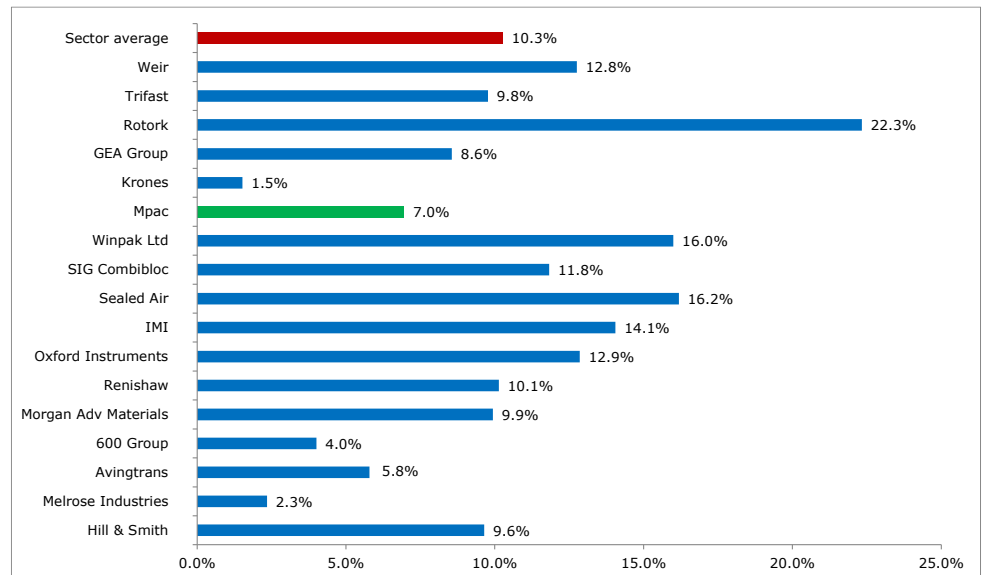
Appendix - Valuation benchmarks & industry KPIs

CY EBITDA margins



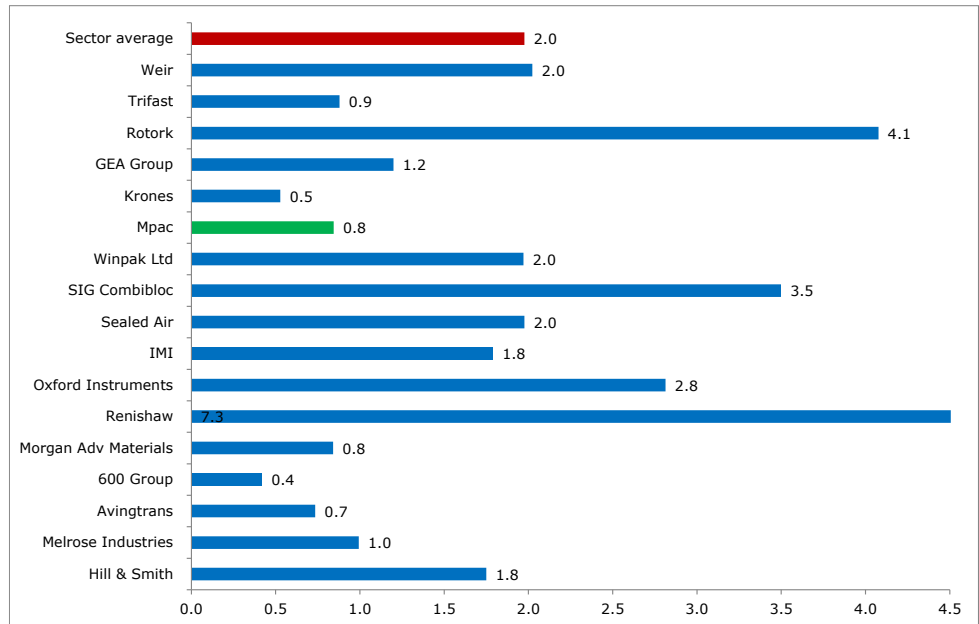
Source: Equity Development

CY EBIT margins



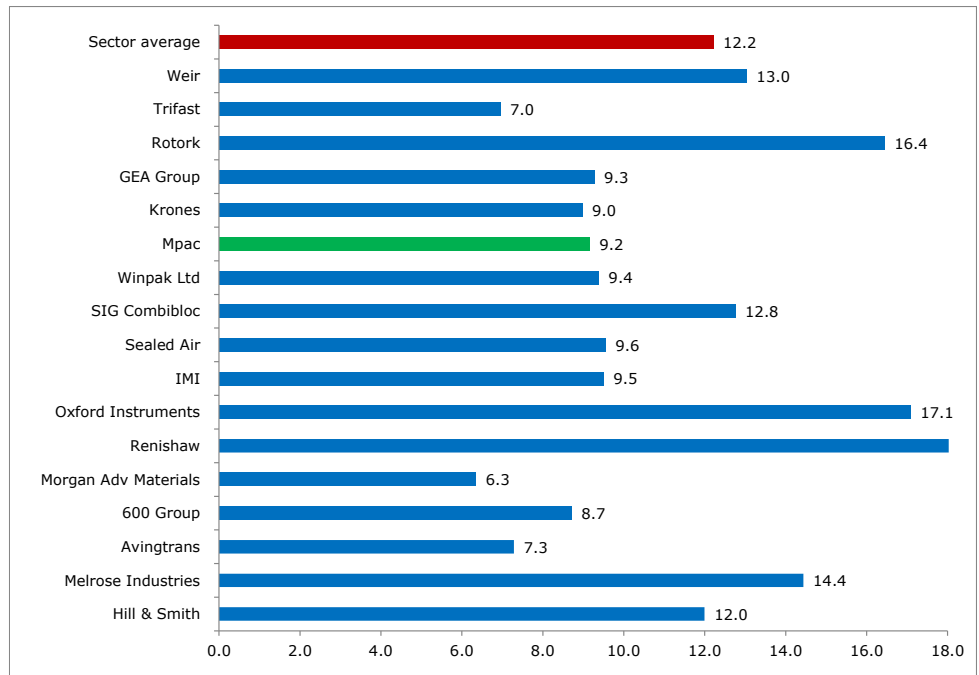
Source: Equity Development

CY EV/Sales multiples



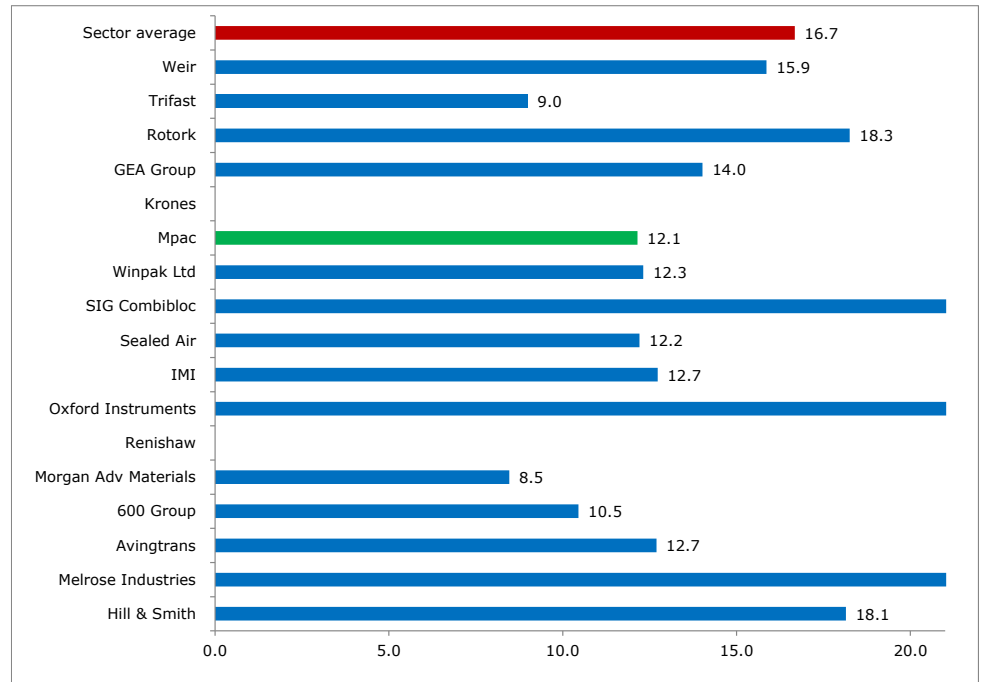
Source: Equity Development. Mpac pension adjusted

CY EV/EBITDA multiples



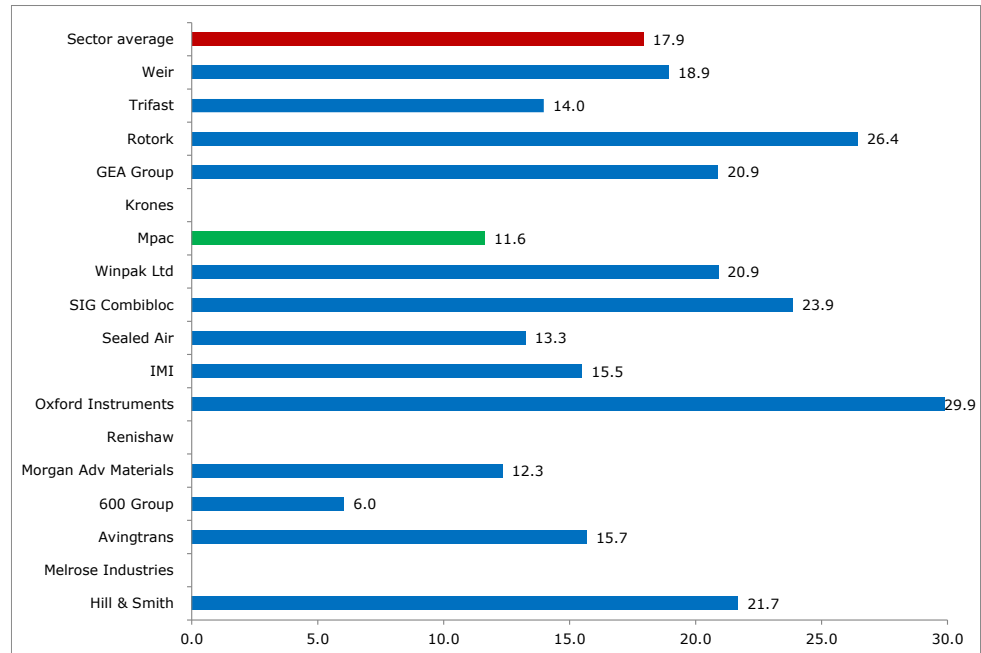
Source: Equity Development. Mpac pension adjusted

CY EV/EBIT multiples



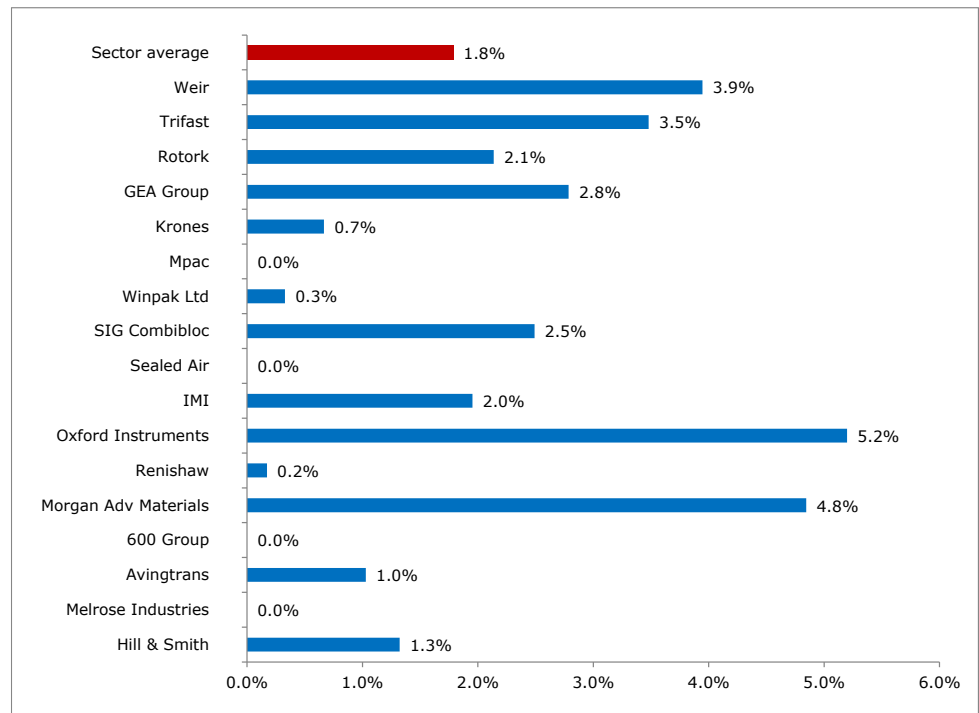
Source: Equity Development. Mpac pension adjusted

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	1,210p	£962.0	-£174.0	£1,136.0
Melrose Industries	115p	£5,587	-£2,915	£8,502
Avingtrans	243p	£76.3	-£7.5	£83.8
600 Group	8p	£8.8	-£12.1	£20.9
Morgan Adv Materials	227p	£647.0	-£130.0	£777.0
Renishaw	5,220p	£3,800	£96	£3,704
Oxford Instruments	1,575p	£904	£77	£827
IMI	1,060p	£2,883	-£246	£3,129
Sealed Air	\$38.70	\$6,037	-\$3,411	\$9,448
SIG Combibloc	€ 16.46	€ 5,268	-€ 1,239	€ 6,507
Winpak Ltd	\$33.44	\$2,174	\$483	\$1,691
Mpac	280p	£56.5	£9.5	£34.0
Krones	€ 55.50	€ 1,754	-€ 14	€ 1,768
GEA Group	€ 30.50	€ 5,505	-€ 5	€ 5,510
Rotork	304p	£2,648	£165	£2,483
Trifast	102p	£137.7	-£15.2	£152.9
Weir	1,290p	£3,354	-£1,262	£4,616

Source: Equity Development



Investor Access

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