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Sanderson Group (SND) AIM

INVESTMENT SUMMARY

- **The specialist provider of digital technology solutions, innovative software and managed services has released impressive results for the year ended 30 September 2018.**

- **Revenue in the last financial year was £32.05m (£21.56m), representing an increase of 49%. High gross margins meant that this fed through into significantly higher profit and adjusted diluted earnings per share came in at 7.6p versus 6.3p a year earlier.**

- **The balance sheet offers support to the current valuation. Net assets as at 30 September 2018 were £34.4m, up from £27.9m a year earlier. Net cash as at 30 September 2018 was £3.03m, with cash generated from operations offset by dividend payments and acquisition costs. This reflects the highly cash-generative business model and there was a net cash inflow from operating activities of £5.29m (2017: £4.50m).**

- **This is a high quality business and the latest final results confirm ongoing progress. Pre-contracted recurring revenues represented 55% of total revenue in the period and with the total order book reaching £7.58m at the year end Sanderson appears to be well positioned both for the long term and more immediate future.**

Results and Consensus Forecasts

Year to 30th September	Revenue (£m)	Pre-Tax Profit* (£m)	Earnings per share** (p)	P/E Ratio	Net Dividend (p)	Net Yield (%)
2017A	21.6	3.7	6.3	14.8	2.65	2.8
2018A	32.1	4.8	7.6	12.3	3.00	3.2
2019E	34.0	5.3	8.0	11.7	3.30	3.5
2020E	36.0	5.8	8.8	10.6	3.60	3.9

* - adjusted; ** - diluted adjusted

KEY DATA

Share Price: 93.5p
Prospective p/e ratio: 13.6x
Prospective net yield: 3.3%
Market Capitalisation: £56.1m
Next Results Due (Interims): JUNE
Net Cash (30 September): £3.03m
NAV per share (30 September): 57.3p

BULLET POINTS

- Trading results for the year were ahead of market expectations
- Cash position also ahead of market expectations
- Strong order book means the company is on track to deliver another year of progress
- Progressive dividend policy continues with final dividend and full year dividend both up 13%

Date of Report : 27 November 2018

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Executive Summary

- ***Sanderson Group is specialist provider of digital technology solutions, innovative software and managed services for the retail, wholesale, supply chain logistics, food and drink processing and manufacturing market sectors. The group develops long term relationships with its customers with the majority of product development being customer led and offering tangible benefits.***

- ***There are two divisions. The Digital Retail Division provides IT solutions to businesses operating in ecommerce, mobile commerce and retail sectors in the UK. The Enterprise Division is now made up of three market focused businesses operating in manufacturing, wholesale and supply chain logistics.***

- ***The acquisition of Anisa Consolidated Holdings Limited, for an enterprise value of £12.0m, was completed in November 2017. Anisa became part of the Enterprise Division and specialises in integrated supply chain and enterprise resource planning solutions. This is a cash generative business and the acquisition was earnings enhancing from the outset.***

- ***The group recognises the need to focus on higher margin growth markets such as e-commerce and mobile. With this in mind niche ecommerce business Priam and One iota Limited, which provides cloud-based multi-channel solutions, were acquired in 2013. Proteus Software Limited was sub-sequently acquired in December 2014.***

- ***The sale of Sanderson RBS in January 2012 transformed the balance sheet, resulting in a net cash position. The acquisition of One iota Limited was accompanied by a share placing, which raised £3.5m and this ensured that a healthy cash balance was maintained. The net cash balance as at 30 September 2018 was £3.03m.***

- ***The balance sheet is solid and a progressive dividend policy is in place, with both the final and full year dividends increasing by 13% last year.***

History

The original Sanderson Group was founded in 1983…

The former Sanderson Group was originally founded in 1983 and its shares were floated on the Unlisted Securities Market of the London Stock Exchange in 1988. The company then moved to a full market listing in 1990. Current executive chairman, Christopher Winn, joined in 1995 when he became group chief executive. By 1999, turnover had risen to £100m and in December of that year he led a management buyout of the group as it was taken private.

...the present group subsequently joined AIM in late 2004

The group was then restructured and in 2003 it was demerged into three separate businesses — Sanderson, Civica and Talgentra. The present group kept the Sanderson name and brand and its shares were admitted to AIM in December 2004 through a placing at 50p.

In January 2012 the group disposed of Sanderson RBS…

...since that time a number of acquisitions have been made, most recently Anisa

In January 2012, the group disposed of Sanderson RBS, which specialised in the sale of EPOS solutions to retailers, in order to focus on higher margin growth markets. The group has since expanded with particular emphasis on the development of the Multi-channel retail business, acquiring Catan Marketing and One iota in 2013 followed by Proteus Software in December 2014. The most recent acquisition, Anisa, was significant and added considerable scale.

The group is widely recognised as an established provider of digital technology solutions, innovative software and managed services, primarily in the UK and Ireland.

Activities

Sanderson supplies its services into retail, wholesale, supply chain logistics, food and drink processing and manufacturing. The group delivers solutions to numerous organisations with turnovers typically between £5m and £750m. Its customers include the likes of Richer Sounds, JD Sports, QUIZ, Hugo Boss, DHL, Clipper Logistics, Superdry, Hotel Chocolat, Beaverbrooks and Scotts of Stow.

The group's solutions now primarily consist of Sanderson proprietary owned software, integrated with other market-leading products being delivered, supported and serviced by Sanderson staff.

Sanderson focuses on supplying customers with market led value for money solutions, which provide tangible benefits. The latest versions of the group's software also address regulatory and legislative compliance such as traceability in food manufacturing.

The group has expertise in Enterprise Resource Planning (ERP), which integrates internal and external management information across an entire organisation, embracing finance, manufacturing, sales and service. This facilitates the flow of information between all business functions inside the boundaries of the organisation and manages the external connections. These solutions help organisations to manage their operations and be more productive, competitive and profitable.

Digital Retail

Digital Retail is a growth area and will continue to be a focus for investment

This division is one of two strands to the business. It addresses an attractive, growing market. Revenues from this part of Sanderson rose by over 20% in the last financial year, reaching £8.82m (2017: £7.28m). Operating profit in the year ended 30 September 2018 (adjusted for amortisation of acquisition-related intangibles, share-based payment charges and 'one off' non-recurring items) was £1.56m (2017: £1.18m). Investment in product innovation and delivery capacity continues and this remains an attractive, growing market.

At the year end the underlying order book was £1.07m, some 24% higher than a year earlier when it was £0.86m. The business is well positioned to continue to grow.

Enterprise

Enterprise is the largest of the two reporting divisions

This division accounted for 72.5% of total revenue, having been strengthened by the addition of Anisa. Divisional revenue was £23.23m (2017: £14.28m) and operating profit (adjusted for amortisation of acquisition-related intangibles, share-based payment charges and 'one-off' non-recurring items) was £3.62m (2017: £2.71m). On a like-for-like basis, adjusted for the acquisition, revenue was £14.14m (2017: £14.28m) and operating profit (adjusted for amortisation of acquisition-related intangibles, share -based payment charges and 'one-off' non-recurring items) was £2.49m (2017: £2.71m). Performance improved in the second half of the last financial year and this is expected to continue into the current financial year. The order book at the year end was £5.36m (2017: £1.81m). Excluding the acquisition the underlying order book was up slightly at £1.84m (2017: £1.81m).

Investment is being made to ensure that the company's offering remains strong

Due to stronger performance in the second half, 18 new customers were gained in the year. The division invested almost £3m in software product development, with a key focus being the Wholesale business, which secured a number of new orders for the digital suite of products launched earlier in the year.

Towards the end of the financial year an innovative business intelligence product with enhanced capability was launched. Although it is early days there has already been a high level of interest.

Acquisitions

The Anisa acquisition is proving to be a useful addition to the group

The acquisition of Anisa added around 250 customers. It specialises in the delivery of integrated supply chain and ERP solutions. Over 90 staff are employed across the UK and in smaller operations in Singapore and Australia. The Port of Dover Cargo Limited has appointed Sanderson to supply warehouse management and cargo terminal management software for its new refrigerated cargo terminal. The customer base has been very active, with major orders from Moran Logistics Limited, Culina Group, DX plc and NHS Blood and Transplant during the year. The acquisition has enhanced the range of solutions and services which Sanderson can now offer. In particular hosted managed services, delivered from the company's own dedicated, specialist data centre, provides an opportunity to exploit and accelerate market trends towards subscription and cloud-based options for solution delivery going forward.

Further acquisitions are possible

Further acquisitions remain under consideration.

Final Results

Results were strong and also laid solid foundations to build upon for the current year and beyond

In the year ended 30 September 2018 revenue was up 49% at £32.05m (2017: £21.56m). Pre-contracted recurring revenues, £17.61m versus £11.18m a year earlier, accounted for 55% of total revenue. Gross margin was 80% and operating profit was up by a third to £5.18m (2017: £3.90m). Adjusted basic earnings per share rose from 6.4p to 7.9p.

Digital Retail continues to grow

Digital Retail revenue rose strongly by over 20% to £8.82m (2017: £7.28m) and operating profit (adjusted for amortisation of acquisition-related intangibles, share-based payment charges and 'one-off' non-recurring items) was £1.56m (2017: £1.18m). The underlying year-end order book was £1.07m versus £0.86m a year earlier.

In the Enterprise division revenue was £23.23m (2017: £14.28m), the increase driven by Anisa. Operating profit (adjusted for amortisation of acquisition-related intangibles, share-based payment charges and 'one-off' non-recurring items) was £3.62m (2017: £2.71m). The order book was £5.36m at the period end (2017: £1.81m). Much of the improvement relates to Anisa but excluding the acquisition the order book was up marginally at £1.84m at the period end.

There was net cash of £3.03m at the period end

Net cash at the year end was £3.03m (2017: £6.18m). The final dividend has been increased by 13% to 1.75p per share (2017: 1.55p), taking the total for the year to 3.00p per share (2017: 2.65p). The level of dividend cover, based on adjusted earnings per share, is 2.5x. This is slightly higher cover than in previous years and provides scope for the level of dividends to be increased further in future years.

Forecasts

We continue to believe that further acquisitions could add shareholder value

The addition of Anisa has provided an obvious boost and now that the acquisition has been bedded in there is a very good base from which the business can build further in the coming years.

The level of recurring revenues reached 55% of all revenue last year. This, combined with the healthy order book, should mean that forecasts for the current year are realistic. The company has a track record of at least meeting expectations.

Digital Retail is growing

We do not factor further acquisitions into forecasts. However, we anticipate earnings enhancing deals in future years. There is no reason why earnings should not continue to grow over the medium to long term. Although the more immediate economic outlook is slightly uncertain, the Digital Retail division operates in a growing market with exciting potential.

Valuation

Relatively modest p/e

The shares now stand on a multiple of 12.3x historic adjusted earnings. Given that there is net cash of just over £3m, this is arguably a modest rating given the nature of the business. In particular, the high level of recurring revenues provides considerable reassurance.

The current share price translates into a market capitalisation of £56.1m, which stripping out net cash as at the end of September values the company at £53m. Adjusted operating profit last year was £5.175m, up from £3.896m a year earlier. The value of the company adjusted for net cash represents 1.65x revenue in the last financial year.

As we have mentioned in previous notes, a higher market capitalisation may attract institutional investors

The level of net assets should provide support and we have noted in the past that a market capitalisation of £50m or more could lead to increased interest from institutional investors. Sanderson's valuation has moved back above this level again following the results announcement.

Prospects

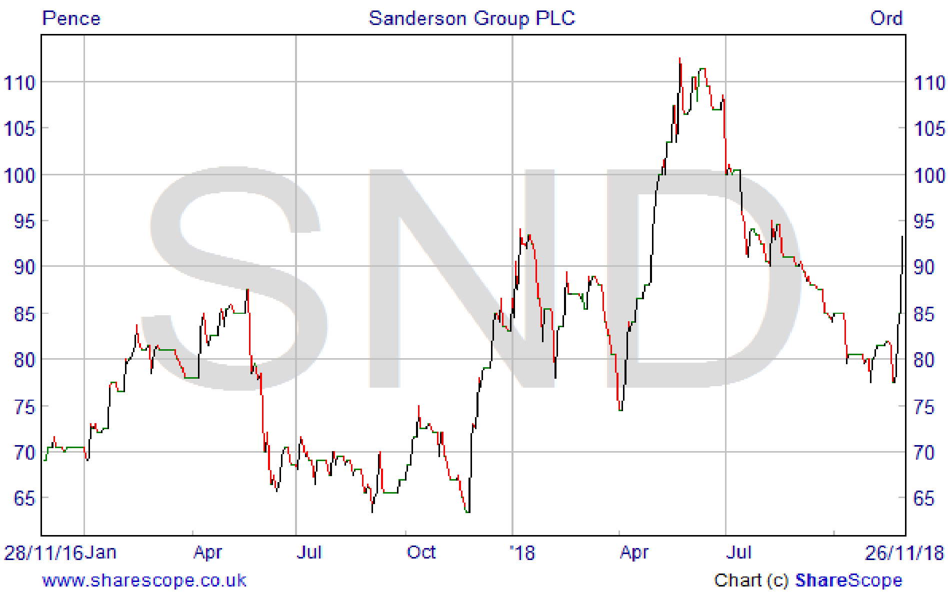
Solid progress continues

Sanderson continues to make good progress. The company has rarely disappointed investors in the past and modest organic growth looks likely in the coming years. If suitable acquisitions can be identified then these could add further value for shareholders. It is clear that Anisa has had a strong positive impact and following this success the company may now be more likely to follow the acquisition up with further deals.

We believe that the Digital Retail division is well placed

The Digital Retail division has excellent prospects. It operates in a growth area and Sanderson Group is carving out a niche position within it.

Share Price Graph



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Profit and Loss Year End 30 Sept	2015 (£m)	2016 (£m)	2017 (£m)	2018 (£m)
Revenue				
Total	**19.2**	**21.3**	**21.6**	**32.1**
Operating Profit				
Total	**3.3**	**3.7**	**3.9**	**5.2**
Movement in fair value of derivatives	0.0	0.0	0.0	0.0
Net finance costs	(0.1)	(0.1)	(0.2)	(0.3)
Exceptional finance charge	(0.3)	(0.1)	0.0	(0.1)
Profit before Tax	**2.9**	**3.5**	**3.7**	**4.8**
Tax	(0.2)	(0.4)	0.2	(0.2)
Profit after Tax	**2.4**	**2.7**	**3.9**	**4.6**
Av number of shares (m)	55.86	56.30	55.58	60.41
EPS (p)	**4.9**	**5.5**	**6.3**	**7.6**
DPS (p)	**2.10**	**2.40**	**2.65**	**3.00**

Ratios	2015	2016	2017	2018
Sales Growth (%)	**17.0**	**11.1**	**1.4**	**48.6**
Operating Margin (%)	**17.2**	**17.3**	**18.1**	**16.1**
EPS Growth (%)	**11.4**	**12.2**	**27.3**	**20.6**
DPS Growth (%)	**16.7**	**14.3**	**10.4**	**13.2**
Dividend Cover (x)	**2.3**	**2.3**	**2.4**	**2.5**

Cash flow Year end 30 Sept	2017 £'000	2018 £'000
Profit for the period	2,867	3,026
Adjustments	1,173	2,674
Operating cash flow	**4,040**	**5,700**
Changes in working capital/provisions	852	(565)
	4,892	**5,135**
Interest paid	-	
Income tax received/(paid)	(394)	158
Net cash flow from operating activities	**4,498**	**5,293**
Purchase of assets	(1,389)	(2,854)
Financing activities	(1,277)	(2,144)
Net Increase in cash and cash equivalents	**1,832**	**295**
Cash and cash equivalents at start of year	**4,344**	**6,176**
Cash and cash equivalents at end of year	**6,176**	**6,471**

Balance sheet Year End 30 September	2017 £'000	2018 £'000
Intangible assets	30,419	43,265
Other non-current assets	1,861	2,341
Total	**32,280**	**45,606**
Current assets	11,807	15,772
Current liabilities	(9,196)	(18,719)
	34,891	**42,659**
Non-current liabilities	(6,960)	(8,284)
Net Assets	**27,931**	**34,375**
Share Capital	5,507	5,997
Share Premium	9,133	9,557
Retained earnings/reserves	13,291	16,490
Shareholders funds	**27,931**	**34,375**

Ratios	2017	2018
NAV (p)	**50.8**	**57.3**
Gearing (%)	**n/a**	**n/a**

GENERAL INFORMATION

COMPANY DATA

Stockbrokers:
N+1 Singer

Contact Address:
Sanderson House
Manor Road
Coventry
CV1 2GF

Information:
Christopher Winn
Chairman
Ian Newcombe
Chief Executive
Richard Mogg
Finance Director
t– 0333 123 1400

FINANCIAL CALENDAR

Expected AGM Date:	22 January 2019
Final Dividend Ex-div Date:	14 February 2019
Final Dividend Payment Date:	1 March 2019
Interim Results Due:	June 2019
Year End:	30 September 2019
Final Results Announcement:	November 2019

The above dates should only be used for guidance

Significant Shareholders

Ordinary shares of 10p each	%
C Winn	13.3
Cannaccord Genuity	11.2
Living Bridge	9.2
Miton Asset Management	5.2
Alto Invest	4.5
Brooks Macdonald Asset Management	4.2
Unicorn Asset Management	4.0
D Renshaw	3.5

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VAT. Reg. No. GB 607 1818 48

1 Skipton Road
Ilkley
West Yorkshire
LS29 9EH

Tel : 01943 886602
Fax : 01943 886601
Email : info@brokerlink.co.uk
www.brokerlink.co.uk

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