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Sanderson Group (SND) AIM

INVESTMENT SUMMARY

- **A solid set of interim results, covering the six months ended 31 March 2018, provides further evidence that the company remains on track to deliver another year of progress.**

- **Results were slightly ahead of management's previous expectations, as highlighted in the trading update which was released earlier this month. Revenue and profit both grew by over 30%, boosted by the acquisition of Anisa Group part way through the period in November 2017.**

- **Organic growth should not be ignored and aside from Anisa significant progress has been made. The order book as at 31 March 2018 was over 16% higher than at the same stage a year earlier on a like-for-like basis. The total order book currently stands at over £8.6m.**

- **The balance sheet remains in good shape. Net cash was over £1.3m as at 31 March 2018. This provides a solid base from which the business can be developed further and further acquisitions are possible without stretching resources.**

- **The share price has had a strong run in recent weeks, reflecting the quality of earnings and long term potential of the business.**

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 (%)
2016A	21.3	3.4	5.5	19.1	2.4	2.3
2017A	21.6	3.7	6.3	16.7	2.65	2.5
2018E	31.0	4.7	6.4	16.4	2.8	2.7
2019E	33.2	5.2	6.9	15.2	3.0	2.9

* - adjusted; ** - diluted adjusted

KEY DATA

Share Price:	**105p**
Prospective p/e ratio:	**16.4x**
Prospective net yield:	**2.7%**
Market Capitalisation:	**£62.8m**
Next Results Due (Finals):	**NOV**
Net Cash (31 March):	**£1.39m**
NAV per share (31 March):	**52.8p**

BULLET POINTS

- Strong growth in both revenue and profit
- Notably strong order book provides reassurance moving forwards
- Net cash position despite Anisa acquisition
- Progressive dividend policy continues
- Full benefits of the Anisa acquisition feeding through but organic growth has been strong

Date of Report : 23 May 2018

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Executive Summary

- ***Sanderson Group is a software and IT services business specialising in digital technology and enterprise software for businesses operating in the retail, manufacturing, wholesale distribution and logistics sectors. The group develops long term relationships with its customers with the majority of product development being customer led and offering tangible benefits.***

- ***The acquisition of Anisa Consolidated Holdings Limited for an enterprise value of £12.0m was announced on 24 November 2017. Anisa specialises in integrated supply chain and enterprise resource planning solutions. This is a cash generative business and the acquisition should be earnings enhancing from the outset.***

- ***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 made up of two market focused businesses based on manufacturing, mainly covering the food and drink processing industries, and wholesale distribution and logistics.***

- ***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 Catan Marketing Limited, trading as PRIAM, and One iota Limited, which provides cloud-based multi-channel solutions, were acquired in 2013. Proteus Software Limited was subsequently 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 31 March 2018 was £1.39m.***

- ***The balance sheet remains in good shape and a progressive dividend policy is in place.***

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, is significant and added considerable scale.

The group is widely recognised as an established provider of software and IT services in the UK and Ireland with a focus on manufacturing and multi-channel retailing.

Activities

Sanderson is a supplier of innovative software solutions and IT services, specialising in digital retail, manufacturing wholesale and logistics markets, in the UK and Ireland. The group delivers solutions to numerous organisations with turnovers typically between £5m and £250m. Its customers include the likes of Richer Sounds, JD Sports, QUIZ, 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 group software also address regulatory and legislative compliance, for example, 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 Group now represent over a third of total revenue. Operating profit was £1.18m last year versus £0.89m in the year to 30 September 2016. Investment in management, sales and delivery capacity continued in this area as the digital retail market is expected to continue to grow rapidly.

Mobile enablement and deployment remains key to success in this area and Sanderson Group continues to innovate. This market is seen as being relatively immature and should provide some good opportunities over the longer term.

Enterprise

Enterprise is the largest of the two new reporting divisions

Accounting for just under two thirds of total revenue last year, this part of the business comprises two market-focused businesses which are based upon the manufacturing sector and the wholesale distribution and logistics sector. Revenue and operating profit were £14.28m (2016: £14.92m) and £2.71m (2016: £2.80m) respectively in the last full year.

Businesses in general manufacturing such as engineering, plastics, aerospace, electronics and print and the food and drink processing sectors represent the main areas of specialisation for Sanderson Group in manufacturing markets. The company continues to invest in product development and in its sales and marketing capability. Traceability of products and ingredients through the food manufacturing and supply chain and the assurance of product compliance to the latest regulatory standards are a major benefit of the company's solution.

Recurring revenue a significant positive feature

Recurring revenue represents a high proportion of revenue and there is a large customer base with some long standing relationships.

Sanderson Group has expertise in delivering proven software and long term value across a wide range of sectors and types of manufacturing. These include Food, Aerospace, Engineering, Electronics, Plastics and Print with customers including Nairns, Protex and Bromford Industries. The business systems are designed specifically for the markets they address, improving efficiency in manufacturing and bringing cost saving benefits to customers. The size of the UK food and drink processing market is growing and there is an increase in the number of small and medium sized businesses in this sector, which provides an opportunity for further growth.

Acquisitions

The Anisa deal is a major step forward for the group

The acquisition of Anisa complemented the Enterprise division and added around 250 customers. The enterprise value of Anisa was £12.0m with the initial consideration being £2.41m in cash and £2.79m in Sanderson Group shares valued at 70p each. For the period ended 31 December 2016 Anisa delivered revenue of £10.04m, operating profit of £0.38m and profit before taxation of £73k. As at the period end it had net assets of £6.54m.

Further acquisitions are a possibility

There is scope for further acquisitions and some are said to be under consideration. We continue to believe that acquisitions could add value given the current scale of the business and potential to make additions on sensible terms. A relatively conservative approach has been taken to date.

Interim Results

Strong interim results are slightly ahead of management's expectations

The group has made further strong progress In the six months to 31 March 2018 with the results helped by the acquisition of Anisa last November. Group revenue has risen by 34% to £14.61m (2017: £10.90m) with like for like revenue (excluding Anisa) increasing to £11.08m (2017: £10.90m). Pre-contracted recurring revenue increased to £8.25m (2017: £5.40m), representing 56% of total revenue. Adjusted operating profit also rose by 34% to £2.08m (2017: £1.55m) with gross margins remaining high at 80%. Adjusted pre-tax profits increased by 32% to £1.93m (2017: £1.46m) with diluted earnings per share on the same basis emerging at 3.1p (2017: 2.3p).

Operating profit at Digital Retail more than doubled

The Digital Retail division reported a 20% increase in revenue to £4.25m (2017: £3.54m) with adjusted operating profit more than doubling to £0.70m (2017: £0.34m). Sales orders gained during the period included those from Richer Sounds, Beaverbrooks the Jewellers, Thorntons and Scotts of Stow. At 31 March the order book stood at £3.42m (2017: £0.84m).

The Enterprise division was significantly enhanced by the acquisition of Anisa

The Enterprise division was significantly strengthened during the period by the acquisition of Anisa and revenue rose to £10.36m (2017: £7.36m) as a result. Adjusted operating profit rose to £1.38m (2017: £1.21m).

There was net cash of £1.39m at the period end

Net cash at the end of the period was £1.39m with the cash balance excluding the Anisa loan facility remaining strong at £5.06m (2017: £4.51m). As a result, the group has declared an interim dividend of 1.25p, an increase of 14% over the interim dividend last year of 1.10p.

Forecasts

The addition of Anisa provided a considerable boost to forecasts for the current year and beyond. We continue to believe that the acquisition will help drive growth in profits and a significant increase in revenue from the current year onwards. Forecast revenue has been nudged up to £31.0m for the year to 30 September 2018.

As noted previously, the high level of recurring revenues should ensure that forecasts for the current year are at least met. The company has a strong track record of meeting or exceeding expectations.

Further acquisitions should continue to drive increasing shareholder value

Further acquisitions are not factored into forecasts at this stage but it is likely that earnings enhancing deals can continue to be completed in the coming years. This will assist in generating growth in earnings over the medium to long term.

Valuation

Increased share price appears to be justified

The extent to which the Anisa deal enhances earnings still remains to be seen. There has recently been a strong run in the company's share price to over 100p and the shares now trade on a higher multiple of earnings than they have in recent years. This appears to be justified given the quality of earnings and strength of the balance sheet.

Recurring revenues and strong order book reduce risk

The business has been managed relatively conservatively over the years and this provides considerable protection against downside. With over half of revenue being made up of pre-contracted recurring revenues and a notably strong order book there is good visibility of earnings.

Market capitalisation of over £50m may attract more institutional investors

We have pointed out in the past that a market capitalisation of £50m or more could see institutional investors take a greater interest. This level has been achieved and should now offer support to the share price.

Prospects

Steady progress continues

The company continues to make steady progress. It addresses some interesting niche markets and long term prospects remain encouraging. As noted above, recurring revenues should ensure that downside is relatively limited but conversely new business wins should have a meaningful impact on profitability given high gross margins.

Exciting opportunities in Digital Retail

There is a particular emphasis on mobile and ecommerce solutions in Digital Retail. This is a growth area and Sanderson Group is carving out an enviable niche position within it. It can already boast some high profile customers but there is scope for further progress in this area both organically and via acquisitions.

Positive impact from Anisa acquisition

The acquisition of Anisa has had a positive impact. In terms of revenue this deal provided an immediate boost and the acquisition was expected to be earnings enhancing from the outset.

Share Price Graph

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Profit and Loss Year End 30 Sept	2014 (£m)	2015 (£m)	2016 (£m)	2017 (£m)
Revenue				
Total	**16.4**	**19.2**	**21.3**	**21.6**
Operating Profit				
Total	**2.8**	**3.3**	**3.7**	**3.9**
Movement in fair value of derivatives	0.0	0.0	0.0	0.0
Net finance costs	(0.1)	(0.1)	(0.1)	(0.2)
Exceptional finance charge	(0.0)	(0.3)	(0.1)	0.0
Profit before Tax	**2.7**	**2.9**	**3.5**	**3.7**
Tax	(0.3)	(0.2)	(0.4)	0.2
Profit after Tax	**1.9**	**2.4**	**2.7**	**3.9**
Av number of shares (m)	54.19	55.86	56.30	55.58
EPS (p)	**4.4**	**4.9**	**5.5**	**6.3**
DPS (p)	**1.8**	**2.1**	**2.4**	**2.65**

Ratios	2014	2015	2016	2017
Sales Growth (%)	**18.8**	**17.0**	**11.1**	**1.4**
Operating Margin (%)	**17.1**	**17.2**	**17.3**	**18.1**
EPS Growth (%)	**4.8**	**11.4**	**12.2**	**27.3**
DPS Growth (%)	**20.0**	**16.7**	**14.3**	**10.4**
Dividend Cover (x)	**2.4**	**2.3**	**2.3**	**2.4**

Cash flow Year end 30 Sept	2016 £'000	2017 £'000
Profit for the period	2,427	2,867
Adjustments	1,909	1,173
Operating cash flow	**4,336**	**4,040**
Changes in working capital/provisions	(692)	852
	3,644	**4,892**
Interest paid	-	-
Income tax paid	-	(394)
Net cash flow from operating activities	**3,644**	**4,498**
Purchase of assets	(2,759)	(1,389)
Financing activities	(1,148)	(1,277)
Net Increase in cash and cash equivalents	**(263)**	**1,832**
Cash and cash equivalents at start of year	**4,607**	**4,344**
Cash and cash equivalents at end of year	**4,344**	**6,176**

Balance sheet Year End 30 September	2016 £'000	2017 £'000
Intangible assets	30,473	30,419
Other non-current assets	2,279	1,861
Total	**32,752**	**32,280**
Current assets	11,605	11,807
Current liabilities	(10,332)	(9,196)
	34,025	**34,891**
Non-current liabilities	(9,094)	(6,960)
Net Assets	**24,931**	**27,931**
Share Capital	5,485	5,507
Share Premium	9,056	9,133
Retained earnings/reserves	10,390	13,291
Shareholders funds	**24,931**	**27,931**

Ratios	2016	2017
NAV (p)	**45.5**	**50.8**
Gearing (%)	**n/a**	**n/a**

GENERAL INFORMATION

COMPANY DATA

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FINANCIAL CALENDAR

Year End:	30 September 2018
Final Results Announcement:	November 2018
Expected AGM Date:	February 2019

The above dates should only be used for guidance

Significant Shareholders

Ordinary shares of 10p each	%
C Winn	19.6
Cannaccord Genuity	8.9
Living Bridge	8.4
Miton Asset Management	5.3
Alto Invest	4.2
Brooks Macdonald Asset Management	4.2
Unicorn Asset Management	4.0
D Renshaw	3.5

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