# Sanderson Group

Update
10th June 2014

## Further Improved Performance

**Sanderson Group has announced interim results that are in-line with our expectations. The numbers reflect a further improved performance and provide us with confidence in the software and IT services business achieving our revenue and profits forecasts for FY14 and FY15. We continue to be impressed by the high level of recurring revenues, strong and growing range of products and services, and growing presence in the catalogue, online sales and ecommerce markets. We also remain attracted by the healthy balance sheet and strong cash generation. Accordingly, we retain our buy stance, with a target price of 90p.**

### Interims

For the six months ended 31st March 2014, revenue increased by 24.6% to £7.94m (H1 FY13: £6.37m), primarily driven by recent acquisitions, the food and drink business and orders for mobile and ecommerce. Gross margin continued to remain strong, at 87% (H1 FY13: 88%), and gross profit increased by 23.4% to £6.91m (H1 FY13: £5.60m). Underlying EBIT increased by 23% to £1.22m (H1 FY13: £0.99m) as investment in product innovation and in sales and marketing were maintained. Order intake almost doubled to £4.27m (H1 FY13: £2.19m) and order book – which gives us good visibility of future revenues and demonstrates the confidence customers have - increased by 56% to £2.47m (H1 FY13: £1.58m). The resilient operational performance, combined with the strong balance sheet and readily available cash resources (£5.07m), has allowed Sanderson Group to increase its interim dividend by >20% to 0.80p (H1 FY13: 0.65p), which is well covered by basic EPS of 1.4p (H1 FY13: 1.8p).

### Financial forecasts

For FY14, we are forecasting a gross profit of £13.85m on revenue of £16.10m. With new product development accounting for over £4m of new sales over the last 5 years, we expect the group to continue its investment in product innovation, as well as sales & marketing, and are forecasting adjusted PBT of £2.67m. We upgrade our dividend forecast by 12.5% to 1.80p per share (previously 1.60p). For FY15, we are forecasting a gross profit of £14.88m on revenue of £17.30m. Our adjusted PBT figure remains at £3.20m, but we are now anticipating DPS of 2.0p (previously 1.70p).

### Valuation

Given the strong progress made, we continue to see a rating of 15 times forward earnings + net cash as justifiable for setting our target price of 90p. The prospective yield of 2.59% is also attractive. **Buy.**

*Table: Financial overview*

| Year to 30th Sep. | 2012A | 2013A | 2014E | 2015E |
|---|---|---|---|---|
| Revenue (£'000) | 13,374 | 13,828 | 16,100 | 17,300 |
| PBT* (£`000) | 1,613 | 2,186 | 2,670 | 3,195 |
| EPS* (p) | 3.80 | 4.42 | 4.72 | 5.19 |
| Dividend (p) | 1.20 | 1.50 | 1.80 | 2.00 |
| Yield (%) | 1.73% | 2.16% | 2.59% | 2.88% |

*Source: GECR and company.*
*Notes: *Adjusted*

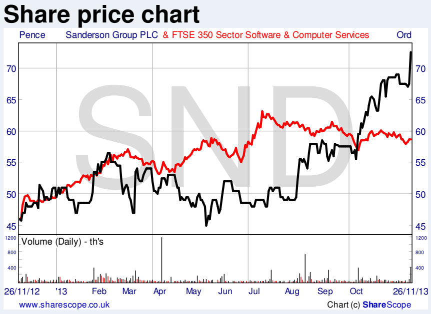
## Buy

**Target price** **90p**

**Key data**

| | |
|---|---|
| Share price | 69.50p |
| 52 week high/low | 76p/48p |
| Primary exchange | AIM |
| EPIC | SND |
| Shares in issue | 51.97 m |
| Market Cap | £36.12 m |
| Sector | Software & Computer Services |

**Share price chart**

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## Interims

Sanderson Group has announced interim results that are in-line with our expectations. For the six months ended 31st March 2014, revenue increased by 24.6% to £7.94m (H1 FY13: £6.37m), primarily driven by the food and drink business and orders for mobile and ecommerce. Gross margin continued to remain strong, at 87% (H1 FY13: 88%), and gross profit increased by 23.4% to £6.91m (H1 FY13: £5.60m). Underlying EBIT increased by 23% to £1.22m (H1 FY13: £0.99m) as investment in product innovation and in sales and marketing were maintained. Order intake almost doubled to £4.27m (H1 FY13: £2.19m), with twelve new customers being acquired at an average value of £143k (H1 FY13: three at an average value of £61k.) and orders for mobile and ecommerce grew strongly and now accounts for over a third of order intake. The order book – which gives good visibility of future revenues and demonstrates the confidence customers have in the firm's offerings - increased by 56% to £2.47m (H1 FY13: £1.58m).

The balance sheet and cash-flow remained strong, with no debt, cash of £5.07m at the period end and almost 100% profit-to-cash conversion. The resilient operational performance, combined with the strong balance sheet and readily available cash resources, has allowed Sanderson to increase its interim DPS by >20% to 0.80p (H1 FY13: 0.65p), which is well covered by basic EPS of 1.4p (H1 FY13: 1.8p).

### Multi-channel division

Revenues increased by 39% to £4.71 (H1 FY13: £3.40m), driven by increased levels of business activity in the wholesale distribution, cash and carry, online sales, ecommerce and catalogue markets. Seven new customers were acquired during the period - including WCF Home Shopping, Astley Clarke and Cloggs – and a number of large orders from existing customers were also gained, including Joe Browns, Badger Office Supplies, Turner Price, Clipper Logistics Group and Healthspan. We note that the acquired One iota business has made a good start as part of Sanderson Group and has helped to expand sales into the areas of mobile enabled online sales and ecommerce, and a number of joint opportunities are being developed.

Operating profit increased by 31% to £848k (H1 FY13: £649k), equating to an operating margin of 18% (H1 FY13: 19%), and the order book grew by 45% to £1.19m (H1 FY13: £822k). These were the first results which incorporate a contribution from One iota, which achieved an operating profit of £154k on revenue of £788k.

### Manufacturing division

Revenue increased by 8.8% to £3.23m (H1 FY13: £2.97m), driven by a strong trading performance from food and drink-focused markets business. Five new customers were gained during the period - including a large bottling and drinks company, Prima Foods UK, Rathfinny Estate and Accommodation Furniture – and large projects with existing customers included Food Partners, Freddy Hirsch and Proctor Paper & Board. We note that while the business focused on the non-food and drink manufacturing markets traded below expectations, Sanderson has taken measures to reduce the cost base and to increase its sales orders post period.

Operating profit increased by 8.3% to £367k (H1 FY13: £339k), equating to an operating margin of 11% (H1 FY13: 11%), and order book increased by 68% to £1.28m (H1 FY13: £761k). We note that recurring revenues represent 61% of total divisional revenues and cover over three-quarters of divisional overheads.

## Forecasts

We expect to see further accelerated growth being achieved in the ecommerce market, fuelled by the development of mobile commerce. We also expect to see growth coming from the food and drink processing sector within the UK. So, while Sanderson continues to invest across all of its business, we expect particular attention being placed on developing its offering in these areas. Furthermore, while selective acquisition opportunities will continue to be considered to augment organic growth, we anticipate the focus now is on delivering on target results and on making the PRIAM and One iota acquisitions successful.

We have kept our revenue and profit forecasts unchanged, but have upgraded our DPS forecast. For FY14, we are forecasting revenue of £16.10m. With a larger amount of higher margin products expected to be sold, we are assuming gross margins of 86%, leading to a gross profit forecast of £13.85m. With new product development accounting for over £4m of new sales over the last 5 years, we expect the group to continue its investment in product innovation, as well as sales & marketing, and are forecasting adjusted PBT of £2.67m. We upgrade our DPS forecast by 12.5% to 1.80p (previously 1.60p).

For FY15, we are forecasting revenue of £17.30m. As mentioned above, we expect a larger proportion of higher margin products to be sold, and are therefore forecasting a gross profit of £14.88m. With further product innovation and sales & marketing investments anticipated, we are forecasting an adjusted PBT figure of £3.20m. We are now anticipating DPS of 2.0p (previously 1.70p).

## Valuation

We continue to be impressed by the high level of recurring revenues at Sanderson. A strong and growing range of products and services, a growing presence in the catalogue, online sales and ecommerce markets, the strengthened balance sheet and strong cash generation also augur well for the company. Accordingly, and given the strong progress made, we consider a rating of 15 times forward earnings + net cash as justifiable for setting our target price of 90p. The prospective yield of 2.59 is also attractive. **Buy.**

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