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Sanderson Group (SND) AIM

INVESTMENT SUMMARY

- Interim results covering the six months to 31 March 2014 provide evidence of further progress. The acquisitions made in 2013, Catan Marketing Limited, trading as PRIAM, and One iota Limited, are helping drive growth in both revenue and profitability. These additions have allowed greater focus on high margin growth areas.

- Recurring gross margin covers 66% of overheads in the Multi-channel retail division and 75% of overheads in Manufacturing. It is worth noting that a number of existing customers are themselves making very good progress, such as Clipper Logistics and MandM Direct.

- The balance sheet remains in excellent shape, with a relatively high net cash position. There was 96% profit to cash conversion before payment of acquisition costs, which demonstrates the underlying strength of the business.

- Performance in the first half has been strong enough to allow the interim dividend to be lifted from 0.65p per share to 0.8p. We therefore raise our total dividend forecasts to 1.8p for the current year and 2.0p for 2014/15, pushing the prospective yield for next year to the 3% level.

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 (%)
2012A	13.4	1.5	2.8	23.6	1.2	1.8
2013A	13.8	1.9	3.7	17.8	1.5	2.3
2014E	15.9	2.5	4.2	15.7	1.8	2.7
2015E	17.0	3.0	4.7	14.0	2.0	3.0

KEY DATA

Share Price:	**66p**
Prospective p/e ratio:	**15.7x**
Prospective net yield:	**2.7%**
Market Capitalisation:	**£34.3m**
Next Results Due (Finals):	**NOV**
Net Cash (at 31 March):	**£5.07m**
NAV per share:	**48.9p**

BULLET POINTS

- Solid interim results reported
- Order book notably strong
- Cash conversion has been very good
- Acquisitions made in 2013 are said to be performing well
- Healthy balance sheet with net cash of over £5m as at 31 March, representing around 10p per share
- Progressive dividend policy continues

Date of Report : 9 June 2014

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Executive Summary

- ***Sanderson is a supplier of innovative software solutions and IT services focussed on multi-channel retail and manufacturing markets in the UK and Ireland. The group develops long term relationships with its customers with the majority of product development being customer led and offering tangible benefits.***

- ***The group recognises the need to focus on higher margin growth markets such as e-commerce and mobile. With this in mind two niche businesses were acquired in 2013. Catan Marketing Limited, trading as PRIAM, was acquired in August. One iota Limited, which provides cloud-based multi-channel solutions, was acquired in October.***

- ***The sale of Sanderson RBS in January 2012 transformed the balance sheet, resulting into a net cash position. The most recent acquisition of One iota Limited was accompanied by a share placing, which raised £3.5m and ensured that a healthy cash balance was maintained. Net cash was over £5m at the interim stage.***

- ***Contracts for both software license and support and maintenance provide Sanderson with a solid recurring revenue base. 56% of revenue was derived from pre-contracted recurring sources in the first half, which helps underpin forecasts.***

- ***Although the majority of revenue comes from additional spend from the existing customer base, the value of orders from new customers has been growing in recent years. Average initial order values from new customers have been on the increase in the recent past.***

- ***Gross margins were 87.8% in the Multi-channel retail division and 86.0% in the Manufacturing division in the first half. The sale of Sanderson RBS led to a step change in gross margin from 70/72% to 84%, as Sanderson RBS had merely been a reseller for a product and therefore had to make a royalty payment to the proprietary owner of the software.***

- ***The balance sheet is strong, with net cash of over £5m as at 31 March 2014. This allowed an interim dividend of 0.8p per share to be declared (2013: 0.65p). This represents year-on-year increase of 23% and continues the progressive dividend policy which has been adopted.***

- ***The company remains cautiously optimistic. The long term future looks bright and although unlikely to happen in the near term, further acquisitions are likely to add value at some point. The order book continues to strengthen and this helps underpin future prospects.***

History

The company's roots go back to 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.

Sanderson joined AIM in December 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...

...acquisitions followed

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, most recently acquiring Catan Marketing and One iota.

The group is now widely recognised as an established provider of software and IT services in the UK and Ireland particularly focussed on Manufacturing and Multi-channel retailing.

Activities

A supplier of innovative software solutions and IT services, specialising in Multi-channel retail and Manufacturing

Sanderson is a supplier of innovative software solutions and IT services, specialising in the multi-channel retail and manufacturing markets, in the UK and Ireland. The group delivers solutions to numerous organisations with turnovers typically between £5m and £250m. Its customers include many household names, such as MandM Direct, Hotel Chocolat, Beaverbrooks and Scotts of Stow.

The group's solutions now primarily comprise 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.

Multi-channel Retail

Multi-channel retail accounts for over two thirds of operating profit and we expect the division to continue to progress

This division accounted for c.70% of operating profit in the first half. As a supplier of software to retail, mail order catalogues, fulfilment, wholesale, cash and carry and online businesses, Sanderson understands the dynamics of multi–channel sales. The group provides a comprehensive range of IT solutions to meet the needs of organisations operating in this sector and its systems offer the flexibility to grow as business requirements change. As well as that, the group's latest products include 'business assurance' which is a range of services designed to protect businesses from system failures and 'Green IT' solutions which deliver energy saving efficiencies to customers.

Customers include Clipper Logistics, which has very recently joined the Main Market, and leading online retailer MandM Direct, which is due to join AIM later this month.

Manufacturing

Manufacturing accounts for around 30% of operating profit

This division accounted for c.30% of operating profit in the first half of the year, a figure which is likely to fall further moving forwards. Sanderson 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 businesses in this sector, which provides an opportunity for growth. The Sanderson food and drink processing business now represents over half of the manufacturing business and new customers should provide a further boost.

Acquisitions

Although small, this is seen as being a highly complementary in terms of its products and customers

In August Catan Marketing Limited was acquired for a maximum consideration of £644,660. The consideration was payable in cash, comprising an initial payment of £500k on completion with an additional £49,660 paid in October. A further payment of £95k is dependent on certain performance criteria being met by the end of August 2014.

Net assets were negligible

Catan Marketing provides e-commerce solutions, trading as 'PRIAM', to over 30 multi-channel retailers. For the year ended 31 August 2012, Catan generated a profit before tax of £27k (2011: £69k) on revenue of £895k (2011: £1.16m). At the date of acquisition, Catan had net assets of approximately £50k.

One iota will have a more meaningful initial impact

More recently and perhaps more significantly, One iota Limited, a leading provider of cloud-based multi-channel retail solutions, was acquired last month for a maximum aggregate consideration of £5.43m. One iota is based in Rossendale, Lancashire, close to Sanderson's catalogue, ecommerce and online sales business, and provides cloud-based, multi-channel solutions via mobile, tablet and in-store devices.

A share placing which accompanied the deal brought in £3.5m

For the year ended 31 January 2013, One iota had unaudited turnover of £0.66m (2012: £0.50m) and profit before taxation of £195k (2012: £158k). As at 31 January 2013, One iota's net assets were £0.85m. For the seven months ended 31 August 2013, One iota had unaudited turnover of £0.61m and profit before taxation of £0.21m. The company raised £3.50m before expenses through the placing of 6,363,636 new ordinary shares at a price of 55p per share at the time of the deal.

Interim Results

Revenue up strongly, due mainly to acquisitions

In the six months ended 31 March 2014 revenue was up significantly at £7.94m (2013: £6.37m) with organic growth of almost 5% aided by the acquisitions which were completed last year. The gross margin was maintained at 87%.

Profit before tax slipped, with earnings per share also down

Operating profit was up 20% to £1.21m (2013: £0.99m) but profit before tax from continuing operations slipped slightly to £0.78m versus £0.85m last year as a result of acquisition-related costs and amortisation. Basic earnings per share were 1.4p (2013: 1.8p), partly reflecting the reduced profit before tax referred to above and also as a result of the dilutive effect of the fundraising which accompanied the One iota acquisition.

The strong net cash position allowed the dividend to be increased

The strong balance sheet and cash generation have enabled the interim dividend to be lifted again. Net cash was over £5m as at the end of March. An interim dividend of 0.8p per share will be paid on 17 August. The ex-dividend date is 16 July. The progressive dividend policy looks set to continue and if our forecasts for 2014/15 are met then the shares will provide a yield of over 3% at the current price.

Multi-channel retail looks well-positioned given its exposure to ecommerce

Multi-channel retail brought in revenue of £4.71m (2012: £3.40m) with One iota contributing £788k. Operating profit was up strongly to £848k (2013: £649m), including £154k from One iota. There are high hopes for this division, which is understandable given the potential for the markets which are being addressed. Seven new customers were picked up in the period, including WCF Home Shopping, Astley Clark and Cloggs.

Manufacturing has exposure to the UK food and drink processing market, which is growing

Food and drink produced a strong performance, which helped generate an increase in revenue in the Manufacturing division. Revenue was £3.23m (2013: £2.97m) and operating profit was £367k versus £339k a year earlier. Five new customers were gained during the period, which compares favourably with the one new customer gained in the same period a year earlier. The order book was £1.28m at the period end (2013: £761k).

Forecasts

Revenue forecasts are underpinned by a strong order book

The company remains on track to meet our forecasts for the current year. The order book stood at £2.47m as at 31 March, which is a significantly higher level than at the same stage last year (2013: £1.58m).

High level of recurring revenue

It is comforting to note the high proportion of overheads covered by recurring margin. Annual operating profit is around £1.5m before any new customer revenue. Recurring margin covers approximately 70% of overheads, with recurring gross margin covering 66% of overheads in Multi-channel retail and 75% of overheads in Manufacturing.

The strong balance sheet provides firepower for acquisitions

The balance sheet is in good shape, including a net cash position of over £5m. Although we expect the recent acquisitions to be integrated further before there is any further corporate activity, we feel that the addition of complementary niche businesses is likely to drive further shareholder value over the long term.

Dividend forecasts revised upwards

With the interim dividend having been lifted significantly from 0.65p per share in 2013 to 0.8p we adjust our forecast for the full year to 1.8p from 1.6p previously. We also move our forecast total dividend for 2014/15 to 2.0p per share from 1.7p.

Valuation

Stripping out cash the business is valued at £29m, which appears conservative

The market capitalisation of £34m means that after stripping out cash the business is valued at £29m. With pre-tax profit of £3.0m forecast for 2014/15 this does not look excessive, even in the near term. Whilst numbers for the longer term are more difficult to quantify, the markets which Sanderson operates in look set for sustained growth in the coming years so there could be significant upside potential from the current share price.

Progressive dividend policy helpful in attracting new investors

The growing dividend is well covered by earnings and there is undoubtedly potential for the dividend payout to be increased in the coming years. There is already a net cash position and the business should generate significant levels of cash.

Acquisitions may add value

Over the longer term further acquisitions are likely to add value. For now, the company is concentrating on organic growth and the integration of PRIAM and One iota but these deals appear to have been very useful.

Prospects

The long term future looks bright for Sanderson

The future for Sanderson continues to look exciting and the markets which it is addressing look set to develop relatively quickly. The company has an excellent track record and this has allowed dividends to be increased significantly, which may attract a wider pool of investors. If our forecasts for 2014/15 are met then the shares will yield over 3%.

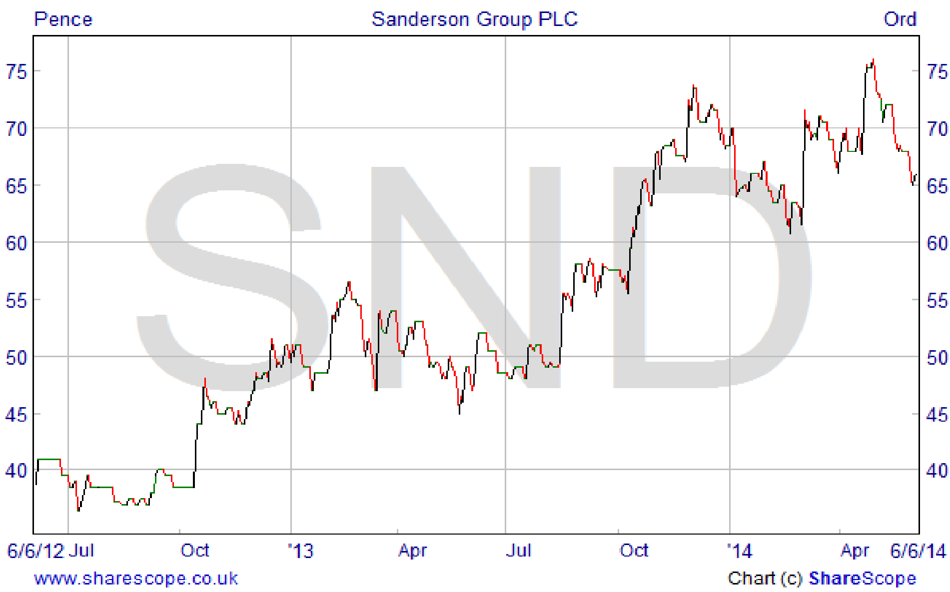
Strong balance sheet and order book provide a solid base

The strong balance sheet and net cash position limit the downside risk to some extent. A comforting order book and the at the fact that a significant proportion of overheads are covered by recurring margin should also provide support to the current share price.

The company has some strong customers and this should help drive the business forward

The company has a very interesting customer base, some of which are developing rapidly in their own right. For example, Clipper Logistics has recently floated and MandM Direct is due to join AIM later in June. This means that those businesses are well funded to drive growth and this can only benefit Sanderson as the fortunes of its customer base continues to improve.

Share Price Graph



Profit and Loss Year End 30 Sept	2012 (£m)	2013 (£m)	2014(E) (£m)	2015(E) (£m)
Revenue				
Manufacturing	6.2	6.6	6.9	7.2
Multi-channel retail	7.2	7.2	9.0	9.8
Total	**13.4**	**13.8**	**15.9**	**17.0**
Operating Profit				
Manufacturing	0.8	0.9	1.0	1.0
Multi-channel retail	1.1	1.1	1.5	2.0
Total	**1.9**	**2.0**	**2.5**	**3.0**
Movement in fair value of derivatives	0.0	0.0	0.0	0.0
Net finance costs	(0.2)	(0.0)	(0.0)	(0.0)
Exceptional finance charge	(0.2)	(0.0)	(0.0)	0.0
Profit before Tax	**1.5**	**2.0**	**2.5**	**3.0**
Tax	(0.2)	(0.3)	(0.2)	(0.5)
Profit after Tax	**1.3**	**1.7**	**1.6**	**2.5**
Av number of shares (m)	46.12	46.54	51.29	51.97
EPS (p)	**2.8**	**3.7**	**4.2**	**4.7**
DPS (p)	**1.2**	**1.5**	**1.8**	**2.0**

Ratios	2012	2013	2014(E)	2015(E)
Sales Growth (%)	**-4.9**	**3.4**	**15.2**	**6.9**
Operating Margin (%)	**14.3**	**16.1**	**15.7**	**17.6**
EPS Growth (%)	**173**	**32.1**	**13.5**	**11.9**
DPS Growth (%)	**60**	**25**	**6.7**	**6.3**
Dividend Cover (x)	**2.5**	**2.5**	**2.6**	**2.8**

Cash flow Year end 30 Sept	2012 £'000	2013 £'000
Profit for the period	2,406	1,691
Adjustments	(184)	725
Operating cash flow	**2,222**	**2,416**
Discontinued operations	(356)	-
Changes in working capital/provisions	(521)	(1,385)
	1,345	**1,031**
Interest paid	(703)	-
Income tax received	377	-
Net cash flow from operating activities	**1,019**	**1,031**
Purchase of assets	10,381	(660)
Investing cash flow - discontinued operations	(140)	-
Financing activities	(7,813)	(775)
Net Increase in cash and cash equivalents	**3,447**	**(404)**
Cash and cash equivalents at start of year	**619**	**4,066**
Cash and cash equivalents at end of year	**4,066**	**3,662**

Balance sheet Year End 30 September	2012 £'000	2013 £'000
Intangible assets	22,404	23,194
Other non-current assets	1,939	1,695
Total	**24,343**	**24,889**
Current assets	7,800	7,238
Current liabilities	(7,480)	(6,782)
	24,663	**25,345**
Non-current liabilities	(4,633)	(4,446)
Net Assets	**20,030**	**20,899**
Share Capital	4,352	4,380
Share Premium	4,205	4,302
Retained earnings	11,473	12,175
Shareholders funds	**20,030**	**20,899**

Ratios	2012	2013
NAV (p)	**46.0**	**47.7**
Gearing (%)	**n/a**	**n/a**

GENERAL INFORMATION

COMPANY DATA

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Information:
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Chairman
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FINANCIAL CALENDAR

Ex-Dividend Date:	16 July 2014
Interim Dividend Payment:	15 August 2014
Next Year End:	30 September 2014
Final Results Announcement:	November 2014
Expected AGM Date:	February 2015

The above dates should only be used for guidance

Significant Shareholders

Ordinary shares of 10p each

	Number	**%**
C Winn	12,765,000	24.6
Hargreave Hale	6,794,907	13.2
ISIS Equity Partners	4,818,257	9.3
Miton Capital Partners	4,454,985	8.6
AXA Framlington Asset Management	2,550,000	4.8
Unicorn Asset Management	1,767,472	3.4

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