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Sanderson Group (SND) AIM

INVESTMENT SUMMARY

- **Today's interim results have revealed revenues of £6.1m on continuing operations, slightly down on last year, although operating profit has increased by over 6% to £0.8m reflecting the fact that the group has retained its higher margin operations. The group starts the second half with a strong order book, up 44% since 30 September, which should be reflected in second half trading.**

- **The interim dividend has also been increased by 66% to 0.5p and we are expecting the total dividend for the year to be 1.2p, an increase of 50% over 2011, giving an attractive yield of 3.0%.**

- **The sale proceeds from January's disposal of Sanderson RBS have transformed the group's balance sheet, with net cash at the half year end of £3.56m. This will enable the company to focus future investment on the higher margin growth areas of the market, in particular e-commerce and mobile, either through organic growth or by small bolt-on acquisitions.**

- **Prospects for Sanderson remain strong and with cash for investment we believe that forecasts could be upgraded as the year progresses, particularly if acquisitions are made. Stripping out the 11.5p per share of forecast year end cash and putting 2012 earnings on a rating of 10x would suggest a share price target of 49p, an increase of 22.5% from current levels.**

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 (%)
2010A	27.0	1.9	3.9	10.3	0.6	1.5
2011A	14.1	0.4	1.1	36.4	0.8	2.0
2012E	13.1	1.8	3.8	10.5	1.2	3.0
2013E	13.8	2.2	4.2	9.5	1.3	3.3

* from continuing operations with 2011 numbers restated to account for sale of Sanderson RBS

KEY DATA

Share Price:	**40p**
Prospective p/e ratio:	**10.5x**
Prospective net yield:	**3.0%**
Market Capitalisation:	**£17.4m**
Next Results Due (Finals):	**NOV**
Net Cash (at 31 March):	**£3.56m**
NAV per share:	**45.6p**

BULLET POINTS

- Strong set of interim results
- Business focussed on high growth e-commerce and online sales
- Both businesses retain strong trading momentum and order intake.
- Cash on the balance sheet will further enhance product and service development.
- Modest rating
- Increased dividend gives an attractive yield.

Date of Report : 15 May 2012

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- ***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 sale of Sanderson RBS in January has transformed the balance sheet, with a net debt position at 30 September being turned into a net cash position of £3.56m at 31 March. Sanderson RBS specialised in the sale of EPOS solutions to high street retailers. With high street retailers facing challenging times, Sanderson saw this as an opportunity to unlock value from the business to enable the group to focus on higher margin growth markets such as e-commerce and mobile.***

- ***Sanderson's contracts for both software and support and maintenance provide it with a solid recurring revenue base. 62% of revenue is recurring which covers 80% of overhead costs and helps underpin forecasts. A further 33% of revenue comes from additional spend from the existing customer base, with 5% of revenue being derived from new customers.***

- ***The interim results show that even in the current economic environment the company continues to make solid progress, especially in the multi-channel retail market. The sale of Sanderson RBS has 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 current order book stands at £1.95m (2011: £1.67m) and is up 44% during the period from 30 September 2011. We anticipate the benefits from this large order book to come through in second half trading and this underpins current forecasts. In terms of cash, the balance sheet at the half year end showed cash of £3.56m and this is forecast to grow to £5m at the year end. This facilitated the hike in the interim dividend by 66% to 0.5p, with the total dividend for the year forecast to be 1.2p, a 50% rise year on year and a progressive dividend policy is expected going forward.***

- ***Following the sale of Sanderson RBS, the group is in a strong position to reinvest its cash in the higher growth areas of the market such as e-commerce and mobile. This might be through internal development or through small bolt-on acquisitions. Stripping out the 11.5p per share of cash and putting the 2012 earnings on a rating of 10x gives a share price target of 49p, 22.5% upside from current levels. However, given current interest rates any acquisition made is likely to be earnings enhancing so we believe current forecasts could be raised over the coming months.***

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 floated on 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

Since then the group has expanded with particular emphasis on the development of the Multi-channel retail business. 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 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 Mothercare, 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 63% of operating profit and we expect the division to be a focus for future investment

At the half year this division accounted for 63% of operating profit. 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.

We expect this division to be a focus point for future investment either through small bolt-on acquisitions or through internal development as there are increasing opportunities for multi-faceted retailers including platforms such as mobile phones and tablet mediums.

Manufacturing

Manufacturing accounts for c.40% of operating profit.

This division accounts for c. 40% of operating profit. 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 more recent products and services now include Factory and Warehouse Automation and Green IT solutions. The Factory and Warehouse Automation solutions have been very successful, delivering in excess of £2m of new sales since their launch in 2010.

Sale of High Street Retail business

Sanderson disposed of RBS, its seller of EPOS solutions to the high street.

Sanderson disposed of Sanderson RBS limited on 20 January 2012 to Torex Retail Holdings Limited ('Torex'). The business specialised in the sale of electronic point of sale ('EPOS') solutions to high street retailers. With high street retailers facing challenging times Sanderson saw this as an opportunity to unlock value from the business to enable the group to concentrate on higher growth markets such as e-commerce and mobile.

The cash consideration was £11.5m.

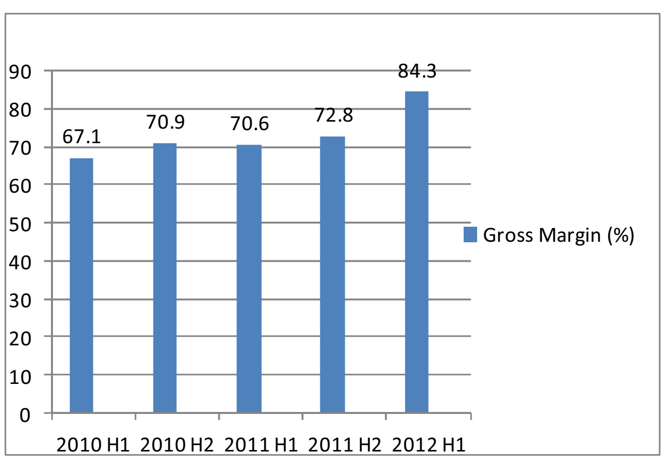
The cash consideration for the deal was £11.5m payable on completion, with a further £0.15m being payable unconditionally on 6 April 2012 and a further £0.1m payable on receipt of specific customer payments. The group is now in receipt of the total consideration of £11.75m following the satisfaction of these conditions. The net assets of Sanderson RBS (excluding cash) at the date of disposal were £9.28m. Adjusting for the cash balance of the discontinued operation and costs relating to its disposal, the group made a gain of £1.82m on the disposal.

This transformed the Sanderson balance sheet leaving it with net cash of £3.56m at 31 March

The sale of this business has transformed the Sanderson balance sheet from a net debt position of £6.7m in September 2011 to a net cash position of £3.56m at 31 March 2012.

The Sanderson RBS business sold one of the only products for which the group was a re-seller rather than a proprietary owner and therefore the group had to make a royalty payment to the owner of the rights. So although RBS accounted for 46.7% of sales in the year to September 2011, it acted as a drag on gross margins. Historically these have been between 70-72% although these are expected to jump to 84% in the continuing operations.

Group gross margin with 2012 H1 being post Sanderson RBS sale



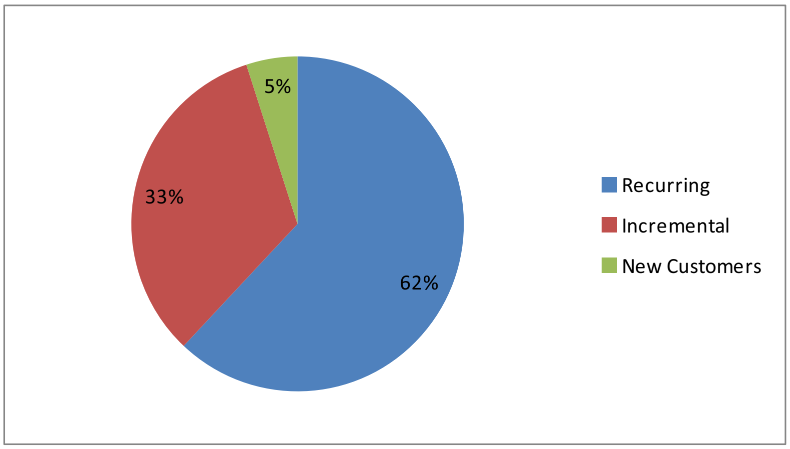
Recurring revenue base provides security

As a licencing business model, the group builds up recurring revenue streams as customers licence not only the software, but also support and maintenance of the product. The group tends to build long term relationships with its customers with the majority of product development being customer driven.

Recurring revenue accounts for c.62% of turnover, which helps underpin forecasts

The group's recurring revenue at the half year accounted for 62% of turnover, with 33% of turnover representing incremental spend from existing customers and the remainder coming from new customers. The annual profit from the recurring revenue stream accounts for 80% of annual overheads giving a secure base on which to develop forecasts.

Annual revenue split



New Product Development

New product development is in the main customer led and often provides tangible benefits to customers

New product development is, in the main, customer led, emphasising the true long term relationships that Sanderson has with its customers. Enhancements to existing solutions often provide customers with tangible benefits such as cost savings and business efficiencies and often incorporate features which address regulatory or legislative compliance. For example food standards and traceability in food manufacturing.

Since 2010, the group has increased the introduction of new products and services which now include Factory and Warehouse Automation, 'Green IT' solutions along with Software as a Service (SaaS), which is software accessed over the internet and other Cloud based solutions.

The 'Green IT' solutions enable customers to conserve energy, as well as saving money. The solution monitors the power consumption of IT systems operating within a company, providing energy forecasting, energy and cost analysis and ultimately enabling a reduction in electrical energy waste. These along with new developments will continue to provide further growth.

Interim Results

The half year results, stripping out the contribution from Sanderson RBS, show revenues of £6.1m, down by 12.8% on last year on a like for like basis. The decline is explained by a non-core contract that did not involve the supply of Sanderson software and was not renewed.

Half year results were strong with the gross margin rising to 84.3%

The gross margin rose to 84.3% from 81.4%, after stripping out RBS, giving a gross profit of £5.18m and, with operating costs being reduced, this led to operating profits rising by 6.6% to £0.8m (2011: £0.75m). Operating profit margins have increased to 13.0% from 10.7% in the comparable period last year.

In terms of divisional split, Multi-channel retail showed a revenue decline from £4.0m to £3.2m, which was due to the non-core contract referred to above. However, operating profit in the division rose by 26.0% to £0.51m (2011: £0.40m). In Manufacturing, revenue was off slightly at £2.9m (2011: £3.0m) and operating profit was also down to £0.29m (2011: £0.35m)

The interim dividend was increased by 66% to 0.5p and we are expecting a total payout for the year of 1.2p

Pre-tax profits before exceptional finance costs of £227k were £640k (2011: £365k) and earnings per share on the same basis were 1.0p (2011: 0.8p). The increase in earnings per share was less than the increase in profits due to a higher tax charge in the most recent period. The exceptional finance costs relate to the early repayment of the group's borrowings following the sale of Sanderson RBS and comprise an early repayment fee together with the associated write-off of unamortised arrangement fees. In view of the strengthened balance sheet and the group's prospects, the interim dividend was raised by 66% to 0.5p (2011: 0.3p).

Current order book is up 44% over the period from 3o September 2011

The order book as at 31 March was £1.95m (2011: £1.67m) and is up 44% over the period since 30 September 2011. The benefits from this large order book are expected to be reflected in second half trading as has been the case over the last 2 years. All in all this is a solid performance with the strength of the order book underpinning current forecasts.

Forecasts

Forecasts excluding RBS are for sales of £13.1m in the current financial year, with a gross margin of 84%. It is expected that the cost base will also be controlled. The net cash position will significantly reduce the interest charge going forward, until this is reinvested. This gives a forecast pre-tax profit figure of £1.8m.

Post the sale of Sanderson RBS the company had cash on the balance sheet of £3.56m at the half year-end and, despite the hike in the dividend payout, we would expect this to build as the company is cash generative. Our forecasts show cash at the year end of £5m, assuming that no acquisitions are made. The dividend for the year is forecast to be 1.2p, a 50% increase on last year.

Forecasts are assuming solid growth to continue, with focus being on the higher growth Multi-channel retail

We are forecasting that the group continues to make good progress with the growth concentrating on the Multi-channel retail business as this is where future investment and development is to be focussed.

With interest rates remaining low we would anticipate that any acquisitions made by the company would be earnings enhancing and would therefore be accretive to current forecasts.

Valuation

Sanderson has a strong balance sheet

Sanderson is in a strong position following the sale of Sanderson RBS, which has left the Group with £3.56m on the balance sheet to invest in higher growth areas.

The rating of 10.5x to September 2012 looks undemanding given the strength of the group's position, particularly when the cash is stripped out, as this equates to 20% of the company's market capitalisation. We believe this looks to be an exciting entry point to a stock which has shown resilience to the economic backdrop and is now in a position to grow over the medium term. The hike in the dividend gives a forecast yield of 3.0% and also adds to the stock's appeal.

We believe a fair value for Sanderson is 10x 2012 earnings, stripping out the 11.5p per share cash. This gives a price target of 49p

For a conservative fair value we believe a rating of 10x 2012 earnings to be achievable and stripping out the 11.5p per share of cash gives a share price target of 49p, a 22.5% uplift on the current price.

Prospects

Sanderson's prospects look encouraging, particularly with the strengthened balance sheet

Sanderson's prospects look very encouraging, particularly with a strengthened balance sheet. The group can now focus investment, whether it be from small bolt-on acquisitions or internal development, into the higher growth areas of the business such as e-commerce and mobile applications.

The take-up of IT solutions developed over the last 2 years should continue to drive growth. These products provide solutions that address business assurance, legislative issues and energy efficiency as well as day to day business functions.

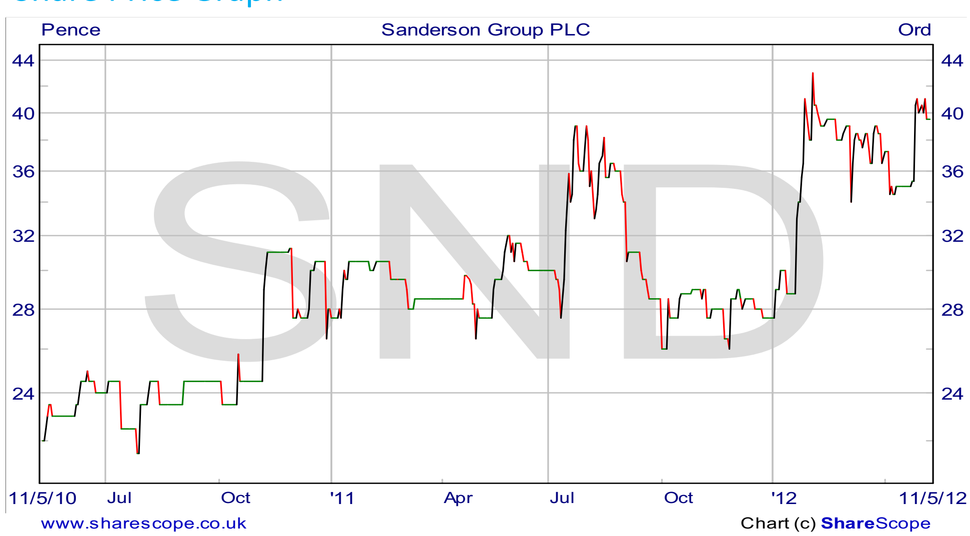
Despite the current economic circumstances the group continues to trade well

Despite the current economic uncertainties, the group continues to trade well. As at 31 March, the value of the order book had increased by 44%, over the period from 30 September 2011, which should be reflected in second half trading. This gives confidence in the Group's near term prospects.

In the medium term the group is looking to grow annual revenue to c. £20m and annual profit to £3m-£4m. As a highly cash generative business, we would expect cash reserves to continue to grow in the absence of any acquisitions.

The group also intends to implement a progressive dividend policy going forward. Over 2012-2013 the dividend is forecast to increase 50% to 1.2p, giving the shares a yield of 3.0%. The 66% increase in interim dividend demonstrates the company's commitment to this.

Share Price Graph



Profit and Loss Year End 30 Sept	2010 (£m)	2011 (£m)	2012(E) (£m)	2013(E) (£m)
Revenue				
Manufacturing	5.8	6.1	5.8	6.0
Multi-channel retail	21.2	7.9	7.3	7.8
Total	**27.0**	**14.0**	**13.1**	**13.8**
Operating Profit				
Manufacturing	0.8	0.8	0.9	0.9
Multi-channel retail	2.3	0.9	1.3	1.4
Total	**3.1**	**1.7**	**2.2**	**2.3**
Movement in fair value of derivatives	0.0	0.1	0.0	0.0
Net finance costs	(1.2)	(1.0)	(0.2)	(0.1)
Exceptional finance charge	0.0	(0.4)	(0.2)	0.0
Profit before Tax	**1.9**	**0.4**	**1.8**	**2.2**
Tax	(0.2)	0.1	(0.2)	(0.4)
Profit after Tax	**1.7**	**0.5**	**1.6**	**1.8**
Av number of shares	43.38	43.38	43.38	43.38
EPS (p)	**3.9**	**1.1**	**3.8**	**4.2**
DPS (p)	**0.6**	**0.8**	**1.2**	**1.3**

Ratios	2010	2011	2012(E)	2013(E)
Sales Growth (%)	**8.4**	**-48.1**	**-6.4**	**5.3**
Operating Margin (%)	**11.5**	**12.2**	**16.5**	**16.5**
EPS Growth (%)	**-**	**-71.7**	**245**	**10.5**
DPS Growth (%)	**-**	**33.3**	**50.0**	**8.3**
Dividend Cover (x)	**6.5**	**1.4**	**4.8**	**3.2**

Cash flow Year end 30 Sept	2010 £'000	2011 £'000
Profit for the period	272	804
Adjustments	3,195	1,182
Operating cash flow	**3,467**	**1,986**
Discontinued operations	-	1,116
Changes in working capital/provisions	(97)	(47)
	3,370	**3,055**
Interest paid	(1,245)	(591)
Income tax received	541	466
Net cash flow from operating activities	**2,666**	**2,930**
Purchase of assets	(351)	(392)
Investing cash flow - discontinued operations	-	(424)
Financing activities	(1,666)	(1,743)
Net Increase in cash and cash equivalents	**649**	**371**
Cash and cash equivalents at start of year	**(401)**	**248**
Cash and cash equivalents at end of year	**248**	**619**

Balance sheet Year End 30 September	2010 £'000	2011 £'000
Intangible assets	32,997	32,066
Other non-current assets	2,151	2,360
Total	**35,148**	**34,426**
Current assets	8,319	7,905
Current liabilities	(14,270)	(13,063)
	29,197	**29,268**
Non-current liabilities	(10,978)	(10,793)
Net Assets	**18,219**	**18,475**
Share Capital	4,338	4,338
Share Premium	4,178	4,178
Retained earnings	9,703	9,959
Shareholders funds	**18,219**	**18,475**

Ratios	2010	2011
NAV (p)	**42.0**	**42.6**
Gearing (%)	**43.0**	**36.4**

GENERAL INFORMATION

COMPANY DATA

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Chairman
Adrian Frost
Finance Director
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FINANCIAL CALENDAR

Interim Dividend Payment Date:	17 August 2012
Next Year End:	30 September 2012
Final Results Announcement:	27 November 2012
Expected AGM Date:	10 March 2013
Final Dividend Payment Date:	31 March 2013
Interim Results Period End:	31 March 2013
Interim Results Due:	14 May 2013

Significant Shareholders

Ordinary shares of 10p each	**Number**	**%**
C Winn	12,745,000	29.3
AXA Investment Managers SA	3,958,137	9.09
Hargreave Hale Ltd	3,796,303	8.72
ISIS EP LLP	3,000,075	6.9
Chelverton Small Co Dividend Trust	2,730,000	6.3
Unicorn Asset Management Ltd	1,540,200	3.6

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