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Sanderson Group (SND)

AIM - Software & Comp. Services

Today's interim results' announcement has shown that software and IT services group Sanderson Group continues to make progress even though trading conditions remain challenging. Although revenues have declined slightly in the six months to 31 March, an improvement in gross margins and reduction in finance costs has led to higher pre-tax profits and earnings per share. Strong cash flow has also resulted in another reduction in net debt whilst the company has maintained its progressive dividend policy.

The group continues to introduce new products and this, combined with increased expenditure on sales and marketing, has resulted in a number of new customers. A surge in orders in March at the manufacturing business also meant that the second half started with a strong order book. Another pleasing feature of the group's progress is that it continues to increase the level of recurring revenues.

The company now looks as though it is set on the growth path with organic growth likely to be the main driver and pre-tax profits and earnings per share are forecast to grow over the next two years. The reduction in debt also means that complementary acquisitions are possible if suitable opportunities arise.

This has not been reflected in the share price of the company, as the shares stand on a very modest prospective p/e ratio if current forecasts are met. Assuming a very modest p/e ratio of 10x this year's earnings, the share price would need to be 52p, almost double the current level. There is scope for a significant re-rating of the shares.

Activities

Sanderson Group operates as a supplier of innovative software solutions and IT services. There is a heavy bias towards the UK market, specifically the multi-channel retail and manufacturing sectors. Long term relationships are built with clients, who tend to be organisations with turnover between £5m and £250m.

Multi-Channel Retail - the group has a wide range of IT solutions, products and services which are aimed at businesses that sell via retail stores, mail order, wholesale and online. These include EPoS systems, retail management systems, e-commerce software, multi-channel software, mail order management and wholesale IT systems. A new internet retail product has also been successfully introduced as has a new module for hospital catering. Services include maintenance and support, IT and managed services, hardware and installation. Customers include Harrods, Selfridges, French Connection, T J Hughes and Salford Royal NHS Foundation Trust.

Manufacturing - software solutions have been created for manufacturing, with some applications designed specifically for the print and food sectors. The Unity ERP (enterprise resource planning) system has been developed using the group's experience in dealing with the manufacturing sector. Formul8 is designed to manage all aspects of food production and distribution and Unity MIS (management information system) is a modern print business system. Unity SBE improves the management and planning of internal resources of smaller businesses.

Results and Consensus Forecasts

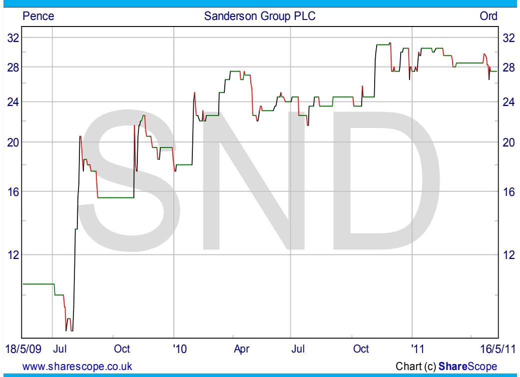
Year to 30th September	Revenue (£m)	Pre-Tax Profit* (£m)	Earnings per share* (p)	P/E Ratio	Net Dividend (p)	Net Yield (%)
2009A	24.9	1.07	4.0	6.9	0.4	1.5
2010A	27.0	1.91	3.9	7.1	0.6	2.2
2011E	27.5	2.40	5.2	5.3	0.8	2.9
2012E	28.5	2.80	5.7	4.8	1.0	3.6

* before amortisation of acquisition-related intangibles, exceptional costs, impairment of goodwill and share-based payment charge

KEY DATA

Share Price:	27.5p
Prospective p/e ratio:	5.3x
Prospective net yield:	2.9%
Market Capitalisation:	£12m
Next Results Due (Fins):	NOV
Gearing:	39%

SHARE PRICE PERFORMANCE



2010/11 High/Low: 31.5p/18p

SNAP BULLETS

- Improved interim results
- Further reduction in net debt
- Successful introduction of new products
- Strong order book
- Progressive dividend policy
- Shares on low p/e ratio

Date of Report : 18 May 2011

COMPANY DATA

Stockbrokers:
Charles Stanley

Significant Shareholdings:

C Winn Esq, Chairman - 29.97%
AXA Framlington IM - 9.21%
ISIS EP LLP - 6.92%
Chelverton AM - 6.29%
Hargreave Hale & Co - 4.99%
Polar Capital Partners - 4.38%
Unicorn Asset Management - 3.55%

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Final Results

The company has continued to make progress in the first half of the current financial year despite the slow pace of recovery in the UK economy. The latter has been a factor in the slight decline in revenue for the period to £13.1m (2010: £13.3m), although an improvement in gross margins to 70.6% (2010: 67.1%) led to operating profit before exceptionals increasing to £1.47m (2010: £1.38m). It is pleasing to see that recurring revenues from software licences and support/service contracts have increased once again, so that in the first half they rose by 6% to £7.1m (2010: £6.7m), representing 54% of total revenues (2010: 51%).

Pre-tax profits before exceptional items increased to £1.08m (2010: £0.75m) whilst earnings per share on the same basis emerged at 2.3p (2010: 1.7p). The interim dividend was raised to 0.30p (2010: 0.25p). Continued strong cash generation has led to another fall in net debt to £7.2m (2010: £9.0m) and this continues the trend of debt reduction, with net debt falling by over 40% since it peaked in March 2008.

In the multi-channel retail business, revenues declined slightly to £10.1m (2010: £10.2m), although operating profit before exceptionals increased to £941k (2009: £840k). The group has developed a new module within its retail offering enabling customers to achieve savings and efficiencies in catering management and this is also being used in hospital catering. Eleven new customers were gained in the period including Shaws Drapers and Yorkshire Trading Company, whilst large orders were received from existing customers including discount retailer Wilkinson and Lakeland.

Revenue at the manufacturing business was slightly down at £3.0m (2010: £3.1m) although those of a recurring nature account for 58% of the total. Operating profit before exceptionals was also slightly lower at £527k (2010: £536k). Two new customers were gained in the period and a large surge in orders in March meant that the business started the second half with order books of £860k, an increase of 88%.over the previous year (2010: £457k).

Prospects

Although the slow pace of the recovery in the UK economy is clearly not helping the group, the first half figures have established a solid platform for the rest of the financial year. It is pleasing to see that recurring revenues continue to increase whilst the improvement in gross margins is also to be welcomed. The order book has also grown, standing at £3.3m at 31 March (2010: £3.0m), with most of this due to be delivered in the second half of the financial year.

The reduction in the level of net debt is part of the group's strategy and this is expected to fall further going forward. Despite this, the company is committed to increasing the dividend payout and both these objectives should be achievable due to the strong cash flow at the group.

The group continues to introduce new products and services and these include Business Assurance, Factory Automation, latest etailing and ecommerce software, a suite of Green IT solutions and, most recently, offerings based on 'Software as a Service' and Cloud delivery models. The group has also increased investment in sales and marketing and this is clearly paying off as it wins new customers.

Sanderson clearly has sound organic growth prospects driven by these factors, but the reduction in net debt also means that complementary acquisitions can be considered if suitable opportunities arise. The shares have scope to make further progress.

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