SMALL CAP SHARE COMMENT

Commissioned Commentary

SANDERSON GROUP

(AIM:SND)
Share price 31.25p

Date: **30th November 2010**
Sector: Software & Computer Services
Market Cap: c£13.5m
www.sanderson.com

Encouraging full year results, improving cash generation, reduction in net debt and positive outlook

The software and IT services business specialising in multi-channel retail and manufacturing markets in the UK and Ireland announced encouraging Preliminary Results for the year ended 30th September 2010 with improving cash generation, a reduction in net debt and growing order book.

- Results

Revenue for the year ending 30th September 2010 increased by 8% to £26.99m with recurring revenues from annual software licences, support and managed service contracts (a key target) increasing to £13.66m and representing 51% of total revenue (2009: 55% of revenue).

Operating profit, before the amortisation of acquisition-related intangibles, exceptional costs impairment of goodwill and before the charge in respect of share-based payments, increased by 12% to £3.09m.

Basic earnings per share were 0.6p (2009: loss per share of 2.7p) and adjusted basic earnings per share before amortisation of acquisition-related intangibles, exceptional costs, impairment of goodwill and share-based payment charges were 3.9p (2009: 4.0p).

Consensus forecasts (currently only the house broker's) were previously for revenue of £25.7m, pre-tax profit of £1.9m and adjusted earnings per share of 4.13p. So today's results exceeded top line estimates but represented a small miss at the earnings level.

Overall gross margins declined from 72% to 69% due to a change in the sales mix with a smaller element of higher margin software business relative to higher element of lower margin hardware sales.

- Positive cash flow

Cash generated from operations increased by 80% to £3.37m (2009: £1.87m) with the result that net debt fell to £7.84m at the year end (2009: £9.96m) from a peak of £12.46m at 31st March 2008. This compares favourably with the house broker's forecast for net debt of £8.5m at year end. Net cash flow from operating activities was £2.67m compared with £1.15m in the prior year. The current ratio was 0.58 (2009: .56)

Management commented that further reductions in net debt form a key part of the Group's plans to strengthen the balance sheet in the short to medium term and there are clear opportunities to renegotiate the debt again to benefit from lower prevailing interest rates.

- Deferred income measure of strength

Deferred income increased by 3% from the prior period, to stand at £7.10m at the year end (2009: £6.91m). Whilst a creditor, deferred income is an important measure of the strength of the business model, being the amount of recurring revenue paid in advance but deferred for revenue recognition purposes to future accounting periods.

- Improved level of momentum continues

Sanderson has continued to experience the improved level of momentum in its businesses which commenced in the late summer of 2009, achieving an increased order intake and further growth in its order book during the year. Notwithstanding the UK economy's slow recovery from recession and competitive market conditions, the Group has continued to gain an increased value of business from new customers in both its operating divisions.

They have continued to invest resources into improving service levels and efficiencies in core operations and in the development of new software products, including the Group's managed service offering, which is anticipated to further enhance market competitiveness and future profitability.

- The Business

Sanderson provides a wide range of software solutions to the multi-channel retail and manufacturing markets. These solutions comprise primarily the Group's proprietary software often integrated with other market-leading products, which are installed, supported and serviced by Sanderson staff.

Multi-channel retail
The Group provides end-to-end, comprehensive IT solutions to businesses operating in retail, mail order, fulfilment and wholesale distribution, and increasingly, to those with an online sales presence. Revenues derived from multi-channel retail operations increased by 10% to £21.17m. Activity levels from the larger existing retail customers continued to be strong, especially in the areas of fraud prevention and PCI compliance. Business from smaller retail customers, including charities, has begun to recover from the low levels of the previous year.

In addition, a total of 24 new customers were gained during the year (2009: 21) including Hamley's, David Austin Roses, TJ Hughes, Aquascutum and Links of London – some nice names in there! Large projects were awarded from a number of existing customers, including Wilkinson, The Original Factory Shop, Fenwick and Lakeland.

Order intake was much improved at £12.95m for the financial year (2009: £10.62m) and the order book at 30 September 2010 was £2.47m (2009: £1.47 m).

Manufacturing
The Group's manufacturing business covers the provision of IT solutions to manufacturing companies which operate primarily in the engineering, plastics, aerospace, electronics, print and food process sectors. Revenues were 2% higher at £5.83m (2009: £5.73m). The most marked recovery in activity was in the area of general manufacturing, especially printing and aerospace.

Four new customers were gained and including Bromford Industries (aerospace), Piroto Labelling (print), Susan Day Cakes (food processing) and MacSween of Edinburgh (food processing), compared with three in the twelve months ending 30 September 2009.

Recurring revenues continue to be strong, accounting for 61% of total revenue (2009: 66%). The gross margin from this revenue stream covers 83% of divisional overheads (2009: 83%).

- Investment in Managed services

Having developed and organically grown a managed services and hosting business now contributing annual revenue in excess of £3.0m per annum, the Group is undertaking a further capital investment in the Milton Keynes managed services centre in order to improve the platform for further growth.

- Continued increase in sales and marketing & product development

The Group has continued to increase its sales and marketing efforts, focusing on the improved account management of existing customers, whilst more aggressively competing and gaining new customers. The new product and services suites of Business Assurance and Factory Automation introduced in the previous year have continued to gain traction in their respective markets. The introduction in March 2010, of solutions based on the latest technologies in the areas of internet retailing and ecommerce have provided further business impetus. The product portfolios were further enhanced by the launch, in the second half year, of a number of energy saving products, collectively branded, Green IT.

In addition to the new products and services already introduced (Business Assurance, Factory Automation and Green IT) further new developments are scheduled for introduction during the year.

- Order intake +22%

Total order intake for the year was £15.55m compared to £12.73m in the previous financial year, with orders from new customers in the twelve months to 30th September 2010 of £3.96m (2009: £1.33m). At 30 September 2010, the order book stood at £3.03m compared to £1.92m at 30th September 2009 with the Group benefiting from an increase in average contract sizes which are up to £125,000 in 2010 from £79,000 in the prior financial year.

The Group's strategy is to be the supplier of choice in target markets, offering modern, functionally rich products, which deliver cost effective solutions to customers, backed by a high quality service and will ensure long-term growth in earnings and enhances value to investors

- Full year dividend +50%

A final dividend of 0.35p per share is proposed, making a total of 0.60p for the year (2009: 0.40p) and equating to a full year yield of approx 1.9% at the current share price (31.25p). The final dividend is due to be paid on 25 March 2011 to shareholders on the register at the close of business on 4th March 2011.

- Pension deficit under control

The pension deficit increased from £1.8m to £3.8m at the 2010 year end. Management commented that a new 7 year funding arrangement was agreed with the trustee during the year which should see the deficit eliminated.

- New Solutions initially targeted to manufacturing

The successful introduction of the Group's new Business Assurance and Factory Automation solutions has recently been complemented by the introduction of internet retailing, ecommerce and Green IT products.

Software as a Service ('SaaS'), as a possible prelude to Cloud Computing solutions will be launched during the next quarter.

The new solutions will initially target smaller manufacturing businesses looking to move to their first enterprise-wide system, a new sector of the market in which our online product offerings are already well-established.

- Positive outlook

There was the usual 'cautious' outlook statement but management also commented that the new financial year has started well illustrated by the increased order book value, and there is a good level of confidence going into the financial year ending 30 September 2011.

- Broker forecasts

For the year ending September 2011 the house broker has moved forecasts to sales of £27.3m, profit before tax of £2.5m and adjusted earnings per share of 4.96p.

At the current share price (31.25p) the shares trade at 6.3x 2011 adjusted earnings estimates with a projected yield of c2.5%.

Chairman Christopher Winn's increased 26% stake acquired in February at 20p is already showing a nice little profit.

- Refinancing could give earnings a big boost

Management spoke of the potential to refinance current debt on more favourable interest terms.

With finance charges of £1.57m in the year (2009:1.53m) on operating profit of £3m there is a clear opportunity here to boost earnings without even worrying about the top line.