SMALL CAP SHARE COMMENT

Commissioned Commentary

SANDERSON GROUP

(AIM:SND)

Share price 26.5p

Date: **28th November 2011**

Sector: Software & Computer Services

Market Cap: c£11.5m

www.sanderson.com

Results in line, cash flow strong, debt down, refinancing in place, decent visibility of earnings and valuation modest – can one ask for more!

The software and IT services business specialising in multi-channel retail and manufacturing markets in the UK issued positive full year results for the year ending 30th September 2011.

With new products and services introduced over the last two years set to support further improvement in the Group's trading performance and the refinancing of its term debt and working capital facilities offering an instant boost to earnings, the outlook looks highly encouraging, despite the obvious challenges from the high street.

- Summary results

Full year revenue came in marginally lower than the prior year at £26.4m (2010:£27m) but the focus on selling and supplying higher margin solutions based upon its 'owned' software and services resulted in an improved gross margin of 71.8% (2010: 69.1%).

Operating profit, before the amortisation of acquisition-related intangibles and the charge in respect of share-based payments, increased by 7% to £3.30m (2010: £3.09m) and adjusted basic earnings per share, increased to 5.5p (2010: 3.9p). Consensus forecasts were previously for adjusted earnings per share of approx 4.74p.

- Cash flow remains very positive

Cash generated from operations improved to £3.43m (2010: £3.37m) compared with operating profit of £3.3m, resulting in net debt falling to £6.72m at year end from £7.84m at the end of the prior year. With net debt having peaked at £12.46m on 31st March 2008 this represents a material improvement. Guidance is for net debt to fall to approx £5.6m by 2012 year end. The Group continues to maintain a tight grip on credit control with a low incidence of bad debts – a legacy of private equity ownership!

- Reduction in financing charges offers a big boost to future earnings

Finance expenses for the year were £1.45m, the largest element of which was represented by bank charges of £804,000. Annual savings from the re-banking with HSBC will save the Group just over £300,000 in the coming year. The one-off exceptional charge of c£379,000, representing the unamortised portion of RBS fees, will also not recur offering a further boost to next years earnings.

- Dividend lifted

The final dividend is 0.45p per share resulting in a total dividend of 0.75p for the year, a 25% increase compared with the prior year and a yield of 2.8% at the current share price. The dividend is covered over 2.5x.

- Recurring revenue offers excellent visibility

Sanderson offers software solutions comprising primarily its own software, often integrated with other market-leading products, which are installed, supported and serviced by Sanderson staff.

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Recurring revenues from annual software licences, support and managed service contracts increased to £13.70m, representing 52% of total revenue (2010: £13.66m.

- Investment in sales and marketing

Over the course of the year the Group continued to invest in its sales and marketing capability, reflected by the 10% increase in sales and marketing costs. It has also accelerated investment in the development of new products and services notably SaaS (Software as a Service) and Cloud based products.

The new product and services suites of Business Assurance and Factory Automation introduced in the previous year have also continued to gain traction in their respective markets.

The Group's energy saving products, collectively branded 'Green IT', look particularly compelling with such offerings as server optimisation software helping to reduce power consumption.

Management commented that, despite some slowdown in activity in the high street retail sector towards the end of the financial year, order intake has been resilient.

- Order book

At 30th September 2011, the order book stood at £2.92m (excluding support) compared to £3.03m at 30th September 2010 and £1.92m at 30th September 2009.

While visibility appears relatively short term relative to annual turnover of £26m, it is worth noting that 50% of overall turnover is covered through recurring revenues from annual software licences, support and managed service contracts. Adding the order book to the recurring revenue commitment suggest visibility of approximately 65% of next year's turnover.

DIVISIONAL BREAKDOWN

- Multi-channel retail
Revenue £20.28m (2010: £21.17m)

End-to-end, comprehensive IT solutions to businesses operating in the areas of online sales, e-commerce, catalogue sales, wholesale cash and carries and 'high street' retail outlets

As referred to previously, a higher proportion of own software and services resulted in gross margins increasing to 68.4% from 65% in 2010.

The wholesale cash and carry business achieved a record profit result in its fifteenth year of organic development within the Group.

Activity levels have remained strong in online sales and e-commerce and from the larger existing retail customers in the areas of fraud prevention and PCI ('Payment Card Industry') compliance.

The Group's new hospitality and catering module within the suite of retail software, which utilises the latest tablet PCs and wireless technology has also already developed a strong following from several NHS Trusts – given the compelling savings achieved through utilising this product the

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UK tax payer would appreciate a wholesale roll out across all NHS Trusts!

A total of 22 new customers were gained during the year (2010: 24) with new customers including Brown Thomas, B&M Retail, Country Homes & Gardens, Twinings and Lewis' Home Retail. In addition, large projects were awarded by a number of existing customers, including Wilkinson, The Original Factory Shop, Fenwick and Lakeland.

- Manufacturing
Revenue £6.15m (2010: £5.83m)

Provision of modern, comprehensive, IT solutions to manufacturing companies which operate primarily in the engineering, plastics, aerospace, electronics, print and food process sectors.

Recurring revenue accounted for 58% of total revenue (2010: 61%) with gross margin from the recurring revenues stream covering 78% of divisional overheads (2010: 78%).

The most marked recovery in activity was in the area of general manufacturing, especially printing and aerospace.

Four new customers were gained including Gardners, Albury Chickens and Dairy Best Victoria, compared with the same number in the previous year ending 30 September 2010.

- Bargain basement

Much like the market as a whole the share price has continued to fall and based on current consensus estimates the shares trade at a seemingly bargain basement 4.5x adjusted earnings estimates of approximately 5.94p for 2012 (subject to reassessment post results), with a projected forward yield of c3.7%.

- Despite gloom on the UK high street overall prospects look good

The outlook remains positive particularly with regard to the Green IT, SaaS and Cloud solutions, although, as can be anticipated from virtually every corner of the market management remains cautious.

The order book and significant element of recurring revenue give cause for optimism and the debt refinancing alone will offer a decent boost to earnings

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