WH SECURITIES

03 November 2011

UK EQUITY RESEARCH

SOFTWARE & COMPUTER SERVICES

BUY

Price **29p**

Target Price 44p

Reuters/BBG	SND.L / SND LN
Index	FTSE AIM
Sector	Software
Market Cap	£12.6m
Shares in Issue	43.52m
Gearing	35%
Interest Cover	7.3x
FCF Yield	16.6%

Performance	Absolute	vs AIM
1 month:	+12%	+7%
3 months:	-24%	-10%
12 months:	+18%	+31%
High/Low	23.5p/39p	

Last Results	Interims: May
Next Results	Finals: End Nov
Next Event	Finals: End Nov

Source: Bloomberg

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Marketing Communication
This document has not been prepared in accordance with legal requirements designed to promote the independence of investment research. Please refer to important disclosures towards the end of this document.

Sanderson Group

Trading statement & Initiation of coverage

Sanderson is a software and IT services business specialising in the multi-channel retail and manufacturing markets in the UK and Ireland. The Group has significantly increased the proportion of revenues from retailers (now 75%) since its 2004 AIM floatation, and in addition to an established presence supplying in-store solutions to high street retailers, has a niche focus on multi-channel retailing, a sector which is enjoying structural growth. After a challenging 2009 Sanderson showed a strong recovery in 2010 with adjusted pre-tax profit up 79% to £1.9m. This momentum has continued into 2011 where we anticipate a further 28% improvement to £2.4m. The shares are trading 25% below their August high of 39p, and are priced well below the sector average and peer group. We initiate coverage with a BUY recommendation and target price of 44p.

H1 2011 showed a marginal improvement in adjusted operating performance to £1.5m, albeit driven more by margin enhancement than revenue improvement. **However lower interest payments helped adjusted earnings per share to increase by 35% to 2.3p**. Sanderson entered H2 with a strong order book of £3.36m (10% up) & even stronger prospect list. Today's trading update states that Sanderson has continued to trade well and profitability for the year ending 30th September 2011 and is in line with market expectations.

Based on our forecasts Sanderson's cash generative ability is sufficiently robust to support its progressive dividend policy whilst continuing to pay down debt. By the end of FY2013 we estimate that the company's net debt balance will have more than halved from its 2010 year end position to £3.4m.

The biggest risk to our forecasts is a continued deterioration in the UK economy. However **the company has built a base of strong recurring revenues (54%)** and its products benefit from a number of defensive characteristics that provide some protection against an economic downturn. **On a sub 5x forward P/E ratio we believe that a considerable element of bad news is already discounted in the current share price**. Our peer group valuation generates an a target price of 44p, 52% above the current share price equating to an EV/EBITDA multiple of under 7x. As recently as June and July we have seen Directors share purchases at up to 33p.

Estimates y/e Sep (£m)	2010A	2011E	2012E	2013E
Turnover	27.0	27.3	28.1	28.9
WHI Ebitda	3.4	3.6	3.9	4.2
WHI PTP	1.9	2.4	3.1	3.6
WHI EPS (p)	3.6	4.9	6.3	6.7
P/E (x)	8.0	5.9	4.6	4.3
EV/EBITDA (x)	6.4	5.5	4.8	4.1
Dividend (p)	0.6	0.8	1.0	1.1
Yield (%)	2.1%	2.8%	3.4%	3.7%
Net funds.(debt)	(7.8)	(7.0)	(5.4)	(3.4)

Source: WH Ireland research / Company data

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Investment Case

The last 18 months of reported trading till 30th March 2011 have shown a continuous upwards trend in profitability

Sanderson Group is a software and IT services business specialising in the multi-channel retail and manufacturing markets in the UK and Ireland. The last 18 months of reported trading till 30th March 2011 have shown a continuous upwards trend in profitability, and the company's announcements since August give us confidence in **our 2011 forecast earnings per share of 4.9p, some 35% ahead of the previous year.** Our forecast year end net debt balance shows a 30% reduction over the last two years to £7m and our estimates show this more than halving to £3.4m by the end of FY2013.

2011 trading has been 'in line' and the Multi-Channel business is performing particularly well

Today's trading statement states that Sanderson has continued to trade well and profitability for the year ending 30th September 2011 is in line with market expectations. The Group continues to experience good trading momentum in its Manufacturing and Multi-Channel businesses, though the high street retail market is more challenging. Sanderson continues to gain new customers across the Group with the Multi-Channel business, having a focus on online sales, ecommerce and catalogue business, having performed particularly well during the year.

Net debt has dropped to under £7m

Sanderson announced an earlier than expected refinancing in August, which will save the company £300k in FY 2012. Net debt now stands at under £7m compared to £7.8m at the 2010 year end. This is despite the exceptional £400k refinancing charge.

Sanderson has won over half a million pounds worth of orders for the new Green IT products

Continued and increased investment in product innovation as well as in sales and marketing has further improved the Group's competitive market position. The new SaaS and Cloud products were launched earlier in the year and the Group has won over half a million pounds worth of orders for the new Green IT products. Sanderson guides further that future sales prospects are good and is looking forward to 2012 with cautious optimism.

We are valuing the company on an EV/EBITDA multiple 24% below that of the peer group.

Our peer group valuation gives us an implied share price for Sanderson of 44p, **suggesting potential upside of at least 52%. This is supported by a DCF analysis with an implied fair value of 52p per share.** Sanderson's customer base undoubtedly faces a difficult period ahead, with economic growth forecasts falling back and consumers facing a continuing squeeze on disposable incomes. Indeed in September the CBI found that 24% of retailers said sales were higher than the same month last year, compared with 39% who reported a fall. This gave a balance of -15%, the weakest measure since May 2010. We are therefore valuing the company on an EV/EBITDA multiple of under 7x, 24% below that of the peer group.

Sanderson generates some £2m trading profit from existing customer revenues

We believe that Sanderson has a number of defensive characteristics that provide some protection against an economic downturn. Sanderson has a resilient revenue base with a recurring revenue run rate in 2011 of 54% of total turnover (up from 51% in 2009), from annual, pre-contracted licence, support & managed service contracts. A further 41% is attributable to incremental discretionary spend from existing customers with the remaining 5% coming from new customers. **On this basis the company is able to generate £2m of trading profit prior to any new customer revenue.** Over the longer term the Group benefits from several drivers that we believe support revenue growth in excess of UK GDP rates.

..and benefits from a number of long term drivers for demand

These include - compliance drivers such as food provenance and PCI (**Payment Card Industry Security Standards)** compliance – pent up demand from previous delays to replacement cycles - a growing trend towards multi channel integration amongst retailers – and technological trends such as shop-floor automation, the proliferation of smart phones and tablets, the 'cloud' and Green IT.

Sanderson listed on aim in 2004..

The roots of the Sanderson business can be traced back to 1983, with a listing on AIM in 2004 at which point the Group raised £14 million at an admission price of 50p. At the time of its IPO the Group's largest sector by revenues was manufacturing (including food and process industries) with the remaining sales split relatively evenly between mail order and wholesale distribution.

..and has grown strongly both organically and through acquisitions

Between 2005 and 2007 the Group developed its Multi-Channel Retail business both organically and via acquisition. The acquisition strategy has helped Sanderson to become a key player in the provision of software and services to the multichannel retail sector which now represents 75% of revenues. The biggest acquisition by Sanderson during this period was that of Retail Business Solutions for up to £14 million in cash and shares (bank debt funded) although the final consideration, net of cash acquired, was nearer £9.5m. This key acquisition, made in late 2007, helped to enlarge the Group's blue chip customer base, expand the product portfolio and provide trading synergies within the Group.

Since 2008 the Group has maintained a solid focus on cash generation and debt reduction.

The year ending September 2009 was a difficult time for the Group. During that period it faced particularly difficult trading conditions, and the company suffered a decline in revenues and operating margins. The Group is now continuing along a strong recovery path, and its focus on the multi channel retail market has provided some downside protection against the greater malaise affecting the UK high street. 2010 showed an 8% increase in revenues to £27m with adjusted operating profit, increasing by 12% to £3.1m. The Group has maintained a solid focus on cash generation and debt reduction. We are forecasting a 2011 year end net debt balance of £7m versus a peak of £12.5m at 31 March 2008.

In H1 2011 adjusted earnings per share increased by 35% to 2.3p.

The first half of 2011 showed a marginal improvement in the adjusted operating performance to £1.5m, albeit driven more by margin enhancement than revenue improvement. The benefits of the Group's shrinking debt balance allowed adjusted earnings per share to increase by 35% to 2.3p. The strong order book of £3.36m (10% up) and even stronger prospect list gives us confidence that the second half has shown further improvements in revenue and profitability. This was substantiated by the November trading statement which indicated that Sanderson continues to experience good trading momentum in its Manufacturing and Multi-Channel businesses, whilst the high street retail market is more challenging, and that adjusted full year profits are expected to be in line with market expectations.

We are therefore forecasting a compound annual growth rate in adjusted eps of 17% over the next two years reaching 6.7p in 2013.

Our 2011 forecasts are broadly in line with consensus and show a pick up in revenue in H2 which will more than compensate for the small decline in H1, resulting in a FY increase of 1% to £27.3m. We believe margin improvements and declining finance charges will allow for an impressive increase in adjusted earnings per share of 35% to 4.9p. Sanderson's revenue profile, growing order book and prospect list, as well as continuing product innovation give us the confidence to forecast 3% sales growth in both 2012 and 2013. Combined with reducing debt levels and associated interest charges, we are therefore forecasting a compound annual growth rate in adjusted eps of 17% over the next two years reaching 6.7p in 2013. However we would caution that the macroeconomic outlook for Sanderson's UK retail and manufacturing clients is far from certain.

The shares are yielding 2.8% on current year estimate rising to 3.7% by 2012.

As a predominantly services based business, with high recurring revenue, Sanderson has enviable cash generative credentials. With improved financing terms and reducing debt levels, this is set to improve further. Our forecast 2011 free cash flows of £1.2m are dampened somewhat by the £400k of exceptional costs relating to the refinancing. By 2013 we are forecasting free cash flows to have effectively doubled to £2.5m. On this basis we argue that Sanderson has significant headroom to continue paying down its debt and maintain a modest dividend. Our forecasts show net debt falling 57% from 2010 levels to £3.4m in 2013. The shares are yielding 2.8% on current year estimate rising to 3.7% by 2012.

Valuation

We have undertaken both a peer group analysis and a discounted cash flow (DCF) valuation. Our peer group valuation, supported by the DCF analysis, derives an implied Enterprise Value of £35.5m. Taking into account the uncertainty over the macroeconomic outlook for Sanderson's customer base and the relative size of the peer group we have applied a further 15% discount equating to an EV/EBITDA multiple of 7.7x and a share price target of 44p.

Peer group

We have collated a small peer group of UK listed comparators to Sanderson, comprising of business software developers/resellers some of which focus on the same industries as Sanderson.

Fig 01*: Peer Group

	Price (p)	Mkt cap (£m)	EV (£m)	Year-End	EV/Sales Hist	EV/Sales Yr1	EV/Sales Yr2	EV/EBITDA Hist	EV/EBITDA Yr1	EV/EBITDA Yr2	PER Hist	PER Yr1	PER Yr2	Yield Hist	Yield Yr1	Yield Yr2	EPS Grth 2yr comp	PEG 2yr
K3 Business Technology Group PLC	165.5	47.1	62.6	Mar	1.2x	1.2x	0.9x	6.3x	6.2x	5.0x	9.5x	6.9x	5.7x	0.5%	0.4%	0.5%	29%	0.2x
Tikit Group PLC	276.5	40.7	36.7	Dec	1.4x	1.3x	1.3x	9.7x	8.6x	7.6x	14.1x	13.6x	12.2x	2.3%	2.4%	2.7%	8%	1.8x
Sage Group PLC/The	286.4	3788.5	3861.6	Mar	2.7x	2.6x	2.6x	9.8x	9.7x	9.5x	14.9x	14.5x	13.8x	2.7%	2.8%	3.0%	4%	3.6x
Workplace Systems International PLC	15	22.2	20.0	Jun	2.2x	1.8x	1.6x	443.7x	11.2x	9.2x	NA	21.4x	16.7x	0.0%	0.0%	0.0%	NA	NA
Misys PLC	285.5	967.8	1062.0	Mar	2.9x	2.4x	2.3x	11.8x	9.3x	8.5x	27.2x	14.1x	12.7x	0.0%	0.0%	0.0%	46%	0.3x
Advanced Computer Software Group PLC	38.5	136.6	167.0	May	1.8x	1.7x	1.7x	7.4x	6.7x	6.5x	8.6x	9.2x	8.6x	0.0%	0.0%	0.0%	0%	NA
Weighted Average					**2.7x**	**2.5x**	**2.4x**	**11.7x**	**9.5x**	**9.1x**	**16.7x**	**14.3x**	**13.3x**					
Simple Average		833.8	868.3		2.0x	1.8x	1.7x	81.5x	8.6x	7.7x	14.8x	13.3x	11.6x	0.9%	0.9%	1.0%	17%	1.5x
Sanderson Group PLC	29	12.6	23.5		0.7x	0.7x	0.6x	5.5x	4.8x	4.1x	5.9x	4.6x	4.3x	2.8%	3.4%	3.7%	17%	0.3x

Source: WH Ireland research / Company data / Bloomberg - Peer group priced at 27 September 2011 * We have included Sanderson's £3.5m pension deficit in our EV calculation. Peer data from Bloomberg is unlikely to include any pension deficits faced by the relevant companies.

The shares are yielding 2.8% on current year estimate rising to 3.7% by 2012.

For comparative purposes, and given that we have passed the 2011 year end for Sanderson, we have taken our 2011 forecasts as the starting point for comparative historical data.

On a forward p/e basis the shares are trading at a 68% discount to the peer groups weighted average

Sanderson compares favourably to the peer group across all the above valuation metrics. On a forward price/earnings basis the shares are trading at a 68% discount to the peer groups weighted average.

Our EV/EBITDA valuation suggests a 44p share price

Given the variety of debt profiles within the peer group we believe that EV/EBITDA is a more appropriate valuation metric. Using the weighted average forward multiple of 9.1x gives Sanderson an implied enterprise value of £35.5m. Given the relatively larger size and scale of some of the peer group we have applied a further discount equating to an EV/EBITDA multiple of sub 7x multiple or target EV of £30m. Stripping out the debt and pension deficit brings us to an implied equity valuation per share of 44p 52% above the current share price.

The shares are on a 2 year PEG ratio of just 0.3x

For those looking for a cash income return on their equity investments, Sanderson also compares favourably with a 3.4% prospective yield against a peer group average of 0.9%. Our forecasts suggest compound growth in earnings per share of 17% over the next two years. Combined with a mid single digit P/E ratio this generates a PEG ratio of just 0.3x which further suggests that the shares have room to appreciate. This again compares well to the peer group average of 1.5x.

Looking beyond the UK listed comparators and competitors we see Sanderson faring well against some of its, albeit much larger, international peers. We looked at NASDAQ listed JDAS, (supply chain systems specialists) and the business systems and software giants

SAP and ORACLE. 2012 P/E multiples for these stocks range between 12.4x and 14.5x compared to 4.6x for Sanderson.

Our DCF model implies fair value at 52p

DCF - Our DCF model runs off of our forecast model through to 2013 and assumes a 1% growth rate thereafter to perpetuity. Our weighted average cost of capital (WACC) assumes a 10% cost of equity and 6% cost of debt to reflect the company's newly arranged banking facilities. Including the pension deficit within the company's enterprise value we have conservatively weighted that element by the higher rate of 10% resulting in an overall WACC of 8.78%. Our model implies fair value at 52p providing strong support for our core peer group valuation of 44p.

Fig 02: DCF Valuation

Sanderson Group £m	2011	2012	2013	Terminal Value	
Operating Cash Flow pre interest and employee benefit contribution	2.8	3.3	3.5		
Capex	-0.4	-0.4	-0.5		
	2.4	2.8	3.1	3.1	
Discount Rate	8.8%	**(Future value of annuity)**		39.3	
NPV	2.2	2.4	2.4	28.1	35.1
Fair value per Share					
Terminal growth	1.0%	**WACC**			
Total Enterprise Valuation	35.1	Cost of Debt	6.0%		
Less Net Debt	-7.0	Cost of Equity	10.0%		
Less Pension Deficit	-3.5				
Equity Valuation	24.6	Mkt Cap + Pension	16	69.5%	6.9%
Diluted shares in issue (m)	47.2	Debt	7	30.5%	1.8%
Value per share (p)	52.0	WACC	8.78%		
Share price	29.0				
Dividend	1.0				
Total expected shareholder return	83%				

Sensitivity - Fair Price Per Share

Terminal Growth Rate

WACC	52.0	0.0%	0.5%	1.0%	1.5%	2.0%
	8.0%	52.1	56.1	60.8	66.1	72.4
	8.5%	47.4	50.9	54.9	59.5	64.8
	8.8%	45.1	48.3	52.0	56.2	61.0
	9.5%	39.6	42.3	45.3	48.8	52.6
	10.0%	36.3	38.7	41.4	44.3	47.7

Source: WH Ireland research / Company data

Company Overview

Sanderson Group is a software and IT services business specialising in the multi-channel retail and manufacturing markets in the UK and Ireland. Whilst the Group is focussed on being the supplier of choice in its target markets, the recent deployment of the Group's Retail-J solution deployed at Kitbag's Manchester City store in Abu Dhabi demonstrates that Sanderson's expertise also has attractions to UK customers with a multi-national presence.

Multi-Channel Retail Solutions (MCRS) now represent 75% of group turnover

The Group's range of software products can be split between its retail and manufacturing offerings. Through a process of organic growth and acquisition activity, **Multi-Channel Retail Solutions (MCRS)** now represent 75% of group turnover. The revenues in this division are split relatively evenly between genuine multi-channel operators and traditional terrestrial retailers. Within traditional retail about half of that revenue is attributed to managed services.

Multi-Channel Retail Solutions

e-commerce continues to expand at double digit rates in the UK

We believe that the Group's offering of systems to retailers with multiple distribution channels, is strategically sound for Sanderson. Whilst e-commerce continues to expand at double digit rates in the UK, the high street is currently under some pressure to grow.

Sanderson differentiates itself from other e-commerce specialists by offering seamless multi channel retail solutions for clients operating

Although the pure e-commerce software and web design/implementation market is a very crowded space, Sanderson differentiates itself by offering seamless multi channel retail solutions for clients operating in either all, or, some of the following distribution channels; telephone, catalogue sales, mail order, online and high street stores. Products range from electronic point of sale systems to complete solutions incorporating Retail EPoS, Sales & CRM, Marketing & Business Intelligence, Ecommerce, and Supply Chain Management. Figure 3 details the range and scope of some of the Group's best selling solutions.

The Group is more than merely a provider and installer of software solutions, but rather a consultancy that seeks to engage with its client base and understand its needs

A recent site visit to Sanderson's Retail division demonstrated to us that the Group is more than merely a provider and installer of software solutions, but rather a supplier that seeks to engage with its client base and understand its needs. Of particular note was the company's newly developed 'concept room' designed to showcase some of the latest innovations in retail technology. Within this room is a customisable retail stand which can be adapted to display merchandise related to specific retail clients. These can then be used to demonstrate items such as bar code scanners which prompt till side display screens to play relevant audio visual content (cross sell suggestions and promotions etc). Other items of note included the eye catching 'spec-less' 3D display screens, (ideal for marketing and queue management), and an interactive information booth which featured a giant touch screen, motion detectors and RFID readers which can intuitively detect products held by passing customers.

The Group holds very little unsold inventory.

The site also comprised testing facilities which ensure hardware arrives at clients with Sanderson's products pre-installed and ready to go. It is important to note that whilst Sanderson can provide the hardware required to run its products (EpOS terminals, PCs, bar code scanners, receipt printers etc) items are ordered on a Just in Time basis and as such the Group holds very little unsold inventory.

Sanderson has won numerous testimonials from its retail client base

Sanderson has more than 600 MCRS customers ranging from small boutique shops with an online presence through to large national retailers and wholesalers. Customers include Harrods, Comet, Wilkinson, Selfridges, Scotts of Stow and Nisa Today. The company's software aims to drive continuous business improvements and Sanderson has won numerous testimonials from its retail client base.

For example Miles Humble, Director of IT at Fenwick commented on the professionalism of Sanderson:

"We were impressed with Sanderson and their wealth of experience in supplying and implementing retail solutions, a close working relationship was quickly established with Sanderson and we found their honesty during our decision making process very refreshing."

and Andrew Leadbitter, Systems & Admin Manager at Tottenham Hotspur Football Club explained the importance of visibility of stock information, which Retail-J provides:

“When you have 4,000 people going through one store in the space of an hour and a half, we need to know what products are selling. We have to get that stock back on the shelves so it is available as soon as the match is over.”

Services including long term managed services contracts are a growing part of the revenue mix

In addition to its various retail focussed software suites Sanderson provides a number of complementary services making it a true one-stop shop for retail customers looking to have the highest standard of IT systems and expertise which in turn translates into operational effectiveness. For SMEs in particular a partnership with Sanderson facilitates cutting edge systems without the need for a cumbersome and expensive IT department. Sanderson’s range of services include:

- Helpdesk & IT Support
- Managed Services
- Project Management
- Implementation & Roll-Outs
- Business Continuity and Disaster Recovery
- Training
- Hosting
- Hardware Procurement
- Hosted & Managed Polling
- Pre-Emptive Maintenance
- PCI DSS Compliance

In difficult economic conditions, we believe that this service element is particularly resilient given that the cost of switching to an in-house service would be prohibitive.

The service element of Sanderson’s offering not only helps give the Group a competitive edge, but has helped it to build a revenue base of 54% of annual turnover. The vast majority of Sanderson’s staff are now client facing service providers. In difficult economic conditions, we believe that this service element is particularly resilient given that the cost of switching to an in-house service would be prohibitive. At our recent site visit to the Retail division in Milton Keynes, it was clear that the Sanderson helpdesk, which in effect replaces much of a client’s need for internal IT support, was well equipped to deal with customer queries.

Fig 03: Sanderson Retail Solutions

MCRS Software Solutions				
Solution	**Description**	**Sanderson IP**	**Client Base/Targets**	**Key Functionalities**
Retail J	Retail-J is widely recognised as the leading EPoS and estate management solution due to its diverse customer base, achieved by its ability to meet all the requirements of medium and large sized retailers.	**No but the Group deployed around 75% of installations of Retail-J in the UK clearly making it the country's number one reseller and consultant.**	Mid to large size general retailers	•Estate management (Access to real-time transactional, stock and HR data etc) • Back office (HR and Inventory Monitoring etc) •EPoS (Credit Card Securityy/PCI Compliance, returns, cross sell suggestions and promotions etc)
Elucid	Elucid is the solution for multi-channel retail selling. Whether you're selling via one sales channel or many, or targeting consumers or businesses, Elucid is a single integrated system that manages your operation.	**Yes**	B2C, B2B, Mail Order, Ecommerce and Fulfilment organisations. All Elucid customers use the system across two or more sales channels.	•Order Management & CRM •Marketing / Business Intelligence •Ecommerce •EPoS for in-store retail •Supply Chain Management (including purchasing & WMS)
Midas	Integrated retail management software, covering merchandising as well as instore EPoS and head office operations	**Yes**	As well as the full system, there is also a cost effective commerce solution for pureplay etailers or retailers with existing systems who wish to extend their reach online, and the store manager communications portal	•Instore EPoS •Stock control & warehouse management •Merchandising •Reporting & analysis •Customer options •Multi-channel retail •Company portal •Financials
Manna	A catering management IT solution for organisations that provide a food & beverage service	**Yes**	Manna is designed for all types of organisations that provide a food and beverage service within the NHS, healthcare and cost sector catering markets.	•Calculating accurate food production costs •Reducing food wastage •Providing full nutritional analysis, so menus are nutritionally balanced & meet NHS guidelines •Handling all production methods •Minimising the time between point of ordering and point of service by using mobile tablet PCs •Increasing patient food service levels
Swords	An end-to-end, fully integrated IT system for delivered wholesalers and cash & carry operations	**Yes**	Sanderson is 'The preferred partner' to Buying Groups in both the UK and Ireland.	•Sales Order Processing •Integrated Sales, Purchase & Nominal Ledger •Management Reporting & Business Intelligence •Purchase Order Processing •Bonded Warehousing •Stock Management •Radio Frequency: Voice or Scan •Web Trading •Electronic Rep & Van Sales System •CRM System •Electronic Ordering

Source: WH Ireland research / Company data

Sanderson has won a prestigious IBM Award for Innovation for its involvement with Enactor.

In addition to the solutions in Fig 03, Sanderson, in early 2011 entered into a long-term distribution agreement with Enactor Limited under which Sanderson will market and sell the full suite of new retail applications currently being developed by Enactor. Enactor is headed up by Mike Carrell, the original founder of Retail-J and as such comes with an outstanding pedigree within the industry. Enactor offers either a full end to end solution or additional modules to complement existing EPoS solutions, and is highly customisable to a retailer's individual needs. Sanderson has won a prestigious IBM Award for Innovation for its involvement with Enactor. The European Award, which was presented at IBM's annual retail summit in The Hague, recognised the pivotal role Sanderson has played in implementing the innovative new Enactor solution at a major UK speciality retailer.

Enactor could be a significant new source of long-term growth for the Group

We believe that the Enactor solution gives Sanderson the firepower to gain further penetration into the tier 1 retail market, as opposed to the mid-market where the Group already has a strong foothold. Despite the benefits of the new technology, current uncertainty surrounding the economic outlook, is likely to dampen industry enthusiasm for mass adoption of a new generation of technology. Nonetheless this addition to the portfolio leaves Sanderson ideally positioned to benefit from an eventual upturn in investment spend by retailers.

Manufacturing Solutions

The manufacturing business stream encompasses the traditional manufacturing sector as well as operators in the food and print industries. The software can cover all of a business's IT need from web portals through to a product configurator for creating bespoke products, inventory and warehouse management and CRM.

In H1 the order book for Sanderson's manufacturing division was up 88%

This part of the business was particularly affected during the recession. However the division experienced a surge in orders for its latest products in March and entered the second half of the 2011 financial year with a strong order book worth £860,000, 88% ahead of the March 31st 2010 order book of £457,000. Although the Group has a larger range of retail solutions, the contribution from manufacturing is still significant at 25% of annual revenues.

Manufacturing enjoys even higher levels of recurring revenues

Currently manufacturing is enjoying an even higher proportion of recurring revenues than the rest of the Group, at some 58% of total divisional income at the last interim results.

Sanderson owns the IP surrounding its Unity ERP solutions

Sanderson's key range in this division is the Unity suite of Enterprise Resource Planning (ERP) products, with different versions available for manufacturing, food and beverage production, print and SME enterprises. UnityExpress is designed specifically for the latter as a 'cloud' based application and hence brings ERP software to a client base for whom such functionality may have been previously unaffordable. This may be an impractical solution for some manufacturers and Sanderson is developing an 'off the shelf' version of Unity to bridge the gap between the full ERP and cloud based versions.

Unity is a modular product and the core functions available to clients are listed below.

- **Product Configurator** - efficiently manage complex estimates
- **MIS Reporting** - advanced reporting for all business needs
- **Sales Order Management** - manage sales orders and quotations
- **Shop Floor Data Collection** - utilise real-time factory information
- **Inventory & Warehouse Management** - improve efficiency and service

- **Production Control** - manage every aspect of production
- **Quality Control** - control documentation, suppliers & complaints
- **Business Intelligence** - advanced management analytics
- **Web Portal** - share MIS information securely information online
- **Capacity Requirements Planning & APS** - intuitive shop-floor scheduling using graphical displays
- **Master Production Scheduling & Material Requirements Planning** - improve short & long-term planning and scheduling
- **KPI Dashboard** - view critical performance measures 'at a glance'
- **Sales Management & CRM** - manage all customer communications
- **Document Management** - reduce paperwork handling
- **Human Resources and Time & Attendance** - manage personnel, wages, and Time & Attendance

As with MCRS, Sanderson offers its manufacturing clients a variety of services ensuring that customers have access to support from the pre-sales stage through to day to day operation.

Market Drivers

Sanderson's client base is facing a challenging environment

With the global economy potentially on the brink of a double dip recession, it is prudent to assume that the domestic retailers and manufacturers who comprise Sanderson's target markets and existing customers, will be subjected to continuing financial pressure and that their IT investment decisions will become subject to increasing scrutiny of key decision makers and budget setters.

But has good reason to continue investing in IT

However there are a number of market drivers that we believe will continue to enhance the demand for Sanderson's products and services beyond that which one might expect to be generated by business confidence (or lack thereof) alone.

Ageing estates

An increasing number of retail estates are approaching the end of their replacement cycles

Typically retailers have a hardware replacement cycle of some 6 to 7 years. When upgrading tills and checkouts etc, this is often an appropriate time for IT managers to review their software requirements too. A recent 2011 survey by retail consultants Martec showed that the proportion of retailers planning to replace existing systems was up year on year, particularly with merchandise management (21% of respondents answered affirmatively). We believe that this is a symptom of previously deferred spending decisions. In the long term investment in IT can help reduce costs and drive revenue for retailers.

Compliance

PCI compliance is a growing issue…

Both the retail and manufacturing industries are facing increasing compliance burdens which Sanderson's solutions help businesses to carry with less weight. For retailers an important regulatory body is the **Payment Card Industry Security Standards Council** (PCI) established in 2006. Whilst it is not necessarily mandatory for retailers to be PCI compliant, it is much easier to conduct business if they are. Certain payment processors will refuse to deal with retailers who are not PCI compliant. Furthermore being PCI compliant improves the security of client data, thus engendering customer trust, and lowering the risk of liabilities/fines arising from credit card fraud.

…as is food provenance

In manufacturing, particularly in food products where Sanderson has a specialisation, there is a growing regulatory burden on producers to label products clearly, and to demonstrate a clear trail of the provenance of ingredients. This is typically easier with a full functioning ERP system such as Unity in place.

Multi-channel integration

Multi-channel integration is a pressing issue for retailers

According to Martec and Sanderson, Multi-channel integration is a pressing issue for retailers. As retailers expand their channel offerings further, be it through stores, mail order, bespoke websites, mobile apps or third party channels, such as eBay or Amazon, the importance of being able to see all customer intelligence and stock information in one place is increasing. Having a fully integrated multi channel solution not only drives cost savings and reduces stock holding periods, but enables consumers to benefit from a seamless experience whether buying from a mobile phone or returning an item to a physical store. With effective multi channel integration a consumer should never have to face the disappointment of ordering an item that turns out not to be in stock. A growing trend amongst retailers is the introduction of click and collect services, which straddles both the web and terrestrial channels.

New trends and technology

In addition to the proliferation of Multi-Channel Retail there are a number of other technological developments that will drive demand for Sanderson's expertise and we detail the main ones below. Some are specific to retail, others to manufacturing and some are relevant to both.

We have seen a first hand demonstration of Sanderson's energy saving solution

Sanderson has demonstrated that it is capable of keeping pace with the market and developing niche products for specific customer groups.

Automation

Automation is a key driver of IT investment spend in manufacturing and delivers huge cost savings and efficiency benefits for manufacturers. Sanderson's Unity ERP solution is well equipped to handle automated barcode and RFID data capture.

Proliferation of smart phones and tablets

Within manufacturing the increasing presence of tablets, enables management to access information anytime anywhere. However this is only possible with the right software solution.

Within retail, the very same devices open up a completely new and rapidly growing sales channel. The previously mentioned Martec survey showed that whilst just 14% of the leading 125 non-food retailers now offered an M-commerce channel, a further 14% were planning to adopt one.

Green IT

In a time of high energy costs, the ability to be energy efficient is important for margins across both the retail and manufacturing industries. Furthermore green credentials are becoming increasingly important from a marketing perspective. We saw a first hand demonstration of Sanderson's energy saving solution in the 'Concept Room', which can monitor and optimise energy consumption across an entire IT estate. The initial response amongst Sanderson's customers has been positive.

Cloud

Cloud computing is another buzz phrase gaining prominence in IT circles. The term refers generally to the delivery of computing as a service where applications are delivered over a network, typically the Internet. This offers users a number of advantages, particularly small businesses who lack the capital and infrastructure to run their own systems internally. Issues including those about data security and product functionality mean that widespread adoption of cloud based business critical applications amongst Sanderson's customer base may be impractical or some way in the future. However with the roll out of Unity Express Sanderson has demonstrated that it is capable of keeping pace with the market and developing niche products for specific customer groups.

Group Financial Estimates

Fig 04: Income statement

Year to September	2010 A £(m)	2011 E £(m)	2012 E £(m)	2013 E £(m)
Turnover	**27.0**	**27.3**	**28.1**	**28.9**
Growth y-o-y	*8.4%*	*1.0%*	*3.0%*	*3.0%*
COGS	(8.4)	(7.9)	(8.1)	(8.4)
Gross Profit	**18.6**	**19.4**	**19.9**	**20.5**
Gross Margin (%)	*69.0%*	*71.0%*	*71.0%*	*71.0%*
Trading Profit	**3.1**	**3.3**	**3.6**	**3.9**
Trading Margin (%)	*11.5%*	*12.3%*	*13.0%*	*13.5%*
Amortisation	(1.4)	(1.3)	(0.9)	(0.2)
Impairment of goodwill	0.0	0.0	0.0	0.0
Exceptional costs	0.0	(0.4)	0.0	0.0
Share based charges	(0.0)	(0.0)	(0.0)	(0.0)
Operating profit	**1.7**	**1.6**	**2.7**	**3.7**
Net finance expenses	(1.2)	(0.9)	(0.5)	(0.3)
Pre-tax profit	**0.5**	**0.7**	**2.2**	**3.4**
Tax Rate	-46.2%	-5.0%	-5.0%	-12.0%
Tax	*-0.2*	*-0.1*	*-0.2*	*-0.4*
Net profit	**0.3**	**0.6**	**2.1**	**2.9**
Basic diluted Eps (p)	0.6	1.2	4.4	6.2
Adjusted pre-Tax Profit	**1.9**	**2.4**	**3.1**	**3.6**
Adjusted net profit	**1.7**	**2.3**	**3.0**	**3.2**
Adjusted diluted EPS (p)	*3.6*	*4.9*	*6.3*	*6.7*
Diluted Shares (m)	46.4	47.2	47.2	47.2
DPS (p)	*0.6*	*0.8*	*1.0*	*1.1*
Adjusted EBITDA	**3.4**	**3.6**	**3.9**	**4.2**

Source: WH Ireland research / Company data

Revenue

We expect that H2 2011 will more than compensate for H1 and forecast a 1% rise in full year 2011 revenues to £27.3 million

Despite a 1.3% decline in revenues for the 6 months ending 31st March 2011, the 10% rise in the value of the company's order book, and healthy prospect list, gives us confidence that the second half will more than compensate for H1 and we expect a 1% rise in full year 2011 revenues to £27.3m.

We expect 2012 to demonstrate the benefits of the growing order book

We expect 2012 to demonstrate the benefits of the growing order book, expanding prospect list and improving competitive market position. However given the increasing storm clouds gathering over the UK economy, we are being relatively cautious about sales growth and are forecasting a 3% increase in revenues to £28.1m.

Upside could come from early adoption of Sanderson's newer product lines, or a surge in replacement activity

We are assuming the same growth rate for 2013, generating a revenue estimate of £28.9m. However if some life is breathed into the economy by then, this could be bettered. Upside could come from early adoption of Sanderson's newer product lines, or a surge in replacement activity as retailers feel pressed to upgrade ageing estates.

Gross profit

In H1 2011 Sanderson managed to advance its gross margin 350 basis to 70.6%

In H1 2011 Sanderson managed to advance its gross margin 350 basis to 70.6% due to a larger contribution from the Group's proprietary products to the revenue mix. Going forward we assume that gross margins will settle at 71%.

Trading profit

We are expecting an 8% increase in trading profit to £3.3m in 2011…

We view Sanderson's key metric of operating performance as trading profit, which we define as operating profit before the amortisation of acquisition-related intangibles and share-based payments. For FY 2011 we believe the gross margin improvement, combined with a small increase in revenues, and a relatively fixed cost base, will allow trading margins to advance 80 basis points to 12.3%, resulting in an increase of 8% in trading profit to £3.3m. On a divisional basis this translates to a margin of 16.8% in manufacturing and 11% in MCRS.

…reaching £3.9m in 2013

In 2012 we are of the opinion that operational gearing will enable trading margins to advance by a further 80 basis points to 13%, which will allow trading profit to increase by a further 8.9% to £3.6m. We are forecasting continued margin improvement of 50 basis points in 2013 and an increase in trading profit of 6.9% to £3.9m.

Pre tax profits

New banking facilities will generate annual finance charge savings of some £300k

Given the company's recently negotiated improved banking facilities and continued propensity to pay down its debt any increases in trading profit will be amplified at the pre-tax level as finance charges come down. The company's recently renegotiated bank facilities (August 2011) will generate annual finance charge savings of some £300k, although will incur a one off exceptional charge of £400k in the 2011 financial year. Notwithstanding this exceptional item we have forecast a reduction in net finance costs of 24% to £0.9m. On an adjusted basis, (before exceptional items, amortisation of acquisition-related intangibles and share-based payments) we therefore see pre-tax profit rising by 28% to £2.4m.

In 2012 we expect a 29% increase in adjusted pre-tax profits to £3.1m

In 2012 we see the benefits of the new finance facilities coming through and are forecasting a further 44% reduction in net finance charged to £0.5m allowing adjusted pre-tax profits to push ahead a further 29% to £3.1m.

Between 2011 and 2013 we forecast adjusted pre-tax margins to improve from 9% to 12.4%

As free cash flow continues to erode the Group's net debt balance we expect interest charges to fall a further 40% in 2013 to £0.3m. Our adjusted pre-tax profit forecast is £3.6m some 14.5% ahead of the previous year. Between 2011 and 2013 we forecast adjusted pre-tax margins to improve from 9% to 12.4%, a function of both improving operating margins and falling interest charges.

Earnings per share

For FY 2011 we forecast adjusted EPS to rise 35% to 4.9p.

We use diluted adjusted (as above) earnings per share as our core measure of EPS. In addition to the 43.52m ordinary shares in issue, as per the interim report there were a further 3.84m potentially dilutive options (some of which have now been exercised), and hence we have used 47.22m as our denominator going forward. For FY 2011 we forecast adjusted EPS to rise 35% to 4.9p. Sanderson continues to benefit from accumulated tax losses from its previous acquisition activity and we are assuming a nominal tax rate of 5% for 2011 and 2012 rising to 12% in 2013. Thereafter it should rapidly trend towards the 28% standard rate. Our forecasts show adjusted EPS to rise a further 28.5% in 2012 to 6.3p and 6% in 2013 to 6.7p

Dividend

We are forecasting an annualised dividend for 2011 of 0.8p, an increase of 33%

In the 2010 annual report the Group stated its intention to reinstate a progressive dividend policy. We are forecasting an annualised dividend for 2011 of 0.8p, an increase of 33%, equating to a final dividend of 0.5p (interim dividend 0.3p). In 2012 we are forecasting a further 25% increase in dividends per share to 1p which works out at a payout ratio of 16% of adjusted EPS. We are maintaining this ratio going forward which generates a further increase in DPS of 10% in 2013 to 1.1p.

Downside risk to forecasts

Running a scenario assuming a 3% decline in 2012 revenues still projects an adjusted EPS figure of 4.5p equating to a P/E ratio of just 6.4x

Whilst our forecasts currently assume a modest 3% revenue growth in 2012, we considered it prudent to run a scenario in which the demand for Sanderson's products, particularly new customers and incremental sales were to slump. Assuming a 3% sales decline, a negative 6% revenue swing from our base case 2012 scenario, this brings us to a top line number of £26.4m. Should this happen we believe trading margins would fall to 10.4%, 260 basis points below our base case scenario, equating to a trading profit of £2.7m, 25% below our current estimates. This equates to an adjusted earnings per share figure of 4.5p 28.5% below our existing forecast. Even after running this downside scenario the shares are trading on a forward price to earnings ratio of 6.4x, suggesting that the market is already pricing in significantly worse forward trading. We therefore argue that the valuation as it stands offers a high element of downside protection.

Fig 05: Cashflow statement

Year to September	2010 A £(m)	2011 E £(m)	2012 E £(m)	2013 E £(m)
Net Profit	0.3	0.6	2.1	2.9
Amortisation and Impairment	1.38	1.32	0.90	0.20
Depreciation	0.26	0.26	0.26	0.26
Share based payments	0.0	0.0	0.0	0.0
Net Finance charges	1.2	0.9	0.5	0.3
Income tax	0.2	0.1	0.2	0.4
Operating cash flow pre changes in working cap	**3.4**	**3.2**	**3.9**	**4.2**
Movement in receivables	*(1.5)*	*0.8*	*(1.5)*	*(0.3)*
Movement in inventories	*0.0*	*0.0*	*0.0*	*(0.1)*
Movement in payables	*1.8*	*(1.1)*	*1.0*	*0.1*
Employee benefit plan	(0.3)	(0.3)	(0.3)	(0.3)
Interest paid	(1.2)	(0.9)	(0.5)	(0.3)
Income tax received	0.5	(0.1)	(0.2)	(0.4)
Net cash from operations	**2.7**	**1.6**	**2.5**	**3.0**
Purchases of plant, property and equipment	(0.2)	(0.2)	(0.2)	(0.3)
Development Capex	(0.2)	(0.2)	(0.2)	(0.2)
Net cash used in investment activities	**(0.4)**	**(0.4)**	**(0.4)**	**(0.5)**
Repayment of borrowings	(1.5)	(1.5)	(1.5)	(1.5)
Lease repayments	(0.0)	(0.0)	(0.0)	(0.0)
Dividends	(0.2)	(0.4)	(0.5)	(0.5)
Net cash used in financing activities	**(1.7)**	**(1.8)**	**(1.9)**	**(2.0)**
Net Cash Flow	**0.6**	**(0.6)**	**0.1**	**0.5**
Movement in net (debt)/cash	2.1	0.9	1.6	2.0
Closing net (debt)/cash	**(7.8)**	**(7.0)**	**(5.4)**	**(3.4)**
Free Cash Flow	**2.3**	**1.2**	**2.1**	**2.5**
Cash Conversion	**120%**	**51%**	**66%**	**69%**

Source: WH Ireland research / Company data

Cashflow

Our 2011 cash flow forecasts are impacted by exceptional charges. By 2013 we are expecting annual net cash from operations of £3m

Our 2011 forecasts show a reduction in net cash generated from operations of 41% to £1.6m due largely to the non recurrence of an income tax rebate and the exceptional charges incurred for the arrangement of new banking facilities. Our 2012 estimates show a return to a more normalised cash flow profile with net cash generated from operations at £2.5m. We estimate that this figure will improve by a further 19% in 2013 to £3m reflecting the improvement in underlying trading.

We are assuming annual increases in net capital expenditure of 10% as Sanderson continues the development of its product and service offering. Based on these assumptions this figure will reach £0.5m by FY 2013.

We expect net gearing to fall from 38% to 15% over the next 2 years

Based on our forecasts Sanderson's cash generative ability is sufficiently robust to support its progressive dividend policy (a cash cost of circa £0.5m annually) whilst continuing to pay down debt. By the end of FY 2013 we estimate that the company's net debt balance will have more than halved from its 2010 year end position to £3.4m.

Fig 06: Balance sheet

Year to September	2010 A £(m)	2011 E £(m)	2012 E £(m)	2013 E £(m)
Plant property and equipment	0.4	0.4	0.4	0.4
Intangibles	33.0	31.8	31.1	31.1
Deferred tax	1.7	1.7	1.7	1.7
Non current assets	35.1	34.0	33.2	33.2
Inventories	0.3	0.3	0.2	0.3
Receivables	7.7	6.9	8.4	8.7
Income tax receivable	0.1	0.1	0.1	0.1
Cash and equivalents	0.2	(0.4)	(0.2)	0.3
Current Assets	8.3	6.9	8.5	9.4
Bank loans and borrowings	(1.6)	(1.6)	(1.6)	(1.6)
Trade and other payables	(5.0)	(3.9)	(4.9)	(5.1)
Derivative financial instruments	(0.5)	(0.5)	(0.5)	(0.5)
Deferred Income	(7.1)	(7.1)	(7.1)	(7.1)
Current liabilities	(14.3)	(13.2)	(14.2)	(14.3)
Net current liabilities	**(6.0)**	**(6.3)**	**(5.6)**	**(4.9)**
Loans and Borrowings	(6.4)	(5.0)	(3.5)	(2.0)
Pension and other employee obligations	(3.8)	(3.5)	(3.3)	(3.0)
Deferred Income	0.0	0.0	0.0	0.0
Deferred tax liabilities	(0.8)	(0.8)	(0.8)	(0.8)
Non current liabilities	(11.0)	(9.3)	(7.5)	(5.8)
Net Assets	**18.2**	**18.4**	**20.0**	**22.5**
Share Capital	4.3	4.4	4.4	4.4
Share Premium	4.2	4.2	4.2	4.2
Retained earnings	9.7	9.9	11.5	13.9
Shareholders Funds	**18.2**	**18.4**	**20.0**	**22.5**

Source: WH Ireland research / Company data

Balance Sheet

As is not uncommon with companies in the software sector the largest figure on Sanderson's balance sheet is its intangible assets at close to £32m. This is largely comprised of goodwill from acquisitions.

In August 2011 Sanderson announced that it had changed bankers from the Royal Bank of Scotland to HSBC, having agreed a having advanced a four year term loan of £7.4m together with a £1million working capital facility.

Sanderson's pension deficit will next be valued in H1 2012

Sanderson carries on its balance sheet a pension deficit of £3.8m relating to a defined benefit scheme which is now closed to future accrual. We are assuming an annual cash contribution to the scheme of £0.3m although much will depend on the next actuarial valuation due in the first half of the 2012 financial year.

Board of Directors

Christopher Winn, Executive Chairman

Educated at Queen Elizabeth School, Kirkby Lonsdale and Nottingham University, Winn worked for British Olivetti until 1974 when he joined the ACT Group - ACT Group became the second UK IT company to be listed on the London Stock Exchange in 1979. He served on the Group plc Board between 1983 and 1994, undertaking a number of senior roles and in 1995; he joined the former Sanderson Group, becoming Group Chief Executive later in that year. In 1999, he led a management buyout of the former Sanderson Group with the support and backing of Alchemy Partners. Following restructuring and the demerger of the original Group, the business which was focused primarily on UK commercial markets and which retained the Sanderson Group name, gained admission to the London Stock Exchange AIM market in December 2004.

Adrian Frost, Finance Director

A graduate of Sheffield University, Frost qualified as a Chartered Accountant whilst working for RSM Robson Rhodes. In 1996, he joined Hadley Industries plc as Group Financial Controller. Frost joined Sanderson in 2000, shortly after the management buyout, and worked closely with the Board in restructuring the former Group into three separate businesses Sanderson, Civica and Talgentra. He was appointed Finance Director of Talgentra following the formal demerger of the Group, and rejoined Sanderson Group plc in May 2005.

David Gutteridge, Non-Executive Director

David Gutteridge is the senior independent Non-Executive Director of Sanderson Group plc. He is the Chairman of Tinglobal Limited, an IT infrastructure and support solutions provider, and was, until recently, a Non-Executive Director at AIM listed Cyan Technology plc, a fabless semiconductor company developing configurable low power microcontrollers. He has also acted as an independent consultant involved in strategic business development and corporate transactions. He is a member of the Chartered Institute of Management Accountants. He was co-founder of Financial Objects plc in 1995 and, as Finance Director and then Chief Operating Officer, led several acquisitions and the full listing on the London Stock Exchange in 1998. Prior to this he held a number of senior financial and commercial roles at ACT Group plc, Seiko Epson Ltd and Logica plc.

Philip Kelly, Non-Executive Director

Philip Kelly is a Non-Executive Director of Radius Solutions (UK) Limited (formerly a wholly owned subsidiary of Radius plc, which was taken private with funding from the Alchemy Plan in 1998). He is also a Non-Executive Director of Coalition Holdings Limited, a provider of technical and desktop services. He has more than 20 years' experience as the Chief Executive of private and publicly quoted software companies supplying the commercial and public sectors in the UK, Europe and the USA. Kelly had previously worked for Digital Equipment and 3i Consultants. He was nominated for appointment to the Board by Alchemy Partners.

John Paterson, Non-Executive Director

John Paterson has extensive City experience as an investment analyst. He was Managing Director of Albert E Sharp Securities stockbrokers from 1993 until the acquisition of Albert E Sharp by Old Mutual in 1998, and he was instrumental in setting up Arden Partners in 2002 where he was a Director until November 2004.

Operating Board

David Mahoney, Managing Director Sanderson RBS
Mahoney has more than 20 years' experience in software and IT services, focused mainly on retail solutions. He joined RBS in 1997, having spent the previous 10 years with Dixons Stores Group (DSG). Early roles concentrated on improving professional services offerings and he was promoted to Operations Director in 2002, having previously held the roles of Development Director and Support Director. His focus during this phase was to define the managed service strategy, to refine the company's structure and to ensure that the organisation was optimised to meet customer expectations. Mahoney was appointed Managing Director in 2008 and continues to promote the managed service offering and reinforce our position as a top tier solution provider.

Ian Newcombe, Managing Director Multi-Channel Solutions
Newcombe has more than 30 years' experience in software and IT services. Beginning his career in electronics, he moved into the computer industry in 1979 when he joined ACT Group plc, where as a local board member, he helped establish an international IT support and software services business. In 1996, Newcombe joined Mitsubishi Electric of Japan at UK board level. As International Project Director, he was instrumental in the formation of an ISP (Internet Service Provider) and online financial services business, successfully launching a range of innovative products in the UK and Europe. In 1999, he was appointed Consulting Director of Talgentra Ltd, now an Experian plc company, where he developed a new consulting services business which rapidly expanded overseas. In 2005, Newcombe became Managing Director of what is now the enlarged multi-channel sales division of Sanderson.

Steve Watson, Deputy Chairman Sanderson Retail Division
After graduating from the University of Bristol with a degree in modern languages, Watson qualified as a chartered accountant with Price Waterhouse. He subsequently spent 10 years working for Swiss Bank Corporation in London, where he was an executive director in the bank's investment banking division, specialising in the field of cross-border mergers and acquisitions in the financial services industry. In 1992, he became one of the founder directors of what is now Sanderson RBS. During the 15 year period prior to the acquisition of this company by Sanderson Group plc, Steve held a number of senior roles at Sanderson RBS including Finance Director, Chief Operating Officer and Chief Executive. Watson was appointed Deputy Chairman of the retail division of Sanderson in October 2008.

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Analysis of the environment

Porter's five competitive forces model

Buyers
Bargaining power of buyers

Rating **3**

Should the macroeconomic environment deteriorate further, it is likely that Sanderson will show some price flexibility towards its customers. However in the long terms this will strengthen customer partnerships and loyalty.

Total
18

Suppliers
Bargaining power of suppliers

Rating **4**

Sanderson's largest supplier of IT solutions is Torex (Retail-J). However license fees thereof are less than 5% of revenues. The majority of sales are generated from the Group's own services & intellectual property.

Industry Competitors
Rivalry among existing firms

Rating **3**

Sanderson is a relatively small participant on a global basis, against the likes of SAP, Torex and Oracle. However it is well entrenched within its target markets and can arguably offer a more tailored service than its larger peers.

Substitutes
Threat of substitute products

Rating **4**

Once a business has chosen its ERP or Retail Management system, it can be extremely disruptive to change it as it is so integral to the fabric of an enterprise. This is demonstrated by Sanderson's growing base of recurring revenues.

Potential entrants
Threat of new entrants

Rating **4**

The business software market is already a relatively crowded space. Whilst the emergence of new entrants is possible, there are significant financial and technical barriers to becoming a successful competitor.

5 Low
4 Low/Medium
3 Medium
2 High/Medium
1 High

SWOT analysis

Strengths

- Improving competitive position as the business supplier of choice to the UK mid tier manufacturing and retail sector
- 54% recurring revenue base. 95% of revenues from existing customers.
- Strong cash generation. Our forecasts show gearing falling from 38% to 18% by 2013

Weaknesses

-The Group does not own all of its core IP. However it does have a number of its own solutions gained through acquisitions and in house development

-The Group has a pension deficit to fund of £3.8m. The next actuarial valuation is due in the first half of the 2012 financial year

Threats

- The macroeconomic outlook is the largest downside risk to our forecasts. However August's trading statement showed that Sanderson was continuing to show solid trading momentum.

Opportunities

- Sanderson has considerable exposure to the growth in multi channel retail and technological developments in both retail and manufacturing
- The partnership with Enactor could, in the medium to long term, enable Sanderson to grab a larger share of the Retail market

Disclosures

WH Ireland Recommendation Definitions

Buy
Expected to outperform the FTSE All Share by 15% or more over the next 12 months.

Outperform
Expected to outperform the FTSE All Share by 5/15% over the next 12 months.

Market Perform
Expected to perform in line with the FTSE All Share over the next 12 months.

Underperform
Expected to underperform the FTSE All Share by 5/15% or more over the next 12 months.

Sell
Expected to underperform the FTSE All Share by 15% or more over the next 12 months.

Speculative Buy
The stock has considerable level of upside but there is a higher than average degree of risk.

Share Price Target
The share price target is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon.

Stock Rating Distribution
As at the quarter ending 30 September 2011 the distribution of all our published recommendations is as follows:

Recommendation	Total Stocks	Percentage %	Corporate
Buy	53	85%	32
Speculative Buy	3	5%	3
Outperform	4	7%	2
Market Perform	2	3%	2
Underperform	0	0%	0
Sell	0	0%	0
Total	62	100%	39

This table demonstrates the distribution of WH Ireland recommendations. The first column illustrates the distribution in absolute terms with the second showing the percentages.

Conflicts of Interest Policy
This research is classified as being "non-independent" as defined by the FSA's Conduct of Business Rule 12.3. Please refer to www.wh-ireland.co.uk for a summary of our conflict of interest policy.

Analyst Certification
The research analyst or analysts attest that the views expressed in this research report accurately reflect his or her personal views about the subject security and issuer.

Companies Mentioned

Company Name	Recommendation	Price	Price Date/Time
K3 Business Technology Group PLC	NA	165.5p	27 Oct 2011/1545
Tikit Group PLC	NA	276.5p	27 Oct 2011/1545
Sage Group PLC/The	NA	286.4p	27 Oct 2011/1545
Workplace Systems International PLC	NA	15p	27 Oct 2011/1545
Misys PLC	NA	285.5p	27 Oct 2011/1545
Advanced Computer Software Group PLC	BUY	38.5p	27 Oct 2011/1545
JDAS	NA	$31.87	01 Nov 2011/1121
SAP	NA	€42.92	01 Nov 2011/1121
ORACLE	NA	$32.77	01 Nov 2011/1121

Share Price Date/Time

Company Name	Recommendation	Price	Price Date/Time
Sanderson Group	Buy	29p	02 Nov 2011/Close

Summary of Company Notes

Headline	Date
Trading statement & Initiation of coverage	03 Nov 2011

Summary of Security Recommendations

Recommendation	From	To	Analyst*
Buy	03 Nov 2011	Current	CA

**Current Analyst (CA), Previous Analyst (PA)*

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Sanderson Group

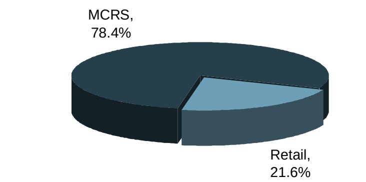
Sanderson Group ("Sanderson" or the "Group")is a software and IT services business specialising in the multi-channel retail and manufacturing markets in the UK and Ireland. The Group is the number one UK supplier, in terms of installations, of the leading retail enterprise management solution Retail-J as well as supplying its own bespoke proprietary software. The Group has a sales profile with over 50% of recurring revenues from license fees and service and maintenance contracts from its clients, for many of whom Sanderson's products are business critical.

Valuation	2010A	2011E	2012E	2013E
P/E (x)	**8.0**	**5.9**	**4.6**	**4.3**
EV/EBITDA (x)	**6.4**	**5.5**	**4.8**	**4.1**
EV/Sales (x)	0.8	0.7	0.7	0.6
Dividend Yield (%)	**2.1%**	**2.8%**	**3.4%**	**3.7%**
Dividend cover (x)	*6.0*	*6.1*	*6.3*	*6.3*
Dividend cash cover (x)	*4.2*	*(0.6)*	*1.3*	*2.0*
FCF Yield (%)	18%	10%	16%	20%
P/NAV (x)	0.7	0.7	0.6	0.6
PEG (x)	NA	0.2	0.2	0.7
P/E at target price (x)	12.2	9.0	7.0	6.6
EV/EBITDA at target price (x)	8.9	7.8	6.9	6.1

Major Shareholders	%
Christopher Winn	30.0
Axa Framlington	9.2
ISIS	6.9
Hargreave Hale	6.5
Chelverton Asset Management	6.3
Unicorn Asset Management	3.6
Polar Capital Partners	2.9

Returns Profile	2010A	2011E	2012E	2013E
ROCE (%)	10.2%	11.7%	13.2%	13.9%
WACC (%)	8.8%	8.8%	8.8%	8.8%
Spread (%)	1.5%	3.0%	4.4%	5.2%
CROCE (%)	7.6%	4.4%	7.5%	8.9%
ROE (%)	9.2%	12.6%	14.9%	14.0%

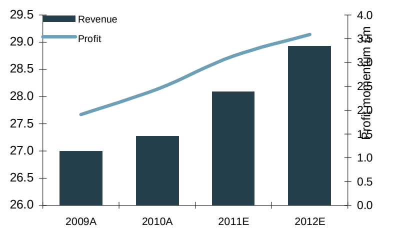
Revenue Segmental (FY11E)



Profit & Loss (£000S)	2010A	2011E	2012E	2013E
Turnover	27.0	27.3	28.1	28.9
WHI EBITDA	3.4	3.6	3.9	4.2
WHI operating profit	**3.1**	**3.3**	**3.6**	**3.9**
Net interest	(1.2)	(0.9)	(0.5)	(0.3)
PTP adjusted	**1.9**	**2.4**	**3.1**	**3.6**
Taxation	(0.2)	(0.1)	(0.2)	(0.4)
PAT adjusted	1.7	2.3	3.0	3.2
PAT reported	0.3	0.6	2.1	2.9
WHI EPS (p)	**3.6**	**4.9**	**6.3**	**6.7**
Dividend (p)	**0.6**	**0.8**	**1.0**	**1.1**

Turnover & Profit momentum

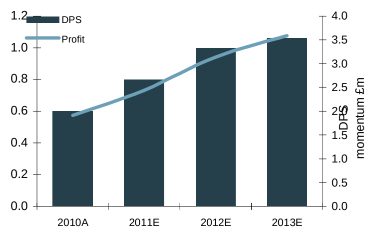
Revenue momentum £m



Performance Ratios	2010A	2011E	2012E	2013E
Sales growth (%)	8.4%	1.0%	3.0%	3.0%
EBITDA growth (%)	12%	7.4%	8.2%	6.5%
PTP growth (%)	79%	28%	29%	14%
EPS Growth (%)	-15%	36%	29%	6%
Dividend Growth (%)	*33%*	33%	25%	6%
Dividend Cover (x)	*6.0*	*6.1*	*6.3*	*6.3*
Interest Cover (x)	2.6	3.7	7.3	13.0
EBITDA Margin (%)	12%	13%	14%	14%
Operating Margin (%)	**11%**	**12%**	**13%**	**13%**
PTP Margin (%)	7.1	9.0	11.2	12.4

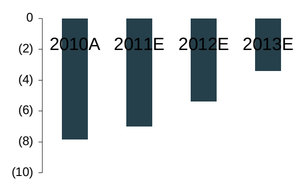
EPS & DPS momentum

EPS Momentum (p)



Summary Cashflow (£000s)	2010A	2011E	2012E	2013E
Operating CF pre working cap	3.4	3.2	3.9	4.2
Working capital	0.3	(0.3)	(0.5)	(0.2)
Employee benefit plan	(0.3)	(0.3)	(0.3)	(0.3)
Net finance charges	(1.2)	(0.9)	(0.5)	(0.3)
Income tax	0.5	(0.1)	(0.2)	(0.4)
Net cash from operations	**2.7**	**1.6**	**2.5**	**3.0**
Net capex	(0.4)	(0.4)	(0.4)	(0.5)
Operating FCF	**2.3**	**1.2**	**2.1**	**2.5**
Net cash used in financing activities	**(1.7)**	**(1.8)**	**(1.9)**	**(2.0)**
Net Cash Flow	**0.6**	**(0.6)**	**0.1**	**0.5**
Movement in net (debt)/cash	**2.1**	**0.9**	**1.6**	**2.0**
Closing net (debt)/cash	**(7.8)**	**(7.0)**	**(5.4)**	**(3.4)**
Free Cash Flow	**2.3**	**1.2**	**2.1**	**2.5**

Net Cash/Debt (£m)



Summary Balance Sheet (£000s)	2010A	2011E	2012E	2013E
Total Non-Current Assets	35.1	34.0	33.2	33.2
Current Assets	8.3	6.9	8.5	9.4
Liabilities	(25.2)	(22.4)	(21.7)	(20.1)
Net Assets (£m)	**18.2**	**18.4**	**20.0**	**22.5**
Gearing (%)	43%	38%	27%	15%
NAV (p)	38.6	39.0	42.5	47.7