SMALL CAP SHARE COMMENT
Commissioned Commentary

SANDERSON GROUP

(AIM:SND)
Share price 47p

Date: **5th June 2013**
Sector: Software & Computer Services
Market Cap: c£21m
www.sanderson.com

Interim results present further improvement in operating margins

The software and IT services business specialising in the multi-channel retail and manufacturing markets in the UK and Ireland issued positive interim results for the 6 months ending 31st March 2013 with earnings boosted by improving operating margins.

- Financials summary

Revenues from continuing operations were £6.37m (2012: £6.14m), operating profit from continuing operations £0.91m (2012: £0.80m) and basic earnings per share from continuing operations 1.8p (2012: 0.4p).

Cash generation was strong with operating cash inflow of £0.90m boosting period end cash to £4.50m (2012: £3.56m) and supporting a 30% increase in the interim dividend to 0.65p per share (2012: 0.5p).

Gross margins improved further to 87.9% (2012: 84.3%) reflecting delivery of more of the Group's proprietary software and other 'owned' services.

Pre-contracted recurring revenues from continuing operations grew to £3.96m (2012: £3.80m) accounting for approximately 62% of total revenues.

It's worth noting the continued transition to more 'owned' software and services which is reflected in the improved gross margins from 81.4% back in 2011 to the current level.

The balance sheet remains in decent shape with that growing cash balance despite the ongoing investment in new product development and sales.

The order book at period end was of £1.59m.

- Order slippage covered by margin improvement

Management commented that while pre-sales and support activities are high in the first quarter of the year, customer decisions confirming the adoption of new systems are more likely to be made between February and September, giving the Group's results a level of seasonality.

While new customer wins were down on the prior year (3 at an average of £61k vs 9 at an average of £76k) the improved margin made up the difference, which could be a likely scenario for the year as a whole. Since the period end the Group has gained a further four new customers at an average initial contract value of over £200k.

- Investment of past supports sales growth

Over the last three years, new products and services introduced include Factory & Warehouse automation, Green IT solutions, as well as SaaS ('Software as a Service') and Cloud delivery models. Solutions using mobile technologies, both in response to, as well as in anticipation of customer demand, continue to provide an area of high interest and high development activity. These new product developments have accounted for over £4m of new sales over the last five years and the latest solutions which are enabled by mobile technologies are currently accounting for around 10% of total sales orders.

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Despite the generally gloomy economic backdrop Sanderson has continued to invest in the sales channel with a further £0.25m investment in sales and marketing capability in the period the reward for which will be realised over the coming months and years. This investment has been facilitated by cost savings in the management, finance and administrative functions since 2009.

- Divisional review

Multi-channel retail
Provision of comprehensive IT solutions to businesses operating in the areas of online sales, ecommerce, mail order and catalogue sales, wholesale distribution, cash and carry businesses and retail shops.

Divisional revenue: £3.40m (2012: £3.20m)
Operating profit: £614k (2012: £508k)
Period end order book: £822k (2012: £1.27m)

Management commented that traditional mail order markets are quite slow but there are better levels of business activity in the wholesale cash and carry, catalogue, online sales and ecommerce markets.

Two new customers were gained during the period compared with six in the comparative period of 2012. Both new customers operate in the online sales and ecommerce area of business. Projects during the period included a store portal for a large jewellery chain, as well as enhancements to ecommerce systems for companies such as Aspinal of London, JoJo Maman Bébé, Joe Browns, Axminster Tool Centre and Topgrade Sportswear.

Manufacturing
Provision of ERP solutions for businesses in the engineering, plastics, aerospace, electronics, print and food and drink manufacturing sectors

Divisional revenue: £2.97m (2012: £2.95m)
Operating profit: £296k (2012: £293k)
Period end order book: £761k (2012: £784k)

Divisional recurring revenue represents 64% (2012: 62%) of total divisional revenues and covers 82% of divisional overheads.

Over the past two years, the Group has invested an additional £500k in accelerated product development and in its sales and marketing capability addressing the UK food and drink market where traceability of products and ingredients back through the supply chain, is a strong feature of its food and drink solution – a key requirement for the food and drink industry. The Group has a number of well advanced sales prospects and continues to be active in this sector.

Management commented that the general manufacturing market has continued to be quite slow with one new customer gained in the period (2012: three new customers). Large projects delivered during the period included Brookfarm, a manufacturer of macadamia nut products, Anstey Wallpaper Company, Tunnock's biscuits and Proctor Paper & Board.

- The future remains online

As has been the case previously particular emphasis and focus will continue to be made in further developing the range and scope of solutions for online sales and ecommerce businesses as well as the development of mobile solutions across all of the Group's target markets.

- Confident of achieving market expectations

Management comment offered the usual degree of caution and the "continuing challenging trading conditions within the UK" but, despite the lower revenue, "a good level of confidence of achieving market expectations" for year to 30 September 2013".

They are currently considering a number of small acquisition opportunities but, in light of current market conditions, are adopting a very cautious approach and intent on maintaining a strong balance sheet.

The medium term objective (3-5 years) remains to grow annual revenue to £20m and annual profit to £3m-£4m supported by growth in online sales and ecommerce.

- Broker forecasts

Estimates for the full year ending September 2013 are for sales of £14m, normalised profit before tax of £2.1m, normalised earnings per share of 3.9p and a full year dividend of 1.50p, equating to a yield of 2.9% at the current share price (50p). For the year ending September 2014 estimates are for sales of £15.1m, normalised pre-tax profit of £2.4m and normalised earnings per share of 4.11p.

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63-81 High Street.
Rickmansworth, Herts WD3 4DZ
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