Sanderson Group

Update
5th June 2013

Improved Performance

Sanderson Group has announced interim results which show further improvements in revenues and operating profits. While we have amended our forecasts slightly to reflect challenging trading conditions, we continue to be impressed by the high level of recurring revenues - which cover two-thirds of business overheads - a strong and growing range of products and services, a growing presence in the catalogue, online sales and ecommerce markets, a strengthened balance sheet and strong cash generation. Accordingly, we retain our buy stance, with a target price of 66p.

Interims

For the 6-months ended 31st March 2013, gross profits increased to £5.6m (H1 FY12: 5.18m), reflecting higher revenues of £6.37m (H1 FY12: £6.14m) and an improved margin of 87.9% (H1 FY12: 84.3%) as the group placed an emphasis on more buoyant sectors, as well as the sale of its higher margin proprietary software and services. The balance sheet and cash-flow remained strong, with no debt, cash of £4.5m (H1 FY12: £3.56m) and 100% profit-to-cash conversion. The resilient operational performance, combined with a strong balance sheet with readily available cash resources, has allowed Sanderson Group to increase its interim DPS to 0.65p (H1 FY12: 0.50p), which is well covered by basic EPS of 1.8p (H1 FY12: 0.4p).

Business Review

Traditional mail order markets were quite slow in the period, but there were better levels of business activity in the wholesale cash and carry, catalogue, online sales and ecommerce markets. While the general manufacturing market continued to be a bit sluggish, the group has a number of well advanced sales prospects and continues to be active this sector, with a large order being signed since year-end.

Financial forecasts

We have lowered our revenues forecast slightly for FY13 to £13.8m (previously £14m) to reflect the challenging economic conditions, but anticipate a larger amount of higher margined products to be sold. We expect the group to continue its investment in product innovation, as well as sales & marketing, and have kept our PBT forecast unchanged at £2m. For FY14, we have reduced our revenue forecast to £14.6m (previously £15.1m), and have reduced our PBT forecast to £2.3m (previously £2.4m).

Valuation

Given the strong progress made, we consider a rating of 13 times forward earnings + net cash as justifiable for setting our target price of 66p (previously 68p). The prospective yield of 3.4% is also attractive.

Table: Financial overview

Year to 30th Sep.	2011A	2012A	2013E	2014E
Revenue* (£m)	14.1	13.4	13.8	14.6
PBT (£m)	0.4	1.5	2.0	2.3
EPS* (p)	1.1	3.0	4.09	4.34
Dividend (p)	0.75	1.20	1.50	1.60
Yield (%)	1.60%	2.55%	3.19%	3.40%

Source: GECR and company.
*Notes: *Continuing operations*

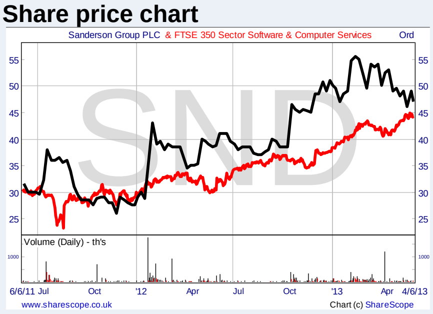
Buy

Target price 66p

Key data

Share price	47.00p
52 week high/low	56.50p/36.50p
Primary exchange	AIM
EPIC	SND
Shares in issue	43.8 m
Market Cap	£20.59 m
Sector	Software & Computer Services

Share price chart



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Interims

Sanderson Group has announced interim results which show further improvements in revenues and operating profits. For the 6-months ended 31st March 2013, gross profit increased to £5.6m (H1 FY12: 5.18m), reflecting higher revenues of £6.37m (H1 FY12: £6.14m) and an improved margin of 87.9% (H1 FY12: 84.3%) as the group placed an emphasis on more buoyant sectors as well as the sale of its higher margin proprietary software and services. Pre-contracted recurring revenue continued to grow and now stands at £3.96m (H1 FY12: £3.80m), representing 62% of total revenues. While the order intake has been slower than a year earlier, the order book remains good at £1.59m (H1 FY12: £1.95m) and sales prospects continue to be healthy. The group maintained its investment in product innovation, in addition in sales and marketing, leading to an operating profit of £910k (H1 FY12: £801k).

The balance sheet and cash-flow remained strong, with no debt, cash of £4.5m (H1 FY12: £3.56m) and 100% profit-to-cash conversion. The resilient operational performance, combined with the strong balance sheet and readily available cash resources, has allowed Sanderson Group to increase its interim DPS to 0.65p (H1 FY12: 0.50p), which is well covered by basic EPS of 1.8p (H1 FY12: 0.4p).

Traditional mail order markets were quite slow, but there were better levels of business activity in the wholesale cash and carry, catalogue, online sales and ecommerce markets. Divisional revenue increased to £3.40m (H1 FY12: £3.20m), operating profit increased to £614k (H1 FY12: £508k) and the order book remained healthy at £822k (H1 FY12: £1.27m).

While the general manufacturing market continued to be a bit sluggish, the group has a number of well advanced sales prospects and continues to be active this sector, with a large order being signed since year-end. Divisional revenues increased to £2.97m (H1 FY12: £2.95m), operating profit increased to £296k (H1 FY12: £293k) and the order book was strong at £761k (H1 FY12: £784k). Recurring revenue accounted for 64% (H1 FY12: 62%) of total revenue and covered 82% of divisional overheads.

Forecasts

Since year end, the group has won a further 4 new customers at an average initial contract value of >£200k. Looking forward, we expect to see an increase in activity from both divisions leading up to the typically busy Christmas period. We have, however, lowered our revenues forecast slightly for FY13 to £13.8m (previously £14m) to reflect the challenging economic conditions, but have maintained our gross profit forecast of £11.59m, with a larger amount of higher margined products expected to be sold. With new product development accounting for over £4m of new sales over the last 5 years, we expect the group to continue its investment in product innovation, as well as sales & marketing, and have kept our PBT forecast unchanged at £2m. We have also kept our DPS forecast unchanged at 1.50p.

For FY14, we have reduced our revenue forecast to £14.6m (previously £15.1m), but, as mentioned above, we expect a larger proportion of higher margined products to be sold, and are therefore forecasting a gross profit of £12.7m. With further product innovation and sales & marketing investments anticipated, we are forecasting a PBT figure of £2.3m (previously £2.4m). We have kept our DPS forecast unchanged at 1.6p.

We believe online sales and e-commerce offer significant growth opportunities and expect a relatively small acquisition to be made shortly, perhaps within the next month, in this area. With the latest mobile enabled technologies accounting for c.10% of total sales orders, and strong demand being shown by customers, we also believe this could be an area of significant growth and believe an acquisition within this area could be on the cards at a later date.

Valuation

We continue to be impressed by the high level of recurring revenues, which cover two-thirds of business overheads. A strong and growing range of products and services, a growing presence in the catalogue, online sales and ecommerce markets, the strengthened balance sheet and strong cash generation augur well for Sanderson. Accordingly, and given the strong progress made, we consider a rating of 13x forward earnings + net cash as justifiable for setting our target price of 66p (previously 68p). The prospective yield of 3.4% is also attractive.

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