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Sanderson Group (SND) AIM

INVESTMENT SUMMARY

- Today's interim results covering the six months to 31 March have revealed a slight increase in revenues to £6.37m on continuing operations (2012: £6.14m). On the same basis, pre-tax profit more than doubled to £0.85m (2012: £0.41m) with earnings per share increasing to 1.8p (2012: 0.4p).
- The group continued to enjoy strong cash generation and, at the end of the period, it had net cash balances of £4.50m, up from £4.1m at 30 September. This equates to just over 10p per share.
- The interim dividend has been increased by 30% to 0.65p per share (2012: 0.50p) and, with the full year dividend likely to rise to 1.5p, that would put the shares on a prospective dividend yield of 3.2%.
- The second half of the financial year has started well with new orders being won to add to the order book which stood at £1.59m at the end of the period. The second half should also benefit from additional investment in sales and marketing.
- Although the Board is very mindful of the low levels of business confidence and continued challenging trading conditions, the strong balance sheet and sound business model provide confidence that this year's market expectations can be achieved with further progress likely next year too.
- We have raised our share price target on the shares to 60p, representing about 12x current year earnings per share plus the 10p per share net cash.

Results and Consensus Forecasts

Year to 30th September	Revenue (£m)	Pre-Tax Profit* (£m)	Earnings per share*(p)	P/E Ratio	Net Dividend (p)	Net Yield (%)
2011A	14.1	0.4	1.1	42.7	0.75	1.6
2012A	13.4	1.5	3.0	15.7	1.20	2.6
2013E	14.0	2.1	4.1	11.5	1.50	3.2
2014E	15.0	2.4	4.3	10.9	1.75	3.7

* from continuing operations with 2011 numbers restated to account for sale of Sanderson RBS

KEY DATA

Share Price:	**47p**
Prospective p/e ratio:	**11.5x**
Prospective net yield:	**3.2%**
Market Capitalisation:	**£20.6m**
Next Results Due (Finals):	**NOV**
Net Cash (at 31 March):	**£4.50m**
NAV per share:	**47.1p**

BULLET POINTS

- Good interim results in challenging markets
- Strong cash flow has led to very strong balance sheet with net cash of £4.5m
- Business focussed on higher margin proprietary products
- Potential for growth both organically and through acquisition
- Second half has started well
- The shares still stand on only a modest rating and we have a share price target of 60p
- Increased dividend gives an attractive prospective yield.

Date of Report : 5 June 2013

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Interim Results

Revenue was up 3.7% . . . .

In the six months to 31 March, group revenue on continuing operations rose by 3.7% to £6.37m (2012: £6.14m) whilst the delivery of more proprietary software and other 'owned' services meant that gross margins increased further to 87.9% (2012: 84.3%). This allowed operating profit on continuing operations to increase by over 13% to £0.91m (2012: £0.80m). A significant fall in finance costs meant that at the pre-tax level, profits on continuing operations more than doubled to £0.85m (2012: £0.41m) with a lower tax charge also meaning that earnings per share rose sharply to 1.8p (2012: 0.4p). As a sign of confidence in the future, the interim dividend was raised by 30% to 0.65p (2012: 0.50p). These are impressive results given the difficult trading conditions which saw some slippage of sales orders into the second half of the year.

. . . . .although improved margins and lower finance costs saw profits and earnings per share jump sharply

The multi-channel retail division increased revenue during the period to £3.40m (2012: £3.20m) with two new customers being gained compared with six in the comparable period the year before. Although traditional mail order markets were slow, other areas of retail including wholesale cash and carry, catalogue, online sales and ecommerce markets saw better levels of activity. The two new customers gained during the period operate in the online sales and ecommerce area of business. 60% of revenues at the division are recurring and they cover 79% of the divisions overheads. Operating profit at the division rose by over 20% to £614k (2012: £508k) and the period end order book was strong at £822k (2012: £1.27m).

20% increase in operating profit from multi-channel retail

The manufacturing division maintained its revenue and operating profit at similar levels to the previous year at £2.97m (2012: £2.95m) and £296k (2012: £293k) respectively. Recurring revenues at the division represent 64% of total revenue (2012: 62%) and these cover 82% of divisional overheads, thus providing significant re-assurance that the division will remain profitable. The order book at the division remains strong at £761k (2012: £784k) and, over the last two years, the group has invested an additional £500k in product development and the sales and marketing capability for the business which addresses the UK food and drink market. Traceability of products and ingredients is becoming ever more important following recent food scares and this is a strong feature of the Sanderson food and drink proposition. The division gained one new customer during the period (2012: three new customers).

£500k invested in the last two years in accelerated product development and sales and marketing capability

Cash generation continued to be strong and net cash balances at 31 March were £4.50m, up from £4.07m last September and £3.56m at 31 March 2012.

Net cash of £4.50m at period end

The order book at 31 March was £1.59m, which is less than the £1.95m of last year with most of the shortfall being in the multi-channel retail division. The order book here is down to £822k (2012: £1.27m) although last year's figure was challenging for the group as it is put under pressure to fulfil orders on time. In the manufacturing division, the order book was £761k at the period end (2012: £784k). However, since the year end, the pace of orders has picked up with four new customers being acquired at an average contract value of over £200k.

Strong order book leaves the Group well positioned for the current year

Activities

Sanderson is a supplier of innovative software solutions and IT services, specialising in the multi-channel retail and manufacturing markets, in the UK and Ireland. The group delivers solutions to numerous organisations with turnovers typically between £5m and £250m. Its 400 customers include many household names, such as Hotel Chocolat, Associated British Foods, Beaverbrooks and Scotts of Stow.

The group's solutions now primarily consist of Sanderson proprietary owned software, integrated with other market-leading products being delivered, supported and serviced by Sanderson staff. One advantage of supplying proprietary products is that the company can achieve strong profit margins as it can dictate the price at which products are sold.

Sanderson focuses on supplying customers with market led value for money solutions, which provide tangible benefits. The latest versions of group software also address regulatory and legislative compliance, for example, traceability in food manufacturing. The group continues to invest in product innovation and, over the last three years, new products and services which have been introduced include Factory & Warehouse automation, Green IT solutions, as well as SaaS ('Software as a Service') and Cloud delivery models. Solutions using mobile technologies continue to provide an area of high interest and high development activity. Over the last five years, new product developments have generated over £4m of new sales and the latest solutions which are enabled by mobile technologies currently account for 10% of total sales orders.

The group has expertise in Enterprise Resource Planning (ERP), which integrates internal and external management information across an entire organisation, embracing finance, manufacturing, sales and service. This facilitates the flow of information between all business functions inside the boundaries of the organisation and manages the external connections. These solutions help organisations to manage their operations and be more productive, competitive and profitable.

The group employs around 150 employees with over 70% of these employed on the technical side.

Multi-channel Retail

This division accounted for 53% of revenues and 67% of operating profit in the six months to 31 March. As a supplier of software to retail, mail order catalogues, fulfilment, wholesale, cash and carry and online businesses, Sanderson understands the dynamics of multi–channel sales. The group provides a comprehensive range of IT solutions to meet the needs of organisations operating in this sector and its systems offer the flexibility to grow as business requirements change. As well as that, the group's latest products include 'business assurance' which is a range of services designed to protect businesses from system failures and 'Green IT' solutions which deliver energy saving efficiencies to customers.

There are over 200 customers in this division and these include Beaverbrooks, Toni&Guy, Hotel Chocolat, Machine Mart and Thorntons. Mobile commerce is growing rapidly

We expect this division to be a focus point for future investment either through small bolt-on acquisitions or through internal development as there are increasing opportunities for multi-faceted retailers including platforms such as mobile phones and tablet mediums.

Manufacturing

This division accounted for 47% of revenue and 33% of operating profit in the six months to 31 March. Sanderson has expertise in delivering proven software and long term value across a wide range of sectors and types of manufacturing. These include Food, Aerospace, Engineering, Electronics, Plastics and Print, with customers including Nairns, Protex and Bromford Industries. The business systems are designed specifically for the markets they address, improving efficiency in manufacturing and bringing cost saving benefits to customers.

Prospects

Sanderson has demonstrated its resilience in difficult trading conditions

Despite the difficult trading conditions that have been experienced in the last two years or so, Sanderson has demonstrated its resilience by steadily increasing its revenues, profits, earnings per share and dividend. Last year's disposal of the Sanderson RBS business, which supplied high street retailers, has allowed the group to focus on higher margin growth markets such as ecommerce and mobile. It also transformed the balance sheet, releasing significant net funds.

Strengthened balance sheet

The strength of the balance sheet is a key strength of the company, with net funds of £4.5m providing funds for future expansion both organically and by acquisition if suitable opportunities are identified. However, the directors are aware of the fragility of business confidence and so continue to adopt a very cautious stance which includes maintaining a strong balance sheet.

The second half has started well . . . .

After the good first half, the group has started the second half well winning new orders and gaining new customers. If the group is to reach its target of £14.0m of revenues this year, it will have to generate £7.6m in the second half following the £6.4m achieved in the first half. Of that, recurring revenues will account for £3.9m, the existing order book will generate another £1.6m leaving a shortfall of £2.1m although the company is confident that with an improving order book this target will be met.

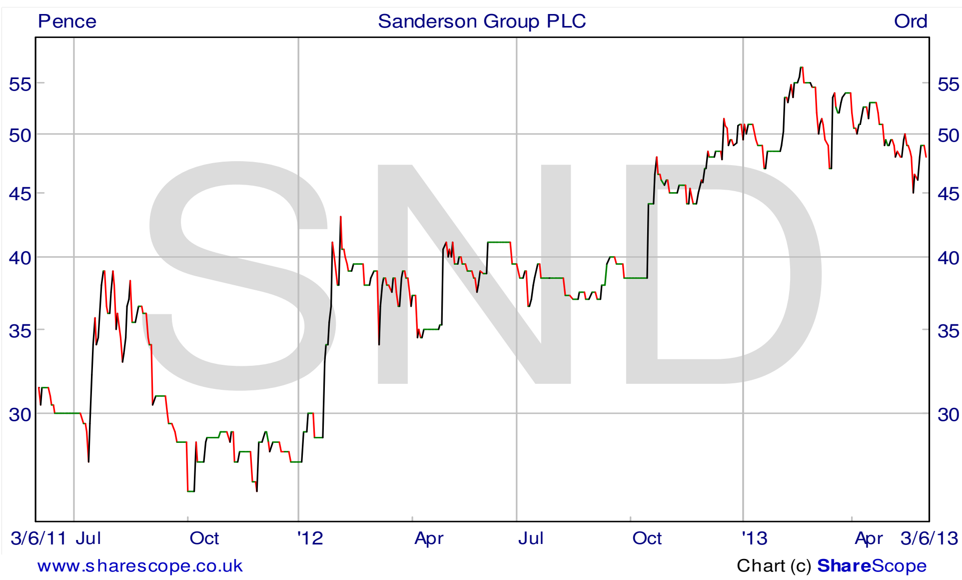
. . . . . and further ahead the group should benefit from increased demand in ecommerce and mobile

Looking further ahead, the group has a medium term target to increase annual revenue to £20m with annual pre-tax profits of between £3m - £4m. Online sales and ecommerce are expected to grow rapidly as is the use of mobile devices and Sanderson is actively developing products for these markets.

Valuation

The shares are off the high for the year of 57p and it must not be forgotten that net cash accounts for over 10p per share of the current share price. Stripping this out, the current share price looks too low, and assuming 12x earnings for the current year would give a share price of 49.2p. Adding the 10.3p of cash per share to this provides a share price target of around 60p and this provides scope for the shares to be re-rated. This is likely as profit forecasts are likely to be raised going forwards as the group introduces more products.

Share Price Graph



Profit and Loss Year End 30 Sept	2011* (£m)	2012 (£m)	2013(E) (£m)	2014(E) (£m)
Revenue				
Manufacturing	6.2	6.2	6.3	6.5
Multi-channel retail	7.9	7.2	7.7	8.5
Total	**14.1**	**13.4**	**14.0**	**15.0**
Operating Profit				
Manufacturing	0.8	0.8	0.9	1.0
Multi-channel retail	0.9	1.1	1.2	1.4
Total	**1.7**	**1.9**	**2.1**	**2.4**
Movement in fair value of derivatives	0.1	0.0	0.0	0.0
Net finance costs	(1.0)	(0.2)	0.0	0.0
Exceptional finance charge	(0.4)	(0.2)	0.0	0.0
Profit before Tax	**0.4**	**1.5**	**2.1**	**2.4**
Tax	0.1	(0.2)	(0.3)	(0.6)
Profit after Tax	**0.5**	**1.3**	**1.8**	**1.9**
Av number of shares	43.38	43.51	43.67	43.68
EPS (p)	**1.1**	**3.0**	**4.1**	**4.3**
DPS (p)	**0.75**	**1.20**	**1.50**	**1.75**

Cash flow Year end 30 Sept	2011* £'000	2012 £'000
Profit for the period	804	2,406
Adjustments	1,210	(184)
Operating cash flow	**2,014**	**2,222**
Discontinued operations	1,116	(356)
Changes in working capital/provisions	(75)	(521)
	3,055	**1,345**
Interest paid	(591)	(703)
Income tax received	466	377
Net cash flow from operating activities	**2,930**	**1,019**
Purchase/Disposal of assets	(392)	10,381
Investing cash flow - discontinued operations	(424)	(140)
Financing activities	(1,743)	(7,813)
Net Increase in cash and cash equivalents	**371**	**3,447**
Cash and cash equivalents at start of year	**248**	**619**
Cash and cash equivalents at end of year	**619**	**4,066**

*** - restated**

Ratios	2011	2012	2013(E)	2014(E)
Sales Growth (%)	**-48.1**	**-4.9**	**4.5**	**7.1**
Operating Margin (%)	**12.2**	**14.3**	**15.0**	**16.6**
EPS Growth (%)	**-71.7**	**173**	**36.7**	**4.9**
DPS Growth (%)	**33.3**	**60.0**	**25.0**	**16.6**
Dividend Cover (x)	**1.5**	**2.5**	**2.7**	**2.5**

Balance sheet Year End 30 Sept	2011 £'000	2012 £'000
Intangible assets	32,066	22,404
Other non-current assets	2,360	1,939
Total	**34,426**	**24,343**
Current assets	7,905	7,800
Current liabilities	(13,063)	(7,480)
	29,268	**24,663**
Non-current liabilities	(10,793)	(4,633)
Net Assets	**18,475**	**20,030**
Share Capital	4,338	4,352
Share Premium	4,178	4,205
Retained earnings	9,959	11,473
Shareholders funds	**18,475**	**20,030**

Ratios	2011	2012
NAV per share (p)	**42.6**	**46.0**
Gearing (%)	**36.4**	**n/a**

GENERAL INFORMATION

COMPANY DATA

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FINANCIAL CALENDAR

Interim Dividend Payment Date:	17 August 2013
Next Year End:	30 September 2013
Final Results Announcement:	27 November 2013
Expected AGM Date:	10 March 2014
Final Dividend Payment Date:	31 March 2014
Interim Results Period End:	31 March 2014
Interim Results Due:	14 May 2014

Significant Shareholders

Ordinary shares of 10p each	Number	%
C Winn	12,745,000	29.30
Hargreave Hale Ltd	4,936,753	11.27
ISIS Equity Partners	3,000,075	6.85
AXA Framlington Asset Management	2,900,000	6.62
Chelverton Asset Management	2,250,000	5.14
Unicorn Asset Management Ltd	1,540,200	3.52
Miton Capital Partners	1,531,393	3.50

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