WHIreland Est 1872

05 June 2013

UK EQUITY RESEARCH

SOFTWARE & COMPUTER SERVICES

Buy

Price	**48p**
Target Price	57p

Reuters/BBG	SND.L / SND LN
Index	FTSE AIM
Sector	Software & Computer Services
Market Cap	£21.0m
Shares in Issue	43.8m
Pension Deficit	£4.3m
Gearing	Net Cash
Dividend cover	2.7x

Performance	**FTSE AIM**	**Sector**
1 month:	-5.1%	-6.4%
3 months:	-3.1%	-9.1%
12 months:	16.7%	5.0%
High/Low		58p/33p

Key Data:

EPS CAGR 3-year	2011-2014	21.5%
WHI Operating Margin		15.1%
Free Cashflow Yield		7.1%

Last Results	Interims – June
Next Results	Finals - Nov
Next Event	Pre close - Oct

Source: Capital IQ

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~WH Ireland provides paid for research services to Sanderson Group

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~

Interim Results – Modest revenue growth and improving margins

Sanderson Group, the software and IT services business specialising in multi-channel retail and manufacturing markets in the UK and Ireland, has today announced interim results for the 6 month to March 2013 in line with the guidance given in the 30th April trading update. Against a backdrop of 'challenging' conditions, Sanderson grew revenues 4% to £6.4m and adjusted PBT by 35% to £0.85m driven by strong gross margin improvement. We are now assuming a similar level of growth in H2 although this is partly offset by margin improvements. Our adjusted PBT forecast has been moved to £2.0m from £2.2m. The second half has begun with 4 client wins. Sanderson continues to trade at a discount to the sector. Given its cash generative nature, high level of recurring revenues, and superior dividend yield, we find this unwarranted and re-iterate our BUY recommendation and 57p target price. Further upside could arise from acquisitions or corporate activity where we have seen a number of software companies being acquired on multiples in the high teens. Sanderson trades on a PE of 12x and yields 3.1%.

In terms of cash generation the results were strong with cash generated by operations up 58% to £1.2m, a 105% conversion. Net cash increased by £0.9m to £4.5m, up 26% from the same date in 2012.

Whilst activity in terms with existing customers was strong, with projects carried out for the likes of Aspinal of London and Tunnocks Biscuits, the three new clients wins in the period represented a slower conversion rate against the nine acquired in H1 2012. Encouragingly, activity levels have improved since the period end with four customer wins with average initial contract values of over £200k, a good strike rate for the last two months. Our amended forecasts now look for 4% revenue growth over FY 2012, accelerating to 6.4% in 2014, which we believe is achievable given the improving product portfolio in areas such as mCommerce which grew at 162% in the period. We are forecasting adjusted EPS growth of 5.5% in 2013 and 8.6% in 2014 to 4.3p.

The FTSE 350 Software and Computer Services Sector is trading on a 19x 2013 PE rating, falling to 16.8x in 2014. We therefore remain entirely comfortable maintaining our 57p target price which equates to 13.2x 2014 EPS. Should the Group's medium term growth strategy be executed smoothly we see scope to raise our fundamental valuation as high as £1 per share, or more in the event of a corporate bid. We maintain our BUY rating.

y/e Sep (£m)	2011A*	2012A*	2013E*	2014E*
Turnover	14.1	13.4	14.0	14.9
WHI Ebitda	2.0	2.2	2.2	2.3
WHI PTP#	1.0	1.9	2.0	2.2
WHI diluted EPS (p)#	2.4	3.8	4.0	4.3
P/E (x)	20.3	12.7	12.0	11.0
EV/EBITDA (x)	16.0	9.8	9.4	8.2
Dividend (p)	0.8	1.2	1.5	1.6
Yield (%)	1.7%	2.5%	3.1%	3.3%
Net funds.(debt)	(6.7)	4.0	5.0	6.2

**from continuing operations only*

#adjusted for exceptional items, share based payments and amortisation

Investment Case

eCommerce stands to continue double digit growth for years to come

Since the balance sheet transforming sale of 'Sanderson RBS' in January 2012, the group has shown continuing growth in profitability. The multi-channel retail business continues to enjoy structural growth through its proprietary solution, Elucid, which is benefitting from the growth in eCommerce. Elucid provides an all in one package allowing retailers to seamlessly operate through any combination of online, in-store, mail order and wholesale sales channels, increasing visibility and control. Forrester research, for example, continues to forecast 10% compound annual growth in UK online retail sales through to 2017 so, even as the market matures, growth is still impressive. Mobile commerce is becoming an increasingly important part of the mix and is an area where Sanderson has increased its developmental focus. Mobile solutions showed 162% sales growth in H1, representing 10% of order intake.

Sanderson can cover its development needs from internal cash flow and resources

Sanderson's manufacturing solutions focus on a number of sectors but we highlight the £500k invested over the last two years for the Sanderson business which addresses the UK food and drink market. Traceability of products and ingredients back through the supply chain, is a strong feature of the Sanderson 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.

Gross margin progression to 88% is highly encouraging as are recurring revenues of 62%

The gross margin progression has been highly encouraging as Sanderson increases the proportion of proprietary products within its sales mix. A gross margin of 88% at today's interims represents an improvement of 800 basis points over the last two years. Sanderson's high recurring revenue levels (some 60%) continue to provide excellent a solid foundation in terms of earnings visibility. Combined with an order book of £1.59m we now have 85% visibility of our second half forecast.

After a relatively slow level of new client wins in H1, conversion has improved into H2

In the early months of H2, new client wins have accelerated with a further four new customers at an average initial contract value of over £200k. Sanderson generates free cash flow in excess of £1.5m per annum in excess its current cash pile of £4.5m which gives it the flexibility to increase dividends, service the moderate pension deficit (£4.3m) or make acquisitions. Sanderson states that selective acquisition opportunities will also be made to augment organic growth and a number of small opportunities are being considered. We do not currently assume any acquisitions in our forecasts.

Valuation

Acquisition activity for quality software companies has been carried out at high multiples of late

A large section of the peer group with which we originally compared Sanderson Group has since been swallowed up by M&A activity. Given Sanderson's recurring revenues, high quality specialist proprietary software and cash generation, we believe that it would appear on the radar of a number of suitors. Recent deals include the acquisition of Tikit by BT for £64.2m or 416p per share in January this year. This valued the supplier of technology solutions and services to legal and accountancy firms at 22x historical earnings, and an EV/EBITDA multiple of 11.7x.

In December 2011, Workplace Systems, a provider of workforce management software solutions, was acquired for 25p per share, or £41m. This was for a company with revenues of £9m, no meaningful operating profits to speak of and net cash of £1.5m

Moving further up the market cap range, the acquisition of Misys, a leading financial software provider, was completed in June 2012 for 350p per share or £1.27bn, approximately 19x earnings and an implied EV/EBITDA multiple of 9.2x.

Sanderson appears to be good value against the sector

Turning to the remaining quoted industry participants, the FTSE 350 Software and Computer Services Sector is trading on a 19x 2013 PE rating, falling to 16.8x in 2014. Therefore, we remain entirely comfortable maintaining our 57p target price which equates to 13.2x 2014 EPS. The shares currently yield 3.1% vs 2.4% for the sector.

In the medium term we see scope to raise our valuation to up to £1 per share

Over the medium term, Sanderson has ambitions to grow revenues to some £20m and profits to £3m-£4m which could be achieved via a combination of organic growth and bite-sized acquisitions. Should this strategy be executed smoothly, **we can see scope to raise our fundamental valuation as high as £1 per share in due course,** or even higher in the event of a corporate bid. We maintain our **BUY** rating.

Interim Results and Current Trading

Adjusted operating profit increased 19%....

The results for the six months to the end of March 2013 show a moderate improvement in revenues, just shy of a 4% increase, to £6.4m. However, improving margins allowed for a faster acceleration of profitability. Gross margins improved to 87.9% (vs 84.3%) partially reflecting a greater contribution from proprietary software and services. This fed through to a 12.3% improvement in reported operating profit to £0.9m despite a 7% increase in operating expenses to £4.7m driven largely by an increased investment in sales and marketing. On an adjusted basis (before amortisation and share based payments) operating profit grew 19% to £1m, a 162 percentage point increase in margin to 15.6%.

…. and adjusted PBT grew by 34%

Non-exceptional finance expenses contracted sharply from £161k to £58k owing to Sanderson's strong cash position, with the ongoing costs owing to notional interest on the pension deficit. Overall, reported PBT more than doubled to £0.85m and on our adjusted basis was up 35% to £0.94m. At just £48k, the effective tax rate on adjusted profits was just 5%. Sanderson expects the benefit of a low effective rate of tax to continue for a further 18-24 months. Combined with the non recurrence of exceptional financing charges reported EPS from continuing operations more than quadrupled to 1.8p. On our adjusted basis, EPS equated to 1.9p more than 10x the 0.17p from H1 2012. As flagged in the April pre-close statement, the interim dividend has been increased to 0.65p, up 30%. Sanderson intends to pay total dividends for the year of 1.5p, implying a final dividend of 0.85p.

Cash conversion was strong

Cashflow continues to be strong with cash generated by operations up 58% to £1.2m, a 105% conversion. The company paid a £0.3m contribution to its defined benefit pension scheme and capitalised £129k of development spend. After a £0.3m dividend payment, net cash increased by £0.9m to £4.5m, up 26% from the same date in 2012.

New client conversion has improved in H2 despite challenging conditions

Operationally, prospecting activity appears to have been high over the period although conversion proved to be a little harder than in the corresponding period last year. At the end of the period the group's order book was down from the £1.95m in H1 2012, although still strong at £1.6m. In multi-channel, three projects were carried out for existing clients with two new client wins (vs 6 in H1 2012). There was one new customer addition in manufacturing. Encouragingly, activity levels have improved since the period end with four customer wins with average initial contract values of over £200k, a good strike rate for the last two months. This is in spite of the Board's remarks on relatively low levels of business confidence and of continuing challenging trading conditions within the UK, and is a testament to the quality and growing range of Sanderson's products and services. Sanderson considers the core decision making period of its customer base as February to September and as such experiences seasonality in favour of the second half of the financial year. H2 2012 saw revenues 10% higher than in H2 2011.

Fig 01 – H1 results review

6 Months Ending March	2012	2013	Growth	FY Forecast	H2 Growth Required vs H1
Revenue £m	6.14	6.40	4.2%	13.98	18%
WHI Operating Profit £m	0.86	1.00	16.3%	2.14	14.3%
WHI EPS p	0.17	1.90	1028.7%	4.00	10.7%

Source: WH Ireland Estimates / Company Data

Forecasts

FY 2013

Our amended revenue forecasts are looking for 4% annual revenue growth

Our previous revenue forecasts were looking for 6% revenue growth for the full year to £14.2m. With 4% revenue growth in H1 and a cautious outlook for the rest of the year, we consider it prudent to trim our top line projection to £13.9m, annual growth of 4.2%. The recent improvement in prospect conversion gives us comfort that this will be achievable.

Our reduced revenue forecasts have been somewhat offset by margin improvements

Margins in H1 were better than anticipated. We are therefore leaving our adjusted operating profit forecast unchanged at £2.1,,a margin of 15.3%. However given the level of notional pension interest we have replaced our net interest income forecast of £0.1m with a net interest expense of £0.1m. The net effect on our adjusted PBT forecasts is a 9% reduction to £2.0m. We have also raised our tax rate expectation from 5% to 8%. Consequently, we are also reducing our FY adjusted EPS figure to 4.0p.

We forecast year end net cash of £4.9m

We continue to see strong net operating cash generation, albeit 10% lower than previously at £1.9m. After capex and dividend payments, this yields a £0.8m annual increase in net cash balances to £4.8m.

FY 2014

2014 could see the benefit of acquisitions

Given the slightly lower projected revenue base carrying forward into FY2014, we are reducing our turnover projection by just 1.5% to £14.9m, year on year growth of 6.4%. Leaving margin assumptions broadly similar to 2013, this leads us to an adjusted pre-tax profit forecast of £2.2m against our prior expectation of £2.4m. This currently assumes no bite sized acquisitions, the likes of which Sanderson states it is reviewing. This equates to 4.3p of adjusted earnings per share vs a previous expectation of 4.7p.

By June 2014 we see cash reaching £5.8m

We are forecasting a 12.2% increase in free cash flow to £1.7m and anticipate year end net cash balances of £5.7m, which in our opinion leaves Sanderson in a comfortable position to further increase its dividend payments. As such, we are forecasting a 7% increase in dividends per share to 1.6p.

Fig 02 – Income Statement

Year to September	2011 A £(m)	2012 A £(m)	2013 E £(m)	2014E £(m)
Turnover	**14.1**	**13.4**	**14.0**	**14.9**
Growth y-o-y	*-47.9%*	*-4.9%*	*4.5%*	*6.6%*
COGS	(2.5)	(2.2)	(2.0)	(2.1)
Gross Profit	**11.6**	**11.2**	**12.0**	**12.8**
Gross Margin (%)	*82.3%*	*83.6%*	*86.0%*	*86.0%*
WHI Operating Profit	**2.0**	**2.1**	**2.1**	**2.3**
Trading Margin (%)	*13.9%*	*14.3%*	*15.3%*	*15.6%*
Amortisation	(0.2)	(0.2)	(0.2)	(0.2)
Impairment of goodwill	0.0	0.0	0.0	0.0
Exceptional costs	0.0	0.0	0.0	0.0
Share based charges	(0.0)	(0.1)	(0.1)	(0.1)
Operating profit	1.7	1.9	1.9	2.1
Net finance expenses	(1.0)	(0.2)	(0.1)	(0.1)
Exceptional finance charges	(0.4)	(0.2)		
Pre-tax profit	0.4	1.5	1.8	2.0
Tax Rate	11.5%	-9.6%	-8.0%	-8.0%
Tax	0.1	(0.2)	(0.2)	(0.2)
Profit from continuing operations	0.5	1.3	1.6	1.8
Net profit from discontinuing ops	0.3	1.1		
Net profit	0.8	2.4	1.6	1.8
Basic diluted Eps (p)	1.70	5.20	3.44	3.78
WHI pre-Tax Profit	1.0	1.9	2.0	2.2
WHI net profit	1.1	1.8	1.9	2.0
WHI diluted EPS (p)	2.4	3.8	4.0	4.3
Diluted Shares (m)	47.2	46.5	47.0	47.0
DPS (p)	0.8	1.2	1.5	1.6
Adjusted EBITDA	2.0	2.0	2.2	2.4

Source: WH Ireland Estimates / Company Data

Fig 03 – Cash Flow

Year to September	2011 E £(m)	2012 E £(m)	2013 E £(m)	2014 E £(m)
Net Profit	0.8	2.4	1.6	1.8
Amortisation and Impairment	0.2	0.2	0.2	0.2
loss on disposal				
Depreciation	0.1	0.1	0.1	0.1
Share based payments	0.0	0.1	0.1	0.1
Net Finance charges	1.4	0.4	0.1	0.1
Post tax profit on discontinued operations	(0.3)	(1.1)		
Movement in Derivatives	(0.1)	(0.0)		
Income tax	(0.1)	0.2	0.2	0.2
Operating cash flow pre working cap	**2.0**	**2.2**	**2.2**	**2.4**
Movement in receivables	*(0.1)*	*(0.7)*	*0.3*	*0.3*
Movement in inventories	*0.0*	*0.0*	*0.0*	*0.0*
Movement in payables	*0.3*	*0.4*	*0.0*	*0.0*
Employee benefit plan	(0.3)	(0.3)	(0.3)	(0.3)
Interest paid	(0.6)	(0.7)	(0.1)	(0.1)
Income tax received	0.5	0.4	(0.2)	(0.2)
Discontinued Ops	1.1	(0.4)		
Net cash from operations	**2.9**	**1.0**	**1.9**	**2.1**
Purchases of plant, property and equipment	(0.1)	(0.2)	(0.3)	(0.3)
Sale of business	0.0	11.1		
Development Capex	(0.3)	(0.2)	(0.2)	(0.2)
Purchase of investment held for resale		(0.1)		
Acquisition of trade and assets		(0.2)		
Divi received		0.0		
Discontinued Ops	(0.4)	(0.1)		
Net cash used in investment activities	**(0.8)**	**10.2**	**(0.5)**	**(0.5)**
Repayment of borrowings	(8.6)	(7.4)	0.0	0.0
New Bank borrowing	7.4			
Fees	(0.3)			
Lease repayments	(0.0)		0.0	0.0
Dividends	(0.3)	(0.4)	(0.7)	(0.8)
Net cash used in financing activities	**(1.7)**	**(7.8)**	**(0.7)**	**(0.8)**
Net Cash Flow	**0.37**	**3.4**	**0.8**	**0.9**
Movement in net (debt)/cash	1.6	10.8	0.8	0.9
Closing net (debt)/cash	**(6.7)**	**4.1**	**4.8**	**5.7**
Free Cash Flow	**2.1**	**0.2**	**1.5**	**1.7**

Source: WH Ireland Estimates / Company Data

Fig 04 – Balance Sheet

As at September	2011 E £(m)	2012 E £(m)	2013 E £(m)	2014 E £(m)
Plant property and equipment	0.746	0.4	0.6	0.8
Intangibles	32	22.4	22.4	22.3
Deferred tax	1.6	1.6	1.6	1.6
Non current assets	34.4	24.3	24.5	24.7
Inventories	0.162	0.0	0.0	0.0
Receivables	7.124	3.6	3.3	3.0
Other financial assets	0.0	0.1	0.1	0.1
Cash and equivalents	0.619	4.1	4.8	5.7
Current Assets	**7.9**	**7.8**	**8.3**	**8.9**
Bank loans and borrowings	(1.0)	0.0	0.0	0.0
Trade and other payables	(4.9)	(2.9)	(2.9)	(2.9)
Derivative financial instruments	(0.4)	0.0	0.0	0.0
Income tax payable	(0.1)	(0.0)		
Deferred Income	(6.7)	(4.6)	(4.6)	(4.6)
Current liabilities	**(13.1)**	**(7.5)**	**(7.5)**	**(7.5)**
Net current (liabilities)/assets	**(5.2)**	**0.3**	**0.8**	**1.4**
Loans and Borrowings	(6.4)	0.0	0.0	0.0
Pension and other employee obligations	(4.0)	(4.5)	(4.2)	(3.9)
Deferred Income	0.0	0.0	0.0	0.0
Deferred tax liabilities	(0.4)	(0.1)	(0.1)	(0.1)
Non current liabilities	(10.8)	(4.6)	(4.3)	(4.0)
Net Assets	**18.5**	**20.0**	**21.0**	**22.1**
Share Capital	4.3	4.4	4.4	4.5
Share Premium	4.2	4.2	4.2	4.2
Retained earnings	10.0	11.5	12.4	13.4
Shareholders Funds	**18.5**	**20.0**	**21.0**	**22.1**

Source: WH Ireland Estimates / Company Data

Significant Shareholders

Fig 05 – Significant Shareholders

SHAREHOLDER	% HOLDING
CHRISTOPHER WINN	29.1
HARGREAVE HALE AND CO	11.3
ISIS EP LLP	6.9
AXA FRAMLINGTON INVESTMENT MANAGEMENT	6.6
CHELVERTON ASSET MANAGEMENT	5.1
UNICORN ASSET MANAGEMENT	3.5

Source: Company Data

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.

Disclaimer

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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 31 March 2013 the distribution of all our published recommendations is as follows:

Recommendation	Total Stocks	Percentage %	Corporate
Buy	71	76	54
Speculative Buy	14	15	14
Outperform	3	3	3
Market Perform	5	6	2
Underperform	0	0	0
Sell	0	0	0
Total	93	100	73

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

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~WH Ireland provides paid for research services to Sanderson Group

Within the past 12 months, WH Ireland has received compensation for investment banking services from this company.

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

Share Price Date/Time

Company Name	Recommendation	Price	Price Date/Time
Sanderson Group	BUY	48p	04 June 2013 @ 16:30

Summary of Company Notes

Headline	Date
Trading statement & Initiation of coverage	3 November 2011
Finals – Earnings per share ahead of our expectations	28 November 2011
Increase in target price to 50p (44p) post-Sanderson RBS sale	30 January 2012
£11.7m sale of High Street Retail business to Torex. Continuing business Q1 orders up	23 January 2012
Interims – Strong margin progression and solid order book	16 May 2012
Strong pre-close trading statement. Target price up to 55p	24 October 2012
Prelims mirror strong trading statement. Target price up to 57p (55p)	27 November 2012

Summary of Security Recommendations

Recommendation	From	To	Analyst
BUY	3/11/2011	28/2/2013	CA
OUTPERFORM	28/2/2013	30/4/2013	CA
BUY	30/4/2013	Current	CA

Current Analyst (CA), Previous Analyst (PA)