Sanderson Group

Update
27th November 2012

Solid Results Lead to Increased Target Price

Sanderson Group, the software and IT services business, has announced full-year results which are slightly better than expectations. We have taken this opportunity to update our forecasts and to include numbers for FY2014. Given the healthy balance sheet and improved market position of the group, together with a good order book, our stance firmly remains as “buy”, but with an improved target price of 56p.

Strong performance and healthy financial position

For the 12-months ended 30th September 2012, PBT from continuing operations increased by 297% to £1.48m (FY2011: £0.37m) on revenue of £13.37m (FY2011: £14.06m). The PBT figure was mainly helped by a lowered finance expense of £0.68m (FY2011: £1.45m) as the group used the £11.75m proceeds received from the disposal of Sanderson RBS to repay all of its bank debt. The group’s financial position has been transformed and the balance sheet now shows net cash of £4.07m (FY2011: net debt of £6.72m). Going forward, we are forecasting an adjusted PBT of £2.4m on revenues of £15.1m for FY2014. We expect to see the group conclude an acquisition during FY2013, but still expect to see a further improvement in the net cash position.

Good earnings visibility

Visibility of earnings remains good, with pre-contracted recurring revenues accounting for 57% of total revenue. The group’s focused investment strategy also led to a growth of 40% in overall order intake to £1.89m (FY2011: £1.35m). We expect to see a continuation of this going forward.

Impressive dividend growth

This strong performance has allowed the board to recommend a final dividend of 0.7p (FY2011: 0.45p), bringing the total dividend for the year to 1.2p (FY2011: 0.75p). This is well covered by EPS of 5.5p (FY2011: 1.9p). We expect DPS to grow to 1.45p by FY2014, but certainly see upside.

Rapidly emerging sectors

We expect to see Sanderson focus on the rapidly emerging online sales & ecommerce and mobile commerce sectors. Indeed, in the current financial year, we expect the group to make at least one acquisition within the ecommerce industry.

Attractive valuation

The full-year results give us further confidence in Sanderson’s investment case and its ability to hit our forecasts. We continue to consider a rating of 10x forward earnings + net cash as comfortably justifiable. This leads to an improved target price of 56p (previously 52p).

Table: Financial overview

Year to 30th Sep.	2011A	2012A	2013E	2014E
Revenue* (£m)	14.1	13.4	14.0	15.1
PBT (£m)	0.4	1.5	2.0	2.4
EPS* (p)	1.1	3.0	3.75	4.17
Dividend (p)	0.75	1.20	1.35	1.45
Yield (%)	1.63%	2.61%	2.93%	3.15%

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

Buy

Target price **56p**

Key data

Share price	46.00p
52 week high/low	48.00p/27.50p
Primary exchange	AIM
EPIC	SND
Shares in issue	43.68 m
Market Cap	£20.09 m
Sector	Software & Computer Services

Share price chart

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Full-year Results

For the 12-months ended 30th September 2012, pre-tax profit from continuing operations increased by 297% to £1.48m (FY2011: £0.37m) on revenues of £13.37m (FY2011: £14.06m).

The pre-tax profit figure was mainly helped by a lowered finance expense of £0.68m (FY2011: £1.45m) as the group used the £11.75m proceeds received from the disposal of Sanderson RBS to repay all of its bank debt. An improved gross margin of 83.6% (FY2012: 82.3%) - which partly reflects the increased emphasis onto higher margin 'owned' software and services - and a lowered operating cost of £9.28m (FY2012: £9.86m) also contributed to improved performance as operating profit increased by 12% to £1.91m (FY2011: £1.71m).

Visibility of earnings remains good, with pre-contracted recurring revenues accounting for 57% of total revenue. The group gained 15 new customers (FY2011: 14), at an average initial contract value of £99,000 (FY2011: £95,000), resulting in a 12% increase in orders from new customers to £1.49m (FY2011: £1.33m). The group's focused investment strategy also led to a growth of 40% in overall order intake to £1.89m (FY2011: £1.35m), with the multi-channel sector accounting for £1.02m (FY2011: £0.56m) and the manufacturing sector making up the remaining £0.87m (FY2011: £0.79m).

Partly reflecting the focus on higher margin products and services, operating profit from the multi-channel retail division increased by 23% to £1.11m (FY2011: £0.90m) on revenues of £7.17m (FY2011: £7.91m). Revenue from customers operating in the online sales, ecommerce and catalogue markets grew by 15% to £2.40m and now accounts for 33% (FY2011: 26%) of the multi-channel retail division. The total number of new customers gained was 9 (FY2011: 10) and the initial order value totalled £1.17m (FY2012: £1.02m).

The manufacturing division achieved an operating profit of £0.80m (FY2011: £0.81m) on revenues of £6.20m (FY2011: £6.14m). Impressively, recurring revenue continued to be strong, accounting for 59% of divisional sales, and the gross margin from the recurring revenue covered 76% of divisional overheads (FY2011: 78%). In a very competitive market, the number of new customers gained was 6 (FY2011: 4) and the initial order intake increased by 5% to £0.32m (FY2011: £0.31m).

This resilient performance from the continuing operations, combined with the profit on the discounted operations, has allowed the board to recommend a final dividend of 0.7p (FY2011: 0.45p), bringing the total dividend for the year to 1.2p (FY2011: 0.75p). This is well covered (4.58x) by EPS of 5.5p (FY2011: 1.9p).

The group's financial position has been transformed during the year and the balance sheet now shows net cash of £4.07m (FY2011: net debt of £6.72m), net current assets of £0.32m (FY2011: (£5.16m)) and net assets of £20.03m (FY2011: £18.48m).

As Sanderson looks to build upon and to further develop its strengthened position within the multi-channel retail and manufacturing markets, we expect to see it continue to invest across all of its businesses, with a particular focus on the rapidly emerging online sales & ecommerce and mobile commerce sectors. Indeed, in the current financial year, we expect the group to make at least one acquisition within the ecommerce business to boost organic growth.

Forecasts

We have updated our forecasts and included numbers for FY2014.

We continue to forecast an adjusted PBT of £2.0m on revenue of £14.0m for FY2013. This leads to earnings per share of 3.75p, and we expect the dividend to be increased to 1.35p per share. We expect the multi-channel retail division to account for £7.6m of total revenue and the manufacturing division to account for the remaining £6.4m. Assuming that only one acquisition is concluded, we are pencilling in a net cash position of £4.8m.

For FY2014, we are forecasting an adjusted PBT of £2.4m on revenues of £15.1m. This leads to an EPS of 4.17p, and we expect DPS to grow to 1.45p, but certainly see upside. We expect the multi-channel retail division to account for £8.5m of total revenue and the manufacturing division to account for the remaining £6.6m. We are pencilling in a net cash position of £6.1m (13.97p/share), but this is dependent on any acquisitions being concluded.

Valuation

The full-year results give us further confidence in Sanderson’s investment case and its ability to hit our forecasts. Introducing forecasts for FY2014, we continue to consider a rating of 10x forward earnings + net cash as comfortably justifiable. This leads to an improved target price of 56p (previously 52p).

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