

Sanderson Group

Update
27th November 2013

In-line With Expectation Full-Year Results

Sanderson Group has announced full-year results which are in-line with our expectations. We have upgraded our forecasts for FY14, while providing numbers for FY15 and FY16. 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 an improved target price of 90p.

Full-Year Results

For the 12-months ended 30th September 2013, gross profit increased by 8.3% to £12.12m (FY12: £11.19m), reflecting higher revenues of £13.83m (FY12: £13.37m) and an improved margin of 87.6% (H1 FY12: 83.6%) as the group placed an emphasis on more buoyant sectors as well as the sale of its higher margin proprietary software and services. Maintaining its investment in product innovation as well as in sales and marketing, adjusted operating profit increased by 8.8% to £2.22m (FY12: £2.04m). Pre-contracted recurring revenue continued to grow and now stands at £7.94m (FY12: £7.66m), representing 57% of total revenues. The order book also remains good, growing by 2.6% to £1.94m (FY12: £1.89m). The cash balance as at 22nd November was in excess of £4.5m.

Financial forecasts

For FY14, we are now forecasting revenue of £16.10m. With a larger amount of higher margin products expected to be sold, we are assuming gross margins of 86%, leading to a gross profit forecast of £13.85m. 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 are forecasting adjusted PBT of £2.67m. We keep our DPS forecast unchanged at 1.60p. For FY15, we are forecasting revenue of £17.30m. As mentioned above, we expect a larger proportion of higher margin products to be sold, and are therefore forecasting a gross profit of £14.88m. With further product innovation and sales & marketing investments anticipated, we are forecasting an adjusted PBT figure of £3.20m. We anticipate DPS of 1.70p, but note that this could be higher given the strong cash generation.

Valuation

Given the strong progress made, we now consider a rating of 15 times forward earnings + net cash as justifiable for setting our target price of 90p (previously 72p). The prospective yield of 2.38% is also attractive.

Table: Financial overview

Year to 30 th Sep.	2012A	2013A	2014E	2015E
Revenue (£'000)	13,374	13,828	16,100	17,300
PBT* (£'000)	1,613	2,186	2,670	3,195
EPS* (p)	3.80	4.42	4.76	5.24
Dividend (p)	1.20	1.50	1.60	1.70
Yield (%)	1.68%	2.10%	2.34%	2.38%

Source: GECR and company.

Notes: *Adjusted

Buy

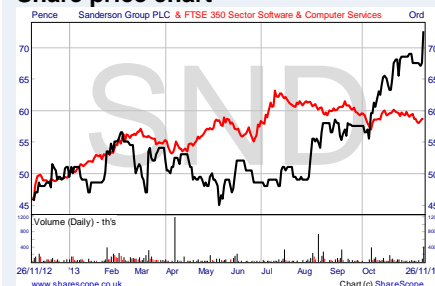
Target price

90p

Key data

Share price	71.50p
52 week high/low	73.40p/45.00p
Primary exchange	AIM
EPIC	SND
Shares in issue	51.48 m
Market Cap	£36.81 m
Sector	Software & Computer Services

Share price chart



Analyst details

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Full-Year Results

Sanderson Group has announced full-year results which are in-line with our expectations. For the 12-months ended 30th September 2013, gross profit increased by 8.3% to £12.12m (FY12: £11.19m), reflecting higher revenues of £13.83m (FY12: £13.37m) and an improved margin of 87.6% (H1 FY12: 83.6%) as the group placed an emphasis on more buoyant sectors as well as the sale of its higher margin proprietary software and services. Maintaining its investment in product innovation as well as in sales and marketing, adjusted operating profit increased by 8.8% to £2.22m (FY12: £2.04m). Pre-contracted recurring revenue continued to grow and now stands at £7.94m (FY12: £7.66m), representing 57% of total revenues. The order book also remains good, growing by 2.6% to £1.94m (FY12: £1.89m).

Figure: Forecast comparison

	Actual (£'000)	GECR forecast (£'000)	Difference (%)
Total revenue	13,828	13,800	0.2%
Cost of sales	(1,711)	(2,208)	(22.5%)
Gross profit	12,117	11,592	4.5%
Other operating expenses	(4,119)	(4,416)	(6.7%)
R&D costs	(5,304)	(5,200)	2.0%
Total operating costs	(10,145)	(9,616)	5.5%
EBIT	1,972	1,976	(0.2%)
EBITDA	2,333	2,227	4.8%
PBT	1,943	1,976	(1.7%)
PAT	1,691	1,792	(5.6%)

Source: Company and GECR

After paying £500,000 of initial consideration relating to the acquisition of Catan Marketing, the balance sheet and cash-flow remains strong, with no debt, cash of £3.66m (FY12: £4.07m) 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 full-year DPS by 25% to 1.50p (FY12: 1.20p), which is well covered by basic EPS of 3.9p (FY12: 5.5p).

During the period, Sanderson gained 14 new customers (FY12: 15 new customers) at an average initial contract value of £119,000 (2012: £99,000), equating to a total value of £1.67m (FY12: £1.49m). We also note that one of the group's long-standing customers placed an extension order worth over £190,000, for the deployment of Sanderson software into a number of its subsidiary businesses all over the world, including Zambia, Botswana, Namibia, Nigeria and Ghana.

Multi-channel division

Revenue from the multi-channel retail division increased by 1% to £7.23m (FY12: £7.17m), boosted by ecommerce activity. A planned investment in the ecommerce business resulted in operating profit growth being limited to 6%, increasing to £1.28m (FY12: £1.21m). The increased level of new customer business has continued with a large order from a new customer, worth almost £250,000, gained at the start of the current financial year.

Manufacturing division

Regarding the manufacturing division, revenue grew by 6.3% to £6.59m (FY12: £6.20m), boosted by strong growth from the food and drink processing business, which now accounts for around 49% (FY12: 44%) of total manufacturing revenue. Nine new customers were gained in the period (FY12: 6 new customers), equating to an order

intake of £3.10m (FY12: £2.74m). Operating profit increased by 12.0% to £932k (FY12: £831k). The order book is strong, at over £1.2m (FY12: £870k).

Acquisition

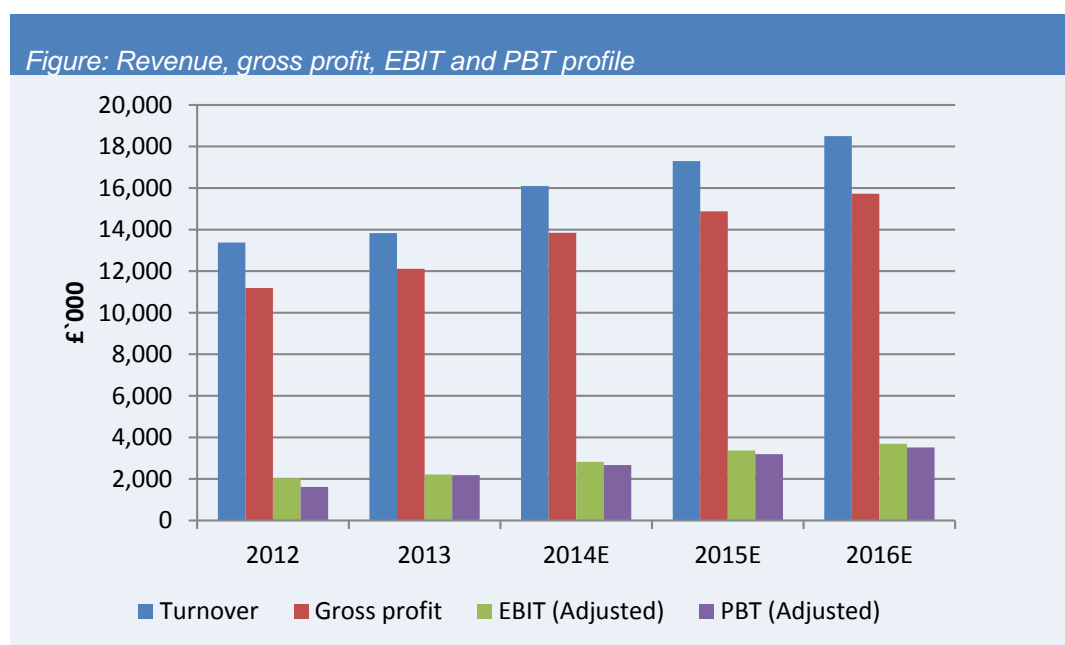
The period saw Sanderson Group augment its existing multi-channel retail business through the acquisition of Catan Marketing, trading as PRIAM, for a maximum consideration of £645k. PRIAM achieved operating profit of £6k on revenue of £147k during the period.

Post-period events

Post-period, further expanding its position in the rapidly growing mobile enabled ecommerce and online sales market, Sanderson Group acquired One iota, a leading provider of cloud-based multi-channel retail solutions, for a maximum consideration of £5.43m. In addition, the group raised £3.5m, through a placing at 55p per share, in a move to boost the balance sheet as well as fund opportunities for further growth. According, after the acquisitions and the share placing, the cash balance as at 22nd November was in excess of £4.5m.

Forecasts

We expect to see further accelerated growth being achieved in the ecommerce market, fuelled by the development of mobile commerce. We also expect to see growth coming from the food and drink processing sector within the UK. So, while Sanderson continues to invest across all of its business, we expect particular attention being placed on developing its offering in these areas. Furthermore, while selective acquisition opportunities will continue to be considered to augment organic growth, we anticipate the focus now is on delivering on target results and on making the PRIAM and One iota acquisitions successful.

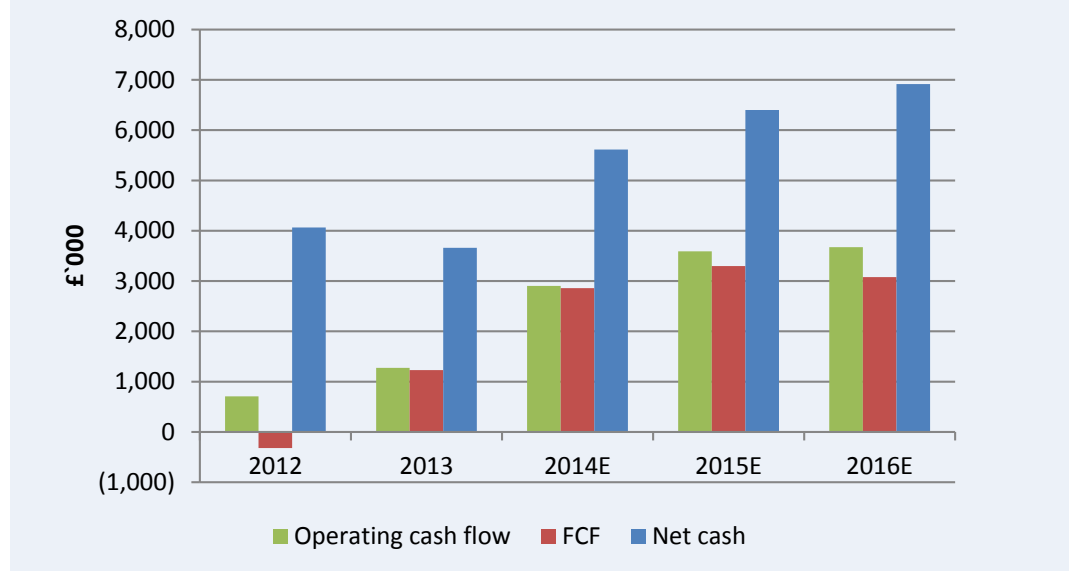


Source: Company and GEGR

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For FY15, we are forecasting revenue of £17.30m. As mentioned above, we expect a larger proportion of higher margin products to be sold, and are therefore forecasting a gross profit of £14.88m. With further product innovation and sales & marketing investments anticipated, we are forecasting an adjusted PBT figure of £3.20m. We anticipate DPS of 1.70p, but note that this could be higher given the strong cash generation.

Figure: Operating cash flow, FCF and net cash



Source: Company and GE

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 15x forward earnings + net cash as justifiable for setting an improved target price of 90p (previously 72p). The prospective yield of 2.38% is also attractive.

Appendix

Figure: P&L forecasts

Year end: 30th Sept.	2012	2013	2014E	2015E	2016E
Revenue (£'000)	13,374	13,828	16,100	17,300	18,500
EBITDA (£'000)	2,157	2,333	3,098	3,786	4,107
Depreciation and amortisation (£'000)	(251)	(361)	(361)	(499)	(499)
Operating profit (£'000)	1,906	1,972	2,737	3,287	3,608
Other income (£'000)	0	0	0	0	0
Net interest (£'000)	(214)	(29)	(150)	(175)	(175)
Share-based payments (£'000)	(65)	(83)	(83)	(83)	(83)
PBT -normalised (£'000)	1,613	2,186	2,670	3,195	3,516
Impairment of acquired intangibles (£'000)	(67)	(66)	0	0	0
Non-recurring items/exceptions (£'000)	(65)	(177)	(83)	(83)	(83)
PBT - reported (£'000)	1,481	1,943	2,587	3,112	3,433
Taxation (£'000)	(185)	(252)	(250)	(500)	(600)
Minorities & preference dividends (£'000)	0	0	0	0	0
Discontinued/assets held for sale (£'000)	1,110	0	0	0	0
Net Income - normalised (£'000)	1,655	1,934	2,420	2,695	2,916
Attributable profit (£'000)	2,406	1,691	2,337	2,612	2,833
EPS - reported (p)	5.5	3.9	4.6	5.1	5.5
EPS (norm., cont.) – FD (p)	3.6	4.2	4.5	5.0	5.4
DPS (p)	1.2	1.5	1.6	1.7	1.8
Average number of group shares - FD (m)	46.5	46.1	53.2	53.9	53.9
Average number of group shares (m)	43.5	43.7	50.8	51.5	51.5

Source: Company and GECR

Figure: Cash flow forecasts

Year end: 30th Sept.	2012	2013	2014E	2015E	2016E
Operating profit - adjusted	2,038	2,215	2,820	3,370	3,691
Depreciation & amortisation	251	361	361	499	499
Pension contribution	(315)	(677)	(360)	(360)	(600)
Other cash and non-cash movements	(1,061)	83	83	83	83
Change in working capital	(206)	(708)	0	0	0
Operating cash flow	707	1,274	2,904	3,592	3,673
Interest	0	0	0	0	0
Tax paid	(703)	0	0	(250)	(550)
Dividends from associates and JVs	0	0	0	0	0
Cash flow from operations	4	1,274	2,904	3,342	3,123
Maintenance capex	(325)	(45)	(45)	(45)	(45)
Free cash flow	(321)	1,229	2,859	3,297	3,078
Expansionary capex	0	0	0	0	0
Exceptionals and discontinued operations	(6,883)	(618)	(462)	(487)	(487)
Other financials	0	0	0	0	0
Acquisitions	0	(440)	(3,130)	(1,150)	(1,150)
Disposals	11,064	0	0	0	0
Net share issues	0	15	3,500	0	0
Dividends paid	(413)	(590)	(813)	(875)	(927)
Change in net cash	3,447	(404)	1,954	785	514
Net cash/(debt)	4,066	3,662	5,616	6,400	6,914
FCFPS - FD (p)	(0.7)	2.7	5.4	6.1	5.7

Source: Company and GECR

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