

Sanderson Group (SND)

AIM



INVESTMENT SUMMARY

- Results for the year to 30 September 2013 have revealed a significantly improved profit before taxation from continuing operations. Although revenue was only modestly higher, there was further improvement in gross margin, which rose to 87.6% versus 83.6% a year earlier.
- Given strong cash generation, it has been possible to maintain the progressive dividend policy. A final dividend of 0.85p per share has been declared, taking the total for the year to 1.50p per share. This represents a 25% improvement on the 2012 payout of 1.20p per share.
- We had previously flagged up the potential for investment in the higher margin growth areas of ecommerce and mobile. The acquisitions of Catan Marketing Limited, trading as PRIAM, then One iota Limited in August and October respectively should help create further value from this area moving forwards.
- Sanderson is in very good shape and having raised £3.5m through a share placing priced at 55p per share in October the business remains well funded. As at 22 November net cash was in excess of £4.5m. Taking this into account we believe that the current market capitalisation of £34.7m leaves scope for further uplift in the share price in due course given the potential for further growth.

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 (%)
2012A	13.4*	1.5	2.8	24.1	1.2	1.8
2013A	13.8	1.9	3.7	18.2	1.5	2.2
2014E	15.9	2.5	4.2	16.1	1.6	2.4
2015E	17.0	3.0	4.7	13.5	1.7	2.5

* on continuing operations

KEY DATA

Share Price:	67.5p
Prospective p/e ratio:	16.1x
Prospective net yield:	2.4%
Market Capitalisation:	£34.7m
Next Results Due (Interims):	JUN
Net Cash (at 30 September):	£3.66m
NAV per share:	47.7p

BULLET POINTS

- Another strong set of results has been posted
- Further improvement in gross margin to an enviable 87.6%
- Recent acquisitions should help maintain positive momentum
- Healthy balance sheet with net cash position
- Progressive dividend policy maintained

Date of Report : 26 November 2013

www.brokerlink.co.uk

Executive Summary

- *Sanderson is a supplier of innovative software solutions and IT services focussed on multi-channel retail and manufacturing markets in the UK and Ireland. The group develops long term relationships with its customers with the majority of product development being customer led and offering tangible benefits.*
- *The group recognises the need to focus on higher margin growth markets such as e-commerce and mobile. With this in mind niche ecommerce business Catan Marketing Limited, trading as PRIAM, was acquired in August. Following the year end One iota Limited, which provides cloud-based multi-channel solutions, was also acquired.*
- *The sale of Sanderson RBS in January 2012 transformed the balance sheet, resulting into a net cash position. The most recent acquisition of One iota Limited was accompanied by a share placing, which raised £3.5m and ensured that a healthy cash balance was maintained. As at 22 November net cash was over £4.5m.*
- *Sanderson's contracts for both software and support and maintenance provide it with a solid recurring revenue base. 57% of revenue was derived from recurring sources last year, which covered 73% of overhead costs and helps underpin forecasts.*
- *Although the vast majority of revenue comes from additional spend from the existing customer base, the value of orders from new customers has been growing in recent years. It is also pleasing to see that the average initial order value from new customers was £119k last year versus £99k the previous year.*
- *Gross margins have improved further to 87.6%. The sale of Sanderson RBS had already led to a step change in gross margin from 70/72% to 84%, as Sanderson RBS had merely been a reseller for a product and therefore had to make a royalty payment to the proprietary owner of the software.*
- *The balance sheet is strong, with net cash as at 22 November of in excess of £4.5m. This means that a final dividend of 0.85p per share could comfortably be declared, which took the total for the year to 1.5p. This represents a 25% rise year on year and continues the progressive dividend policy which has been adopted.*
- *The company is cautiously optimistic. The longer term future looks bright and further acquisitions are likely to add value at some point. However, Sanderson is being pragmatic given the economic backdrop against which it is operating. This means that it is likely to focus on integrating recent acquisitions in the immediate future. A strong order book should also ensure that progress continues to be made.*

History

The former Sanderson Group was originally founded in 1983 and its shares were floated on the Unlisted Securities Market of the London Stock Exchange in 1988. The company then moved to a full market listing in 1990.

Current executive chairman, Christopher Winn, joined in 1995 when he became group chief executive. By 1999, turnover had risen to £100m and in December of that year he led a management buyout of the group as it was taken private.

The group was then restructured and in 2003 it was demerged into three separate businesses — Sanderson, Civica and Talgentra. The present group kept the Sanderson name and brand and its shares were admitted to AIM in December 2004 through a placing at 50p.

Sanderson floated on AIM in December 2004

In January 2012 the group disposed of Sanderson RBS...

...acquisitions have followed

In January 2012, the group disposed of Sanderson RBS, which specialised in the sale of EPOS solutions to retailers, in order to focus on higher margin growth markets. The group has since expanded with particular emphasis on the development of the Multi-channel retail business, most recently acquiring Catan Marketing and One iota.

The group is now widely recognised as an established provider of software and IT services in the UK and Ireland particularly focussed on Manufacturing and Multi-channel retailing.

Activities

A supplier of innovative software solutions and IT services, specialising in Multi-channel retail and Manufacturing

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 customers include many household names, such as MandM Direct, Mothercare, Hotel Chocolat, 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.

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 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.

Multi-channel Retail

Multi-channel retail accounts for around two thirds of operating profit and we expect the division to continue to be a focus for future investment

This division accounted for 58% of operating profit in the year to September 2013, although planned investment limited growth somewhat. 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.

The acquisitions of Catan Marketing and One iota underline the company's commitment to progression in this area.

Manufacturing

This division accounted for c. 42% of operating profit last year, a figure which is likely to fall moving forwards. 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. The size of the UK food and drink processing market is growing and there is an increase in the number of small and medium-sized businesses in this sector, which provides an opportunity for growth. The Sanderson food and drink processing business now represents 49% of the manufacturing business.

Manufacturing accounts for around a third of operating profit

Acquisitions

In August Catan Marketing Limited was acquired for a maximum consideration of £644,660. The consideration was payable in cash, comprising an initial payment of £500k on completion with an additional £49,660 paid in October. A further payment of £95k is dependent on certain performance criteria being met by the end of August 2014.

Although small, this is seen as being a highly complementary in terms of its products and customers

Rugby-based Catan Marketing provides e-commerce solutions, trading as 'PRIAM', to over 30 multi-channel retailers. For the year ended 31 August 2012, Catan generated a profit before tax of £27k (2011: £69k) on revenue of £895k (2011: £1.16m). At the date of acquisition, Catan had net assets of approximately £50k.

Net assets were negligible

More recently and perhaps more significantly, One iota Limited, a leading provider of cloud-based multi-channel retail solutions, was acquired last month for a maximum aggregate consideration of £5.43m. One iota is based in Rossendale, Lancashire, close to Sanderson's catalogue, ecommerce and online sales business, and provides cloud-based, multi-channel solutions via mobile, tablet and in-store devices.

One iota will have a more meaningful initial impact

For the year ended 31 January 2013, One iota had unaudited turnover of £0.66m (2012: £0.50m) and profit before taxation of £195k (2012: £158k). As at 31 January 2013, One iota's net assets were £0.85m. For the seven months ended 31 August 2013, One iota had unaudited turnover of £0.61m and profit before taxation of £0.21m. The company raised £3.50m before expenses through the placing of 6,363,636 new ordinary shares at a price of 55p per share at the time of the deal.

A share placing which accompanied the deal brought in £3.5m

Final Results

Results were solid, with gross margin rising further to 87.6%

In the year to 30 September revenue was up slightly at £13.83m (2012: £13.37m) and there was further improvement in gross margin to 87.6% (2012: 83.6%) due to increased emphasis on higher margin Sanderson proprietary software. Operating profit before amortisation of acquisition-related intangibles, acquisition costs and share-based payment charges was £2.22m (2012: £2.04m). The value of the order book at the period end was £1.94m (2012: £1.89m).

There was a strong net cash position at the year end, which has since increased further

After paying £500k of initial consideration relating to the acquisition of Catan Marketing Limited in the period, the net cash balance at 30 September 2013 was £3.66m (2012: £4.07m). Although there has since been a significant acquisition, a related share placing meant that net cash stood at over £4.5m as at 22 November.

The final dividend was 0.85p per share, taking the total for the year to 1.50p

The strong balance sheet and cash generation have enabled the progressive dividend policy to be maintained. A final dividend of 0.85p per share has been declared, making a total of 1.50p for the year, up 25% on the payout in 2012. The final dividend is due to be paid on 28 March 2014, with the ex-dividend date being 5 March 2014. The progressive dividend policy is due to continue.

Multi-channel retail looks well-positioned given its exposure to ecommerce

Multi-channel retail brought in revenue of £7.23m (2012: £7.17m) with continued strong growth in ecommerce businesses, as would be expected. There was a decline in traditional mail order fulfilment. Completion of a planned investment in the infrastructure and capability of the ecommerce business resulted in operating profit growth being restricted. However, it still rose by 6% to £1.28m (2012: £1.21m). The new year has seen a large order from a new customer, worth almost £250k.

Manufacturing has exposure to the UK food and drink processing market, which is growing

It was a mixed year for manufacturing. The part of the business focused on the food and drink processing sector made good progress and drove overall growth for the manufacturing division. However, the part which addresses the general UK manufacturing market experienced a tougher trading environment than in the previous year. The size of the UK food and drink processing market is growing and there is an increase in the number of small and medium-sized businesses in the sector. The food and drink processing business now represents 49% of the group's manufacturing business (2012: 44%). Revenue was £6.59m (2012: £6.20m) and operating profit was £932k (2012: £831k). Overall order intake was higher at £3.10m (2012: £2.74m). The order book is strong and at the period end stood at over £1.2 million (2012: £870k) with very good sales prospects.

Forecasts

Revenue forecasts are underpinned by a strong order book and high level of recurring revenue

Looking to the current year, recent investment in delivery capacity and capability should continue to bear fruit. We believe that recent acquisitions will help to grow revenue by over £2m in the current year. Recurring revenue should deliver over half of total revenue and with an order book of £1.9m as at the end of September this forecast does not look too demanding.

Sanderson has a strong balance sheet

The acquisition of One iota has taken place since the year end but the placing which accompanied this has ensured that cash resources have not been depleted. We believe that cash generated from operations will see the net cash position improve further in the medium term unless further acquisitions are completed.

We are forecasting that the group continues to make good progress with the growth concentrating on the Multi-channel retail business as this is where future investment and development is being concentrated.

Valuation

Although the share price has performed well, the value of the business is still just £30m

The share price has had a strong run in recent years and the value of the company has multiplied from the lows seen in the depths of the recent downturn. Nevertheless, it is still valued at just £30.2m excluding net cash, which we believe is relatively modest given the potential size of the markets being addressed.

Progressive dividend policy helpful in attracting new investors

Although this is not a high yielding stock, the growing dividend is well covered and this must also be generating some interest. There is certainly potential for dividend increases to be sustained in the coming years.

Using near term profit forecasts to derive a valuation is inappropriate at this stage

On a rating of 16.1x prospective earnings for the current year it could be argued that the shares are not cheap. However, the ability to generate significant growth in profit, both organically and through further acquisitions, is clear. The impact of recent acquisitions will feed through into results for the current year and beyond, boosting growth and this may well result in a higher rating.

Prospects

Sanderson's prospects look solid

The future for Sanderson looks sound. Despite trading conditions which have been far from ideal in recent years the company has continued to build a track record and with the economic outlook now slightly brighter there is room for more progress to be made.

The strong balance sheet and net cash position limit the downside risk to some extent. A healthy order book at the year end also provides a good platform to build upon and additional visibility. Ultimately, Sanderson provides services to some very attractive customers, particularly in multi-channel retail. As the end markets which the company services develop, opportunities will continue to be created.

The company has a very good record of meeting or exceeding forecasts

Sanderson has a habit of at least meeting expectations and the nature of its business should ensure that this remains the case for the foreseeable future. The company is addressing some interesting developing markets and should be well placed to deliver organic growth. Acquisitions such as those completed in recent months have the potential to drive additional growth over the medium to long term.

Share Price Graph



Profit and Loss Year End 30 Sept	2012 (£m)	2013 (£m)	2014(E) (£m)	2015(E) (£m)
Revenue				
Manufacturing	6.2	6.6	6.9	7.2
Multi-channel retail	7.2	7.2	9.0	9.8
Total	13.4	13.8	15.9	17.0
Operating Profit				
Manufacturing	0.8	0.9	1.0	1.0
Multi-channel retail	1.1	1.1	1.5	2.0
Total	1.9	2.0	2.5	3.0
Movement in fair value of derivatives	0.0	0.0	0.0	0.0
Net finance costs	(0.2)	(0.0)	(0.0)	(0.0)
Exceptional finance charge	(0.2)	(0.0)	(0.0)	0.0
Profit before Tax	1.5	2.0	2.5	3.0
Tax	(0.2)	(0.3)	(0.2)	(0.5)
Profit after Tax	1.3	1.7	2.3	2.5
Av number of shares (m)	46.12	46.54	50.91	51.48
EPS (p)	2.8	3.7	4.2	4.7
DPS (p)	1.2	1.5	1.6	1.7

Ratios	2012	2013	2014(E)	2015(E)
Sales Growth (%)	-4.9	3.4	15.2	6.9
Operating Margin (%)	14.3	16.1	15.7	17.6
EPS Growth (%)	173	32.1	13.5	11.9
DPS Growth (%)	60	25	6.7	6.3
Dividend Cover (x)	2.5	2.5	2.6	2.8

Cash flow Year end 30 Sept	2012 £'000	2013 £'000
Profit for the period	2,406	1,691
Adjustments	(184)	725
Operating cash flow	2,222	2,416
Discontinued operations	(356)	-
Changes in working capital/provisions	(521)	(1,385)
Net cash flow from operating activities	1,345	1,031
Interest paid	(703)	-
Income tax received	377	-
Net cash flow from operating activities	1,019	1,031
Purchase of assets	10,381	(660)
Investing cash flow - discontinued operations	(140)	-
Financing activities	(7,813)	(775)
Net Increase in cash and cash equivalents	3,447	(404)
Cash and cash equivalents at start of year	619	4,066
Cash and cash equivalents at end of year	4,066	3,662

Balance sheet Year End 30 September	2012 £'000	2013 £'000
Intangible assets	22,404	23,194
Other non-current assets	1,939	1,695
Total	24,343	24,889
Current assets	7,800	7,238
Current liabilities	(7,480)	(6,782)
Net Assets	20,030	20,899
Non-current liabilities	(4,633)	(4,446)
Share capital	4,352	4,380
Share premium	4,205	4,302
Other reserves		42
Retained earnings	11,473	12,175
Shareholders funds	20,030	20,899

Ratios	2012	2013
NAV (p)	46.0	47.7
Gearing (%)	n/a	n/a

GENERAL INFORMATION

COMPANY DATA

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FINANCIAL CALENDAR

Expected AGM Date:	28 February 2014
Ex-Dividend Date:	5 March 2014
Final Dividend Payment Date:	28 March 2014
Interim Results Period End:	31 March 2014
Interim Results Due:	June 2014
Next Year End:	30 September 2014

The above dates should only be used for guidance

Significant Shareholders

Ordinary shares of 10p each

	Number	%
C Winn	12,745,000	24.8
Hargreave Hale	6,240,907	12.1
ISIS Equity Partners	4,818,257	9.4
Miton Capital Partners	4,454,985	8.7
AXA Framlington Asset Management	2,750,000	5.3
Unicom Asset Management	1,767,472	3.4

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