

Sanderson Group

Update
2nd December 2015

In-line With Expectation Full-Year Results

Sanderson Group has announced full-year results that are in-line with our expectations, with revenue growing by 17% to £19.18m and adjusted operating profit increasing by 16% to £3.30m. The software and IT services company added that it is confident of making further progress and deliver trading results which are, at least, in-line with market expectations for the current financial year (FY16). Accordingly, we have updated are forecasts for FY16 and have issued forecasts for FY17. We continue to classify the shares as a hybrid growth and income stock, with the shares offering investors exposure to the high-growth Enterprise Resource Planning software market as well as a decent prospective dividend yield of 3.70%.

■ Full-Year Results

For the 12-months ended 30th September 2015, group gross profits increased by 16% as gross margins were maintained at 85% (2014: 85%), reflecting a continuing emphasis on the supply of Sanderson proprietary software and services. The group's order book remained strong and at the year-end, stood at £2.35 million (2014: £2.41 million), providing a solid platform from which to achieve progress in the current financial year. Pre-contracted revenue increased by 11.5% to £9.77 million (2014: £8.76 million), representing 51% of total revenues. The gross margin from recurring revenue covered 67% of total group overheads in the year (2014: 71%). At year-end, the cash balance was £4.61 million (2014: £6.16 million). This strong cash generation has allowed Sanderson Group to increase its full-year DPS by 17% to 2.1p (2014: 1.80p), which is well covered by basic EPS of 3.4p (FY14: 3.1p).

■ Financial forecasts

For FY16, we continue to forecast revenue of £20.50m. We are assuming gross margins of 85%, leading to a gross profit forecast of £17.43m. We expect the group to continue its investment in product innovation, as well as sales & marketing, and are forecasting an adjusted EBIT of £3.69m. We are forecasting an interest charge of £200k and an acquisition-related finance charge of £80k, leading to an adjusted PBT of £3.46m. We are forecasting a DPS of 2.30p. For FY16, we are forecasting revenue of £21.50m and gross profit of £18.28m. We are forecasting an adjusted EBIT of £3.96m and adjusted PBT of £3.81m. We anticipate DPS of 2.5p.

■ Valuation

The shares are trading at a 33% discount to the Software & IT services sector on an EV/EBITDA basis (10.4x vs 15.5x). A key risk includes a deterioration in the economic environment.

Table: Financial overview

Year to 30 th Sep.	2014A	2015A	2016E	2017E
Revenue (£'000)	16,411	19,182	20,500	21,500
PBT* (£'000)	2,707	3,165	3,461	3,811
EPS* (p)	4.61	5.05	5.61	6.25
Dividend (p)	1.80	2.10	2.30	2.50
Yield (%)	2.67%	3.11%	3.41%	3.70%

Source: GECR and company.

Notes: *Adjusted

Key data

Share price	67.50p
52 week high/low	73.00p/59.50p
Primary exchange	AIM
EPIC	SND
Shares in issue	54.60 m
Market Cap	£37.13 m
Sector	Software & Computer Services

Share price chart



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Full-Year Results

Sanderson has announced its results for the 12-months ended 30th September 2015.

Group revenue increased by 17% to £19.18 million (2014: £16.41 million). Reflecting prior and continuing investment in the group's sales and marketing capacity and capability, Sanderson achieved an improved intake of sales orders in the year of £10.03 million (2014: £8.71 million), with 21 new customers being gained (2014:17).

Gross profits increased by 16% as gross margins were maintained at 85% (2014: 85%), reflecting a continuing emphasis on the supply of Sanderson proprietary software and services.

Adjusted operating profit (stated before the amortisation of acquisition-related intangibles, share-based payment charges and acquisition-related and restructuring costs) grew by 16% to £3.30 million (2014: £2.84 million).

The group's order book remained strong and at the year-end, stood at £2.35 million (2014: £2.41 million), providing a solid platform from which to achieve further progress in the current financial year. Pre-contracted revenue increased by 11.5% to £9.77 million (2014: £8.76 million), representing 51% of total revenues. The gross margin from recurring revenue covered 67% of total group overheads in the year (2014: 71%).

The company invested in excess of £3 million during the year to further develop its operations, including £1.9 million of consideration and deferred consideration payment in respect of acquired businesses. At year-end, the cash balance was £4.61 million (2014: £6.16 million). This strong cash generation has allowed Sanderson Group to increase its full-year DPS by 17% to 2.1p (2014: 1.80p), which is well covered by basic EPS of 3.4p (FY14: 3.1p).

Figure: Forecast comparison

	Actual (£'000)	GECR forecast (£'000)	Difference (%)
Total revenue	19,182	19,000	1.0%
Cost of sales	(2,964)	(3,021)	1.9%
Gross profit	16,218	15,979	1.5%
Operating costs*	(13,791)	(12,825)	7.5%
EBIT*	3,303	3,351	1.4%
EBITDA*	4,042	3,772	7.2%
PBT*	3,165	2,913	8.7%
PAT*	3,001	2,749	9.2%

Source: Company and GECR

*Adjusted

Multi-channel review

One iota Limited has grown revenue by in excess of 70% during the year. Proteus has made a steady start as part of Sanderson and contributed £1.88 million of revenue and £58k of profit. Ten new customers were gained during the year, including Anzac Wines & Spirits, Dunsters Farm, Superdry and Matthew Algie (2014: ten new customers). Divisional revenue rose by 31% to £12.71 million (2014: £9.68 million) and operating profit rose by 39% to £2.62 million (2014: £1.89 million). The year-end order book continued to be strong at £1.45 million (£1.48 million) and with good sales prospects, the multi-channel retail business is well-positioned to achieve its increased trading targets for the current financial year. Revenues derived from the digital retail market grew by 30% to £5.87 million (2014: £4.53 million)

Manufacturing review

The overall divisional trading performance was lower than expected. The group business which focuses on customers operating in the food and drink market sector experienced some delay in the receipt of expected sales orders and delivered a lower level of profitability as a result. However, one large order with a value in excess of £400k was gained just after the year-end and the outlook for the current year is much improved.

The introduction of the new Unity Express ‘ERP’ (‘Enterprise Resource Planning’) product aimed at new and emerging manufacturing businesses has proved successful and three new customers were gained in the year, albeit at an average contract value of in the region of £35k, compared with the average value experienced by the remainder of the group of c.£75,000 across the 21 new customer contracts signed in the year.

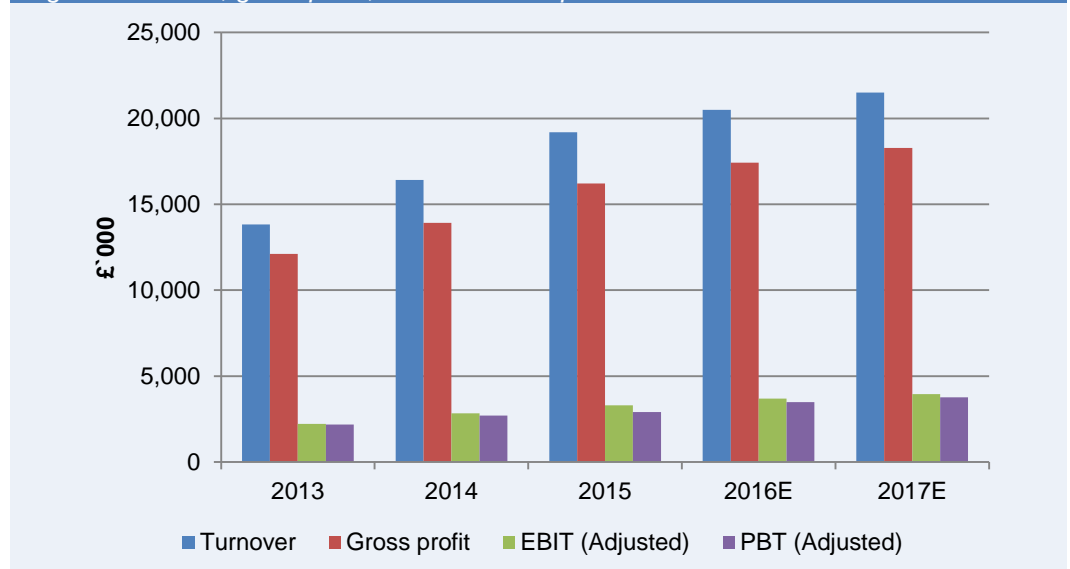
Eleven new customers were gained during the year, including Simtom Food Products, Summit Chairs, St Marcus Fine Foods, Wine Bottling Solutions, Purdie Dished Ends and NutriFresh (2014: seven new customers).

Revenue for the year was £6.48 million (2014: £6.74 million) and operating profit was £680,000 (2014: £952,000). Recurring revenue represents over 58% of total divisional revenue and covers over three-quarters of divisional overheads. A good start to the current year, together with a strong sales prospect list, is expected to ensure that the manufacturing division achieves a much improved trading result for the current financial year (FY16).

Forecasts

The strategy of Sanderson is to achieve sustained growth by further building and developing its businesses operating within the multi-channel retail and manufacturing target markets. The digital retail opportunity, in particular, provides exposure to a market sector which is experiencing rapid growth. Whilst the group will continue to invest across all of its businesses, particular emphasis will be placed on further developing the range of offerings for its fast growing digital retail businesses, for the food and drink processing sector and for entry level systems in the manufacturing division. Mobile solutions continue to be developed across all of the group’s target markets. To augment organic growth, selective acquisition opportunities will continue to be considered.

Figure: Revenue, gross profit, EBIT and PBT profile

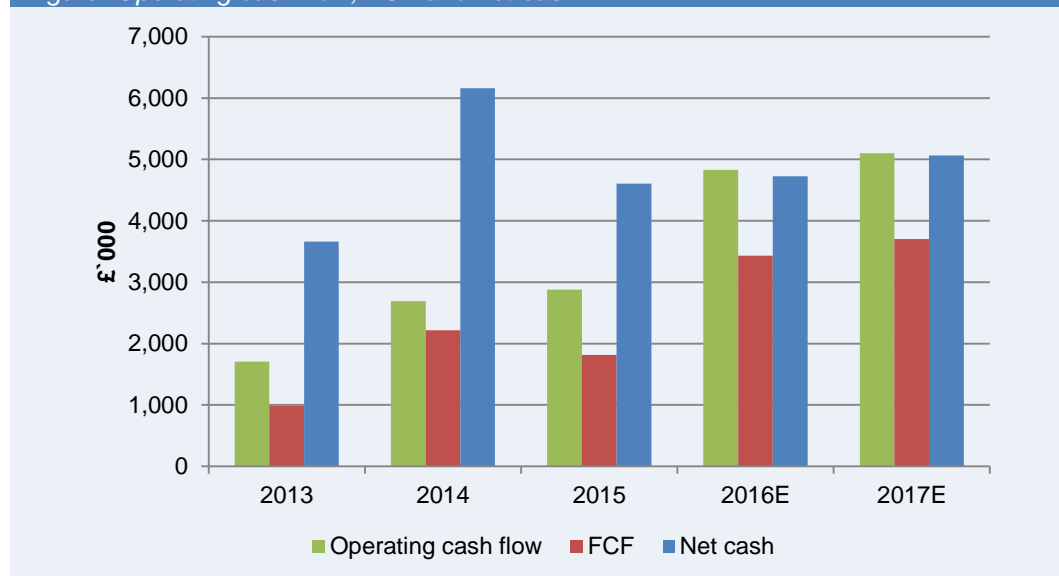


Source: Company and GE

For FY16, we are forecasting revenue of £20.50m. With a large amount of higher margin products expected to be sold, we are assuming gross margins of 85%, leading to a gross profit forecast of £17.43m. 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 an adjusted EBIT of £3.69m. We are forecasting an interest charge of £200k, representing the notional (non-cash) charge on the pension deficit as required by IAS19, and an acquisition finance charge of £80k, leading to an adjusted PBT of £3.46m. We are forecasting a DPS of 2.30p.

For FY17, we are forecasting revenue of £21.50m. As mentioned above, we expect a large proportion of higher margin products to be sold, and are therefore forecasting a gross profit of £18.28m. With further product innovation and sales & marketing investments anticipated, we are forecasting an adjusted EBIT of £3.96m and adjusted PBT of £3.81m. We anticipate DPS of 2.5p.

Figure: Operating cash flow, FCF and net cash



Source: Company and GE CR

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 multi-channel retail and manufacturing markets, the strengthened balance sheet and strong cash generation augur well for Sanderson. The shares are trading at a 33% discount to the Software & IT services sector on an EV/EBITDA basis (10.4x vs 15.5x), and offer an attractive prospective yield of 3.70%.

Appendix

Figure: P&L forecasts

Year end: 30th Sept.	2013	2014	2015	2016E	2017E
Revenue (£'000)	13,828	16,411	19,182	20,500	21,500
EBITDA (£'000)	2,333	2,813	3,559	4,743	5,013
Depreciation and amortisation (£'000)	(361)	(765)	(1,138)	(1,138)	(1,138)
Operating profit (£'000)	1,972	2,048	2,421	3,605	3,875
Other income (£'000)	0	0	0	0	0
Net interest (£'000)	(29)	(132)	(138)	(153)	(153)
PBT -reported (£'000)	1,943	1,916	2,031	3,372	3,722
Impairment of acquired intangibles (£'000)	(66)	(387)	(483)	0	0
Non-recurring items/exceptionals (£'000)	(177)	(404)	(399)	(89)	(89)
PBT - normalised (£'000)	2,186	2,707	2,913	3,461	3,811
Taxation (£'000)	(252)	(318)	(164)	(400)	(400)
Minorities & preference dividends (£'000)	0	0	0	0	0
Discontinued/assets held for sale (£'000)	0	0	0	0	0
Net Income - normalised (£'000)	1,934	2,389	2,749	3,061	3,411
Attributable profit (£'000)	1,691	1,598	1,867	2,972	3,322
EPS - reported (p)	3.9	3.1	3.4	5.4	6.1
EPS (norm., cont.) – FD (p)	4.2	4.4	4.9	5.4	6.0
DPS (p)	1.5	1.8	2.1	2.3	2.5
Average number of group shares - FD (m)	46.1	54.2	55.9	57.0	57.0
Average number of group shares (m)	43.7	51.9	54.4	54.6	54.6

Source: Company and GECR

Figure: Cash flow forecasts

Year end: 30th Sept.	2013	2014	2015	2016E	2017E
Profit for the period	1,691	1,598	1,867	2,972	3,322
Depreciation & amortisation	361	765	1,138	1,138	1,138
Other cash and non-cash movements	364	551	643	642	642
Change in working capital	(708)	(224)	(771)	0	0
Operating cash flow	1,708	2,690	2,877	4,752	5,102
Pension contribution	(677)	(360)	(450)	(600)	(600)
Interest Paid	0	(2)	0	(153)	(153)
Tax paid	0	0	(5)	(300)	(300)
Cash utilised by non-recurring items	0	0	(310)	0	0
Cash flow from operations	1,031	2,328	2,112	3,699	4,049
Maintenance capex	(45)	(113)	(296)	(296)	(296)
Free cash flow	986	2,215	1,816	3,403	3,753
Expansionary capex	0	0	0	0	0
Other financials	(375)	(652)	(515)	(812)	(812)
Acquisitions	(440)	(2,146)	(1,936)	(1,300)	(1,300)
Disposals	0	0	0	0	0
Net share issues	15	3,953	118	0	0
Dividends paid	(590)	(873)	(1,035)	(1,255)	(1,364)
Change in net cash	(404)	2,497	(1,552)	36	278
Net cash/(debt)	3,662	6,159	4,607	4,643	4,922
FCFPS - FD (p)	2.1	4.1	3.3	6.0	6.6

Source: Company and GECR

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