SMALL CAP SHARE COMMENT

Commissioned Commentary

SANDERSON GROUP (AIM:SND)

Share price 67.5p

Results in line, dividend ahead and 3 year plan suggests plenty of potential, especially in digital

Date:**1st December 2015**
Sector: **Software & Computer Services**
Market Cap: c£37m
www.sanderson.com

The software and IT services business specialising in multi-channel retail and manufacturing markets in the UK and Ireland issued preliminary results for the year ending 30th September 2015 in line with pre-close update issued on 27th October 2015. This Group's consistency in the timing of its results statements should be commended….as should the growing dividend! With the use of mobile technologies continuing to grow, the Group looks well placed to benefit.

- About

The Group provides a comprehensive and constantly developing range of modern software solutions together with associated services to businesses in the multi-channel retail and manufacturing markets, with increasing emphasis on their own proprietary solutions.

The primary target market for Sanderson comprises generally small and medium sized businesses, with particular emphasis over the past few years in the development of mobile commerce solutions and food and drink processing solutions. The mobile commerce products, together with in-store technology developments, are collectively referred to as digital retail solutions which enable retailers to capitalise on the huge growth in the widespread adoption of smartphones and tablets and to exploit mobile as a sales channel.

- Summary results

Income statement

Results for the year ending 30th September 2015 show revenue growing to £19.18m (2014: £16.41m), and adjusted operating profit (stated before amortisation of acquisition-related intangibles, acquisition-related costs and share-based payment charges) of £3.30m (2014: £2.84m). The value of the order book at the year-end of £2.35m was marginally down on the prior period (2014: £2.41m), although the timing of a significant order (c£400k), which came in a couple of days after the year end, means this is actually in decent shape.

The overall gross margin of 84.5% (2014:84.9%) is maintained and once again reflects the continuing emphasis on the supply of Sanderson proprietary software and services.

The final proposed dividend was 1.2p per ordinary share (2014:1p), making a total dividend of 2.1p (yield 2.5% at current share price), marginally ahead of forecasts and a 17% increase compared with the prior year.

The accompanying presentation offers an interesting assessment of the theoretical return to shareholders since IPO on 16th December 2004, which we have updated:

	Share Price	% Gain
16th December 2004 IPO price	50.00p	
The current share price	67.00p	
Dividends since December 2004	16.35p	
Theoretical Gain since IPO	33.35p	+66.7%
FTSE 100 since 16th Dec 2004		+34.6%
FTSE Small Cap since 16th Dec 2004		+68.7%

Investor's Champion Ltd
Langwood House,
63-81 High Street.
Rickmansworth, Herts WD3 4DZ
www.investorschampion.com

Balance sheet
The Group's cash position remained strong with net cash at 30th September 2015 of £4.6m (2014: £6.1m), equivalent to 8.4p per share.

Operating profit of £2.4m saw an operating cash inflow of £2.8m with cash largely recycled into supporting acquisitions (£1.9m) and development expenditure (£824k).

Significant development expenditure was incurred in the One iota MESH platform, which is a cloud based platform that delivers enterprise grade solutions in a Software as a Service (SaaS) model.

The pension deficit at 30th Sept 2015 was £4.6m (2014: £4.8m) and, following negotiations with the pension trustee in the summer, the annual funding requirement will fall to £330k in the Financial Year ending September 2016 and £360k in 2017.

- Recurring revenues underpin the business

At the core of the Group's business model is Sanderson software with on-premise and cloud-based licences, together with Sanderson services, provided to customers on an ongoing annual contractual basis. This recurring revenue stream is augmented by consultancy, support and maintenance services. In the year ended 30 September 2015, pre-contracted revenues were £9.77m representing 51% of total revenues (2014: £8.76m). This percentage of the overall is marginally down on the prior year due to a different mix of activity and impact of acquisitions, notably the rapidly expanding One iota business which had a higher element of non-recurring revenue given the deployment of new solutions. The gross margin from recurring revenues covered 67% of total Group overheads in the year (2014: 71%).

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 £10.03m (2014: £8.71m), with 21 new customers being gained (2014: 17).

Based on estimated revenue of £20.1m for the year ending 2016, recurring revenue accounts for £10.7m, the order book £2.35m with a 'gap' of £7.05m to fill, representing 35% of the overall.

- Divisional review

This is the last time the divisional review will be presented in this form as going forward the Group will breakdown its divisional results in terms of a **Digital Retail** business division and an **Enterprise software** division. We expand on this further in the Outlook section below.

Multi-channel retail
Revenue £12.7m (2014: £9.67m)
Operating profit £2.62m (2014: £1.89m)
Order book £1.45m (2014: £1.48m)
Gross margin 86.8% (2014: 86.6%)
350+ customers

The Group provides comprehensive IT solutions to businesses operating in the ecommerce, mobile commerce, retail, distribution, wholesale and logistics sectors of the UK. Mobile enablement and deployment continues to be a key business driver in this sector with increasing levels of business activity.

One iota has grown revenue more than 70% during the year with £120m of transactional revenue undertaken via the MESH platform in 2015. The wholesale distribution and cash and carry market has been a slower area of business during the year but prospects for the coming year have improved, driven by the latest enhanced version of software.

The new Proteus acquisition, which delivers warehouse management software, has made a steady start as part of Sanderson and contributed £1.88m of revenue and £58,000 of profit. The addition of Proteus has helped to further expand the Group's presence in the areas of warehousing, logistics and supply chain. A number of internal 'joint' sales opportunities are being developed.

The deployment and use of mobile technologies is continuing to grow, with Sanderson's mobile & ecommerce growing at 30% as it benefits from retailer investment in digital technology. In the coming year, management expects to focus further efforts on delivering growth across the Group's businesses but especially from the newly emerging digital retail market, where the Group's One iota business has a growing presence.

A Conlumino survey for Barclays in April 2015 revealed that many retailers offer neither a mobile optimised website nor a mobile app, with less than 5% of retailers saying their business was at the cutting edge of mobile commerce and over 60% agreeing mobile features and facilities were essential to maintain market share

Ten new customers were gained during the year, including Anzac Wines & Spirits, Dunsters Farm, Superdry and Matthew Algie (2014: ten new customers). The multi-channel retail division has continued to gain a number of large orders from existing customers who generally invest in and deploy the latest technologies to attract new customers and to maximise sales.

The Top 5 Customers were 'No. 1 Customer' (not named), WCF Home Shopping, MandM Direct, Clipper Logistics and Import Services.

Manufacturing

Revenue £6.48m (2014: £6.74m)
Operating profit £680k (2014: £952k)
Order book £1.2m (2014: £895k)
Gross margin 80% (2014:82.3%)
200 customers

The main areas of specialisation in Manufacturing are food and drink, engineering, plastics, aerospace, electronics and print manufacturing sectors.

Businesses in the food and drink processing sectors and engineering, plastics, aerospace, electronics, print ('general manufacturing'), represent the main areas of specialisation for Sanderson in manufacturing markets. The overall divisional trading performance was lower than expected and this contrasted with the strong trading performance of the prior year.

The Group business which focuses on customers operating in this 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. As stated earlier, one large order with a value in excess of £400,000 was gained just after the year-end and the outlook for the current year to 30 September 2016, is much improved.

The Sanderson business which addresses the general manufacturing market improved its trading performance and this improvement is expected to continue into the current year.

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 £35,000, compared with the average value experienced by the remainder of the Group of nearer £75,000 across the 21 new customer contracts signed in the year. It is expected that Unity Express will augment the Unity solution, which is targeted at larger businesses.

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. This compares with seven new customers in the prior year. Large projects with existing customers included Food Partners, Cook Trading and Freddy Hirsch.

- Acquisitions

On 5 December 2014, the Group acquired the supplier of specialist warehouse management solutions, Proteus Software Limited, for an initial cash consideration of £1.40m. Up to a further £0.5m is payable in March 2016, based upon the trading performance of Proteus in the twelve months following acquisition. Proteus solutions, which complement the Group's own products, services and customers are used by businesses operating in the areas of third party logistics, warehouse management and supply chain distribution. The Proteus business has been positioned within the Group's multi-channel business and its results are reported within this division.

- Broker forecast

Following the results, house broker forecasts for the full year ending September 2016 have been lifted marginally higher and are now for sales of £20.3m, normalised profit before tax of £3.4m, adjusted earnings per share of 5.1p and a dividend of 2.3p, equating to a yield of 3.4%.

- Outlook

The results statement concluded with comment on the adoption of a three-year strategy and business plan to further develop the Group both organically as well as by way of selective acquisitions, thereby increasing profitability, dividends and shareholder value. In connection with this, the presentation reveals a 3 year target for annual revenue of £30m, pre-tax profit of £4m to £5m and eps growth of 50%+. This assumes a combination of acquisitions and organic growth.

Reflecting the growing importance of the Group's digital retail business, going forward, the Group intends to report its breakdown of divisional results in terms of a **Digital Retail** business division and an **Enterprise** software division, which consist of a manufacturing business and a warehouse and logistics business. The combination of more rapid growth available via a Digital Retail division and the steadier growth from the Enterprise Software business is expected to enable the Group to meet its strategic targets over the next three years and beyond.

Applying the proposed Group structure to the existing results would have seen the following:

Digital Retail
Revenue £5.9m (31% of total)
Operating profit £1.3m

Enterprise
Distribution, Wholesale and Logistics
Revenue £6.8m (35% of total)
Operating profit £1.3m

Manufacturing
Revenue £6.5m (34% of total)
Operating profit £0.7m

There was a good level of confidence that, at this early stage of the new financial year, the Group will make further progress and deliver trading results which are, "at least", in line with market expectations for the year ending 30 September 2016.