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Sanderson Group (SND) AIM

INVESTMENT SUMMARY

- **Results for the year ended 30 September 2015 have been released. Revenue and profit were in line with expectations, with surprises unlikely in any case following a trading update in late October. However, the final dividend was increased more than anticipated, nudging the yield above 3%.**

- **The company is confident that it will be able to at least meet current expectations for the new financial year, primarily due to a strong balance sheet and high level of recurring revenues. We share this view given the scope for multi-channel retail to make further progress.**

- **The order book stood at £2.35m at the year end, down marginally on a year earlier but nevertheless at a strong level. With gross margin maintained at a very impressive 85%, the business is well positioned to deliver sustained profitability.**

- **Sanderson is in good shape overall. Performance in manufacturing was somewhat disappointing in the last financial year but the multi-channel retail division has made considerable progress in the recent past, driven by some interesting acquisitions. This division has been seen as key to long term growth for some time and we believe that the market could soon pay greater attention to this part of the business.**

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 (%)
2014A	16.4	2.7	4.4	15.3	1.8	2.7
2015A	19.2	3.2	4.9	13.8	2.1	3.1
2016E	20.4	3.4	5.1	13.2	2.3	3.4
2017E	21.2	3.6	5.2	13.0	2.5	3.7

* - adjusted; ** - diluted adjusted

KEY DATA

Share Price:	**67.5p**
Prospective p/e ratio:	**13.2x**
Prospective net yield:	**3.4%**
Market Capitalisation:	**£36.9m**
Next Results Due (Interims):	**JUN**
Net Cash (at 30 September):	**£4.61m**
NAV per share:	**48.8p**

BULLET POINTS

- Another solid set of final results has been delivered
- Gross margin maintained at 85%
- Acquisitions continue to help drive improved performance
- Strong net cash position and healthy balance sheet
- Increased dividend pushes yield above 3%

Date of Report : 1 December 2015

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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, and One iota Limited, which provides cloud-based multi-channel solutions, were acquired in 2013. Proteus Software Limited was subsequently acquired in December 2014.***

- ***The sale of Sanderson RBS in January 2012 transformed the balance sheet, resulting in a net cash position. The acquisition of One iota Limited was accompanied by a share placing, which raised £3.5m and this ensured that a healthy cash balance was maintained. The net cash balance as at 30 September 2015 was £4.61m.***

- ***Order intake was 15% higher at £10.03m versus £8.71m in the prior year, representing another strong increase. As at the period end the order book stood at £2.35m (2014: £2.41m). This puts the company in a strong position moving into the new year..***

- ***Most revenue comes from additional spend from the existing customer base. However, 21 new customers were gained (2014: 17 new customers).***

- ***Gross margin was maintained at an impressive 85%.***

- ***The balance sheet remains in good shape. Net cash as at 30 September 2015 was £4.61m, down from £6.16m a year earlier but there was considerable investment including £1.9m of consideration and deferred consideration payments in respect of acquired businesses. A final dividend of 1.2p per share was declared, taking the total for the year to 2.1p (2014: 1.8p). A progressive dividend policy is in place.***

- ***Sanderson has adopted a three year strategy with the aim of developing the group both organically and through acquisitions. The business looks well positioned for the medium to long term given scope for further meaningful growth in the multi-channel retail division.***

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.

Sanderson floated on AIM in December 2004

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.

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, acquiring Catan Marketing and One iota in 2013 followed by Proteus Software in December 2014.

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 the likes of MandM Direct, Clipper Logistics, Superdry, 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 accounted for the bulk of operating profit last year and we expect the division to continue to be a focus for future investment, particularly in terms of ecommerce via mobile devices

This division accounted for the majority of operating profit in the year to September 2015 following weaker performance from the Manufacturing division. 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.

Catan Marketing, One iota and Proteus Software have been acquired in the past couple of years and have made a solid contribution so far.

Manufacturing

Manufacturing had accounted for around a third of operating profit

Having accounted for 34% of operating profit in the year to September 2014, we have previously noted that this figure was likely to fall moving forwards. Nevertheless, performance last year was somewhat disappointing and operating profit fell from £952k to £680k. Recurring revenue represented a high proportion of revenue and there is a large customer base with some long standing relationships.

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 further growth.

Acquisitions

Proteus Software is the latest acquisition…

Following on from the acquisitions made in 2013, Proteus Software Limited, a supplier of specialist warehouse management solutions, was acquired in December 2014. The initial cash consideration was £1.4m and up to a further £0.5m is due to be paid in March 2016. This is based on the trading performance of Proteus in the twelve months following acquisition.

…further acquisitions likely at some stage

Further acquisitions are likely. A conservative approach will no doubt be taken but given the opportunities in multi-channel retail, acquisitions are likely to be used to drive further growth.

Final Results

Results were solid, with a significant increase in revenue

In the year ended 30 September 2015 revenue was £19.18m (2014: £16.41m) and the gross margin remained steady at 85%. There was solid progress in the multi-channel retail division, offset by some timing delays in the manufacturing division. Operating profit before amortisation of acquisition-related intangibles, share-based payment charges and acquisition-related and restructuring costs was £3.30m (2014: £2.84m). Adjusted pre-tax profits were £3.17m (2014: £2.71m) and adjusted diluted earnings per share were 4.9p (2014: 4.4p). The value of the order book at the period end was £2.35m (2014: £2.41m).

The order book stood at £2.35m at the period end

There was net cash of £4.61m at the year end

The final dividend was 1.2p per share, taking the total for the year to 2.1p

Net cash stood at £4.61m as at the year end (2014: £6.16m), following over £3m of investment. The net cash equates to approximately 8.4p per share. The balance sheet remains in good shape and this allowed the progressive dividend policy being maintained. A final dividend of 1.2p per share was declared, making a total of 2.1p for the year, up 17% on the payout in 2014. The final dividend is due to be paid on 18 March 2016, with the ex-dividend date being 4 March 2016. The progressive dividend policy is due to continue although growth is likely to be relatively modest.

Multi-channel retail continues to be the most exciting part of the business

Multi-channel retail brought in revenue of £12.71m (2014: £9.68m) with continued strong growth in ecommerce businesses, aided by acquisitions. The division gained ten new customers, the same as in the previous financial year. Proteus, the most recent acquisition, contributed £1.88m of revenue and £58k of profit. Adjusted operating profit from the division was £2.62m (2014: £1.89m).

Performance from manufacturing was disappointing...

...the new year is off to a better start though

Manufacturing suffered from some delays in the food and drink market. Revenue for the division was £6.48m (2014: £6.74m) and adjusted operating profit was £680k (2014: £952k). However, on a more positive note, recurring revenue represents 58% of divisional revenue and covers over 75% of divisional overheads. The new year has also started well.

Forecasts

Modest progress is expected this year in terms of revenue and profit

Sanderson looks well positioned to deliver another solid year of results in the current financial year. The multi-channel retail division should continue to benefit from interesting opportunities in ecommerce and timing issues mean that manufacturing is likely to deliver better performance in the current year than last.

The three year plan should add focus

A three year plan is being implemented and this should ensure that the business delivers improved performance over the medium to long term. We are particularly keen to see the company expand further in multi-channel retail and believe that this area is likely to be fruitful in the coming years.

Bolt-on acquisitions probable, although timescale is uncertain

Bolt-on acquisitions are likely to drive further value into the business. The acquisitions completed in the recent past have made a positive contribution to date and the company certainly has the firepower to act should similar opportunities arise moving forwards.

On balance we believe that Sanderson is a solid business with sound prospects. The net cash position and strong balance sheet provide support to the current share price and exposure to ecommerce may mean that there is interest from a wider pool of investors at some point.

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Valuation

Excluding cash, the value of the business is just £32.3m

The market capitalisation is £36.9m. Subtracting net cash of £4.6m gives a value of £32.3m, which is arguably too low given the rate of growth in some markets which are being addressed.

Strong track record

The business has an enviable record of profitability and the business is managed conservatively, meaning that this should continue for the foreseeable future. Hence the downside risk should be limited to the threat of lower profitability at the worst.

The shares trade on a relatively low P/E ratio

The shares trade on 13.2x prospective earnings for the current financial year, which is again less than at the same stage last year. The impact of recent acquisitions should continue to be felt and organic growth is highly probable.

Prospects

Bright long term prospects

The long term future for the company looks bright. The track record which is being built is impressive and the company is focusing on some attractive niche areas, working with customers who are developing in their own right.

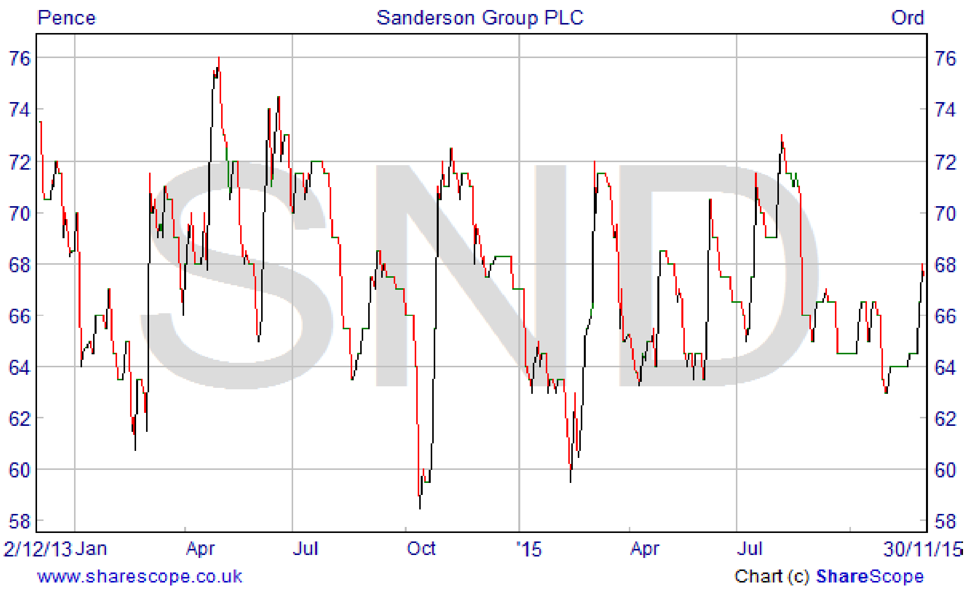
Limited downside

As we have noted, the downside risk is limited and with recurring revenues from existing customers covering such a significant proportion of overheads, the business is well positioned. The significant net cash position means that the business remains well funded to invest both in existing operations and acquisitions.

Current forecasts are undemanding

Current forecasts continue to look undemanding. The business is very stable, with few disappointments for shareholders over the years. We would suggest that there is considerable scope for development in the coming years as the three year plan is executed. Further acquisitions in multi-channel retail are likely to add further value.

Share Price Graph



Profit and Loss Year End 30 Sept	2013 (£m)	2014 (£m)	2015 (£m)	2016(E) (£m)
Revenue				
Manufacturing	6.6	6.7	6.5	7.1
Multi-channel retail	7.2	9.7	12.7	13.3
Total	**13.8**	**16.4**	**19.2**	**20.4**
Operating Profit				
Manufacturing	0.9	0.9	0.7	0.8
Multi-channel retail	1.3	1.9	2.6	2.8
Total	**2.2**	**2.8**	**3.3**	**3.6**
Movement in fair value of derivatives	0.0	0.0	0.0	0.0
Net finance costs	(0.0)	(0.1)	(0.1)	(0.2)
Exceptional finance charge	(0.0)	(0.0)	(0.3)	(0.0)
Profit before Tax	**2.2**	**2.7**	**2.9**	**3.4**
Tax	(0.3)	(0.3)	(0.2)	(0.5)
Profit after Tax	**1.9**	**2.4**	**2.7**	**2.9**
Av number of shares (m)	46.12	54.19	55.86	56.05
EPS (p)	**4.2**	**4.4**	**4.9**	**5.1**
DPS (p)	**1.5**	**1.8**	**2.1**	**2.3**

Ratios	2013	2014	2015	2016(E)
Sales Growth (%)	**3.0**	**18.8**	**17.0**	**6.3**
Operating Margin (%)	**15.9**	**17.1**	**17.2**	**17.6**
EPS Growth (%)	**50.0**	**4.8**	**11.4**	**4.1**
DPS Growth (%)	**25.0**	**20.0**	**16.7**	**9.5**
Dividend Cover (x)	**2.8**	**2.4**	**2.3**	**2.2**

Cash flow Year end 30 Sept	2014 £'000	2015 £'000
Profit for the period	1,598	1,867
Adjustments	1,316	1,781
Operating cash flow	**2,914**	**3,648**
Changes in working capital/provisions	(584)	(1,221)
	2,330	**2,427**
Interest paid	(2)	-
Income tax paid	-	(5)
Net cash flow from operating activities	**2,328**	**2,422**
Purchase of assets	(2,911)	(3,009)
Financing activities	3,080	(965)
Net Increase in cash and cash equivalents	**2,497**	**(1,552)**
Cash and cash equivalents at start of year	**3,622**	**6,159**
Cash and cash equivalents at end of year	**6,159**	**4,607**

Balance sheet Year End 30 September	2014 £'000	2015 £'000
Intangible assets	28,514	30,627
Other non-current assets	1,439	1,788
Total	**29,953**	**32,415**
Current assets	11,091	10,352
Current liabilities	(8,629)	(10,333)
	32,415	**32,434**
Non-current liabilities	(6,598)	(5,807)
Net Assets	**25,817**	**26,627**
Share Capital	5,406	5,460
Share Premium	8,809	9,023
Retained earnings/reserves	11,602	12,144
Shareholders funds	**25,817**	**26,627**

Ratios	2014	2015
NAV (p)	**47.8**	**48.8**
Gearing (%)	**n/a**	**n/a**

GENERAL INFORMATION

COMPANY DATA

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FINANCIAL CALENDAR

Expected AGM Date:	3 March 2016
Ex-Dividend Date:	4 March 2016
Final Dividend Payment Date:	18 March 2016
Interim Results Period End:	31 March 2016
Interim Results Due:	June 2016
Next Year End:	30 September 2016

The above dates should only be used for guidance

Significant Shareholders

Ordinary shares of 10p each	Number	%
C Winn	11,786,924	21.6
Hargreave Hale	7,940,654	14.5
Living Bridge	4,818,257	8.8
Miton Asset Management	4,254,522	7.8
Helium Rising Stars Fund	2,394,753	4.4
Downing ONE VCT	2,193,506	4.0
AXA Investment Management	1,802,500	3.4
Unicorn Asset Management	1,767,572	3.2

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