GECR

Sanderson Group

Update
1st December 2014

In-line With Expectation Full-Year Results

Buy

Sanderson Group has announced full-year results which are in-line with our expectations. We have adjusted our forecasts, mainly to reflect notional interest on the deferred consideration payment due in respect of One iota. 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 ecommerce and mobile commerce markets, a strengthened balance sheet and strong cash generation. Accordingly, we retain our buy stance, with a target price of 87p.

Full-Year Results

For the 12-months ended 30th September 2014, gross profit increased by 14.94% to £13.93m (FY13: £12.12m) as revenue increased by 18.68% to £16.41m (FY13: £13.83m). Gross margin reduced to 84.9% (FY13: 87.6%), but this was skewed somewhat by the delivery of two large infrastructure projects. Adjusted operating profit increased by 28% to £2.84m (FY13: £2.22m), leading to an adjusted pre-tax profit of £2.71m (FY13: £2.19m). The order book also remained good, growing by 24% to £2.41m (FY13: £1.94m), providing a solid platform from which to achieve further progress in the current financial year. The balance sheet and cash-flow remains strong, with no debt, cash of £6.16m (FY13: £3.66m) and 100% adjusted profit-to-operating 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 20% to 1.80p (FY13: 1.50p), which is well covered by basic EPS of 3.1p (FY13: 3.9p).

Financial forecasts

For FY15, we continue to forecast revenue of £17.30m. We are assuming gross margins of 86%, leading to a gross profit forecast of £14.88m. We expect the group to continue its investment in product innovation, as well as sales & marketing, and are forecasting an adjusted EBIT of £3.39m. We are forecasting a higher interest charge of £250k, leading to an adjusted PBT of £3.14m. We are forecasting a DPS of 1.90p. For FY16, we are forecasting revenue of £18.50m and gross profit of £15.73m. With further product innovation and sales & marketing investments anticipated, we are forecasting an adjusted EBIT of £3.60m and adjusted PBT of £3.30m. We anticipate DPS of 2.0p.

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 87p. The prospective yield of 2.90% is also attractive.

Table: Financial overview

Year to 30th Sep.	2013A	2014A	2015E	2016E
Revenue (£'000)	13,828	16,411	17,300	18,500
PBT* (£`000)	2,186	2,707	3,138	3,301
EPS* (p)	4.42	4.61	5.46	5.39
Dividend (p)	1.50	1.80	1.90	2.00
Yield (%)	2.17%	2.61%	2.75%	2.90%

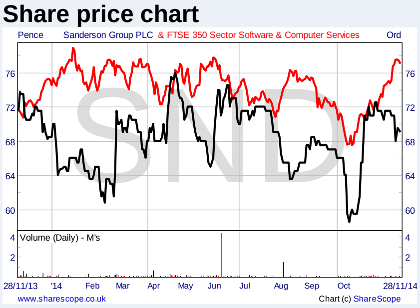
Source: GECR and company. *Notes: *Adjusted*

Target price **87p**

Key data

Share price	69.00p
52 week high/low	76.00p/58.50p
Primary exchange	AIM
EPIC	SND
Shares in issue	51.86 m
Market Cap	£35.78 m
Sector	Software & Computer Services

Share price chart



Analyst details
Emanuil Manos Halicioglu
+44 (0)203 638 6642
Emanuil.Halicioglu@gecr.co.uk

Andrew Noone
+44 (0)203 638 6641
Andrew.Noone@gecr.co.uk

Full-Year Results

Sanderson has announced full-year results which are in-line with our expectations. For the 12-months ended 30th September 2014, gross profit increased by 14.94% to £13.93m (FY13: £12.12m) as revenue increased by 18.68% to £16.41m (FY13: £13.83m). Gross margin reduced to 84.9% (FY13: 87.6%), but this was skewed somewhat by the delivery of two large infrastructure projects. Excluding these two infrastructure projects, gross margin was 86.8%, reflecting the group's continuing emphasis on higher margin Sanderson proprietary software.

Adjusted operating profit increased by 28% to £2.84m (FY13: £2.22m), leading to an adjusted pre-tax profit of £2.71m (FY13: £2.19m). The order book also remained good, growing by 24% to £2.41m (FY13: £1.94m), providing a solid platform from which to achieve further progress in the current financial year.

As with previous years, H2 contributed the larger proportion of annual operating profit, producing an additional £409k (FY13: £239k) of operating profit compared to H1.

Pre-contracted revenues were £8.76m, representing 53% of total revenues (FY13: £7.94m, representing 57%). The gross margin from recurring revenues covered 71% of total group overheads (FY13: 73%).

17 new customers were gained (FY13: 14 new customers) at an average initial contract value of £116k (FY13: £119k). The total value of orders from new customers grew to £1.97m (FY13: £1.67m).

The balance sheet and cash-flow remains strong, with no debt, cash of £6.16m (FY13: £3.66m) and 100% adjusted profit-to-operating 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 20% to 1.80p (FY13: 1.50p), which is well covered by basic EPS of 3.1p (FY13: 3.9p).

Figure: Forecast comparison

	Actual (£'000)	**GECR forecast (£'000)**	**Difference (%)**
Total revenue	16,411	16,100	1.9%
Cost of sales	(2,483)	(2,254)	10.2%
Gross profit	13,928	13,846	0.6%
Operating costs*	(11,089)	(11,026)	0.6%
EBIT*	2,839	2,820	0.7%
EBITDA*	3,200	3,181	0.6%
PBT*	2,707	2,670	1.4%
PAT*	2,389	2,420	1.3%

Source: Company and GECR *Adjusted

Multi-channel division

Revenue from the multi-channel retail division increased grew by 34% to £9.68m (FY13: £7.23m), driven by the ecommerce and mobile ecommerce markets and boosted by the recently acquired One iota business. Revenue from the business operating in the ecommerce and mobile commerce markets now accounts for £4.53m, representing 47% of divisional revenues. One iota revenue increased to £1.66m, which is double the amount of revenue it generated on a year earlier, prior to the acquisition. In fact, in

September, One iota secured its largest order to date, worth £400k, which is expected to be installed, delivered and deployed over the course of the current financial year.

Including a £420k contribution from Oni iota, the division's operating profit increased by 48% to £1.89m (FY13: £1.28m). The profit from the other recently acquired business Priam was minimal, but we expect to see an improved contribution going forward. 10 new customers were gained in the year (FY13: 5 new customers).

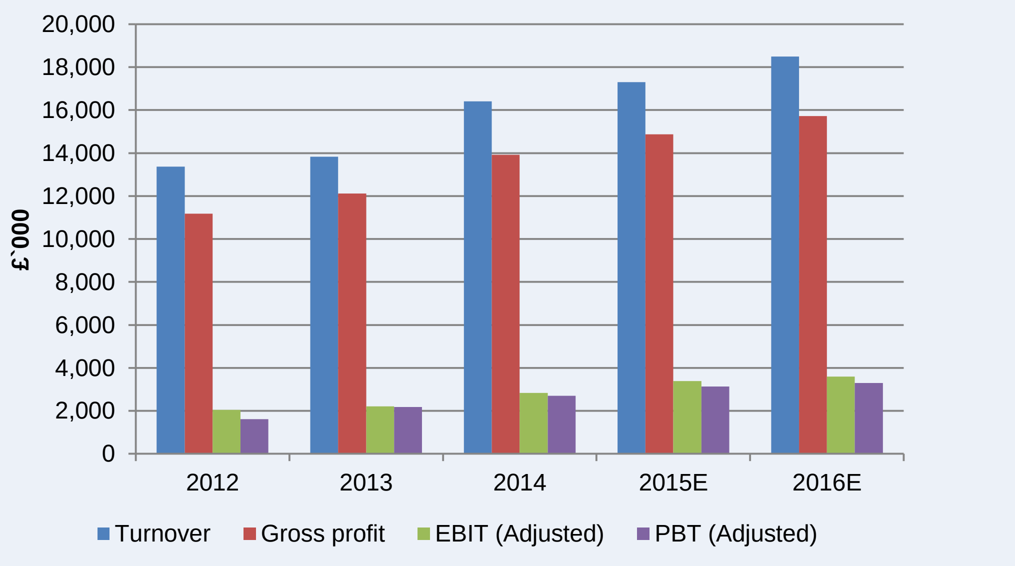
Manufacturing division

Revenue from the manufacturing division increased by 2.3% to £6.74m (FY13: £6.59m), driven by the food and drink processing business, which now accounts for 50% of divisional revenue. Operating profit increased by 2.1% to £952k (FY13: £932k). Order intake was £2.89m (FY13: £3.10m). 7 new customers were gained in the year (FY13: 9 new customers). The order book was £926k (FY13: £1.24m).

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 is on delivering on target results and on making the PRIAM and One iota acquisitions successful.

Figure: Revenue, gross profit, EBIT and PBT profile

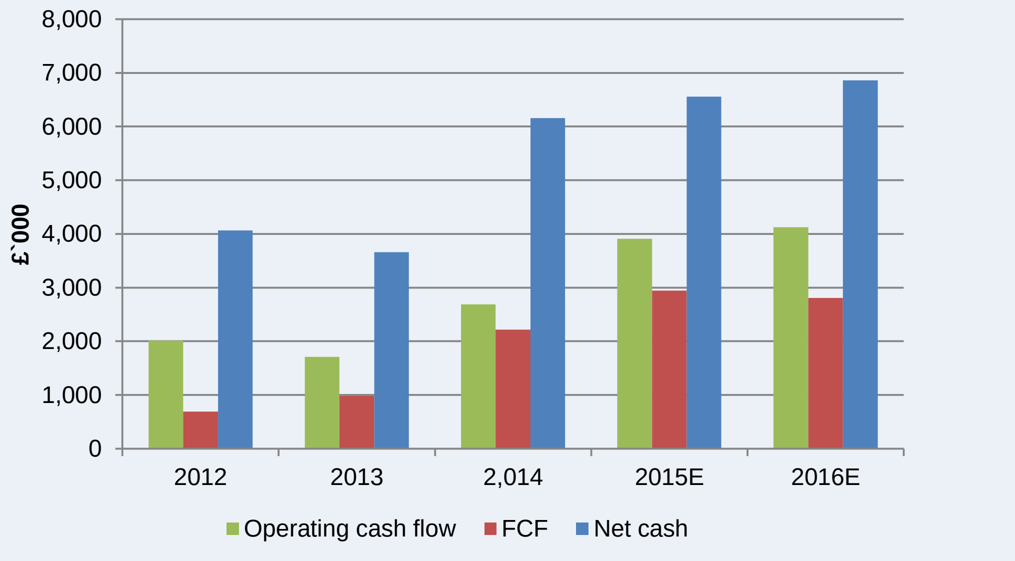


Source: Company and GECR

For FY15, we continue to forecast revenue of £17.30m. 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 £14.88m. 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 £3.39m. We are forecasting a higher interest charge of £250k, due to a deferred consideration from the One iota acquisition, leading to an adjusted PBT of £3.14m. We are forecasting a DPS of 1.90p.

For FY16, we are forecasting revenue of £18.50m. As mentioned above, we expect a larger proportion of higher margin products to be sold, and are therefore forecasting a gross profit of £15.73m. With further product innovation and sales & marketing investments anticipated, we are forecasting an adjusted EBIT of £3.60m and adjusted PBT of £3.30m. We anticipate DPS of 2.0p, but note that this could be higher given the strong cash generation.

Figure: Operating cash flow, FCF and net cash



Source: Company and GECR

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 87p. The prospective yield of 2.90% is also attractive.

Appendix

Figure: P&L forecasts

Year end: 30th Sept.	2012	2013	2014	2015E	2016E
Revenue (£'000)	**13,374**	**13,828**	**16,411**	**17,300**	**18,500**
EBITDA (£'000)	**2,157**	**2,333**	**2,813**	**3,809**	**4,022**
Depreciation and amortisation (£'000)	(251)	(361)	(765)	(522)	(522)
Operating profit (£'000)	**1,906**	**1,972**	**2,048**	**3,287**	**3,500**
Other income (£'000)	0	0	0	0	0
Net interest (£'000)	(214)	(29)	(132)	(250)	(300)
PBT -reported (£'000)	**1,481**	**1,943**	**1,916**	**3,037**	**3,200**
Impairment of acquired intangibles (£'000)	(67)	(66)	(387)	0	0
Non-recurring items/exceptionls (£'000)	(65)	(177)	(404)	(101)	(101)
PBT - normalised (£'000)	**1,613**	**2,186**	**2,707**	**3,138**	**3,301**
Taxation (£'000)	(185)	(252)	(318)	(300)	(500)
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	2,389	2,838	2,801
Attributable profit (£'000)	2,406	1,691	1,598	2,737	2,700
EPS - reported (p)	5.5	3.9	3.1	5.3	5.2
EPS (norm., cont.) – FD (p)	3.6	4.2	4.4	5.0	4.9
DPS (p)	1.2	1.5	1.8	1.9	2.0
Average number of group shares - FD (m)	46.5	46.1	54.2	57.0	57.0
Average number of group shares (m)	43.5	43.7	51.9	52.0	52.0

Source: Company and GECR

Figure: Cash flow forecasts

Year end: 30th Sept.	2012	2013	2014	2015E	2016E
Profit for the period	2,406	1,691	1,598	2,737	2,700
Depreciation & amortisation	251	361	765	522	522
Other cash and non-cash movements	(435)	364	551	651	901
Change in working capital	(206)	(708)	(224)	(250)	(300)
Operating cash flow	**2,016**	**1,708**	**2,690**	**3,910**	**4,123**
Pension contribution	(315)	(677)	(360)	(600)	(600)
Interest Paid	377	0	(2)	0	0
Tax paid	(703)	0	0	0	(300)
Cash utilised by non-recurring items	(356)	0	0	0	0
Cash flow from operations	**1,019**	**1,031**	**2,328**	**3,060**	**2,923**
Maintenance capex	(325)	(45)	(113)	(113)	(113)
Free cash flow	**694**	**986**	**2,215**	**2,947**	**2,810**
Expansionary capex	0	0	0	0	0
Other financials	(7,898)	(375)	(652)	(665)	(665)
Acquisitions	0	(440)	(2,146)	(900)	(800)
Disposals	11,064	0	0	0	0
Net share issues	0	15	3,953	0	0
Dividends paid	(413)	(590)	(873)	(987)	(1,039)
Change in net cash	**3,447**	**(404)**	**2,497**	**395**	**306**
Net cash/(debt)	4,066	3,662	6,159	6,554	6,859
FCFPS - FD (p)	1.5	2.1	4.1	5.2	4.9

Source: Company and GECR

Important Information