SMALL CAP SHARE COMMENT
Commissioned Commentary

SANDERSON GROUP

(AIM:SND)
Share price 70p

Date: **25th November 2014**
Sector: Software & Computer Services
Market Cap: c£38m
www.sanderson.com

Results in line and plenty of opportunities

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 2014 in line with pre-close update issued on 25th October.

- Summary results

Income statement
Results for the year ending 30th September 2014 show revenue of £16.41m (2013: £13.83m), and operating profit (stated before amortisation of acquisition-related intangibles, acquisition-related costs and share-based payment charges) of £2.84m (2013: £2.22m). The value of the order book at the year-end of £2.41m was 25% higher than the prior period.

The overall gross margin of 84.9% was slightly down on the prior year (2013:87.6%) due to the delivery two large infrastructure projects in the Manufacturing Division (with a high hardware content) as the initial phase of a potentially larger software project. The underlying gross margin excluding the large infrastructure projects was 86.8%.

Adjusted and diluted EPS rose 5%, despite the increased share count following the placing earlier in the year.

The final proposed dividend was 1p per ordinary share (2013:0.85p), making a total dividend of 1.80p (yield 2.5% at current share price) and a 20% increase compared with the prior year.

Balance sheet
The Group's cash position remained strong with net cash at 30th September 2014 of £6.16m (2013: £3.7m) boosted by strong operating cash flow and net proceeds of £3.9m from the placing in the year.

The pension deficit at 30th Sept 2014 was £4.8m (2013: £4.17m) with the increase largely attributable to the movement in the discount rate. The annual funding requirement increases to £600,000 per annum from the 2015 financial year (£50,000 per month).

- Recurring revenues underpin the business

As with previous years, the second half of the financial year now contributes the larger proportion of annual operating profit producing an additional £409,000 (2013: £239,000) of operating profit, compared with the first half to 31st March 2014.

Pre-contracted recurring revenues were £8.76m representing 53% of total revenues (2013: £7.94m and 57%) with the gross margin from these covering 71% of Group overheads (2013: 73%). The small fall in the percentage of recurring revenue is due to the impact of initial one-off items emanating from the One iota business. The Group's licence revenues provide good visibility of future earnings and are augmented by consultancy, support and maintenance services.

- Customer wins

17 new customers were secured in the year (2013: 14 new customers) at an average initial contract value of £116,000 (2013: £119,000). The value of orders from new customers grew again with the total increasing to £1.97m (2013: £1.67m, 2012: £1.49m).

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- Divisional review

Multi-channel retail
Revenue £9.68m (2013: £7.23m)
Operating profit £1.89m (2013: £1.28m)
Order book £1.48m (2013: £696k)
Gross margin 86.6% (2011: 87.6%)
260 customers

The Group's multi-channel retail offering provides comprehensive IT solutions to businesses operating in the areas of online sales, ecommerce, catalogue sales, wholesale distribution, cash and carry and retail stores. High levels of activity have been experienced from providing mobile commerce solutions, incorporating the latest 'responsive' web technologies that optimise customers' websites enabling them to adapt to whatever device is being used for optimal viewing, seamless navigation and increased sales.

As for the prior year, growth in the Group's ecommerce and wholesale distribution business was partially offset by a fall in the Group's business which focuses on the traditional mail order fulfilment market. Revenue from the Group's business operating in the ecommerce and mobile commerce markets now accounts for £4.53m, representing 47% of divisional revenues and is expected to grow further in the future. Revenue was boosted by a full year's revenue contribution from One iota of £1.66m, and operating profit of £420,000. More on One iota below.

During the period Priam (www.priamsoftware.com), which was acquired in the previous financial year, was restructured and fully integrated into the Group and whilst its profit contribution was minimal in the year, management anticipate an improved contribution in the current year.

Ten new customers were gained in the year compared with five in the previous year.

The Top 5 Customers include WCF Home Shopping, MandM Direct, Clipper Logistics and Import Services
With the total spend of the top 5 £1.855m.

As we commented previously the acquisition of One iota looks extremely exciting. One iota (www.itsoneiota.com) is focused on cloud-based, multi-channel solutions accessed via mobile, tablet and in-store devices and has increased revenue by over 60% and more than doubled profit during its first year as part of the Group.

Towards the end of the financial year it secured its largest order to date, worth over £400,000. This covers the implementation of an iPad-based solution for a major Tier 1 retailer to help sales assistants maximise in-store sales and support shoppers in buying items that might be out of stock or from extended ranges available in other stores – sounds like the future for retail to us!

The order is expected to be installed, delivered and deployed over the course of the current financial year ending 30 September 2015. We would anticipate a significant element of annual recurring revenue to this order, following the Group's usual operating model.

Manufacturing
Revenue £6.74m (2013: £6.59m)
Operating profit £952k (2013: £932k)
Order book £926k (2013: £1.2m)
Gross margin 82.3% (2012:87.6%)
194 customers

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

The Group's business which addresses the general UK manufacturing market continued to experience slow trading. However, a recently launched product, Unity Express, aimed at smaller manufacturing businesses has a number of good and promising prospects in the sales pipeline. The Group business focused on the food and drink processing sector, benefiting from investment made over the last two years, has continued to make progress and drove overall growth for the Manufacturing division.

The size of the UK food and drink processing market is growing and there is an increase in the number of small and medium businesses in this sector. Both the need for traceability through the food and drink distribution, production and supply chain, combined with a continued drive to reduce operational costs has provided the Group with a good opportunity in this market.

The Sanderson food and drink processing business now represents 50% of the Group's manufacturing business (2013: 49%).

The top 5 customers were Freddy Hirsch Group, Newly Weds Foods, Food Partners, COOK Trading and Richard Austin Alloys with a total spend of £1.269m (19%).

Seven new customers were gained in the year (2013: nine new customers) with good sales prospects in the pipeline.

- Acquisitions

Management commented that while selective acquisition opportunities will continue to be carefully considered to augment organic growth, the current priority is to focus upon delivering 'on target' results and on making the previous acquisitions successful.

- Broker forecast

House broker forecasts for the full year ending September 2015 are for sales of £17.3m, normalised profit before tax of £3.1m, normalised earnings per share of 4.55p and a dividend of 1.90p, equating to a yield of 2.75%.

Gross margins are predicted to remain stable at approximately c86/87% with estimated Corporation Tax of £200k for FY14, increasing to £500k in FY15 as they become fully tax paying.

- Outlook

The outlook statement was perhaps even more cautionary than we are used to from the ever cautious Sanderson management!

Management commented that although business sentiment has continued to show some improvement amongst small and medium-sized businesses, prospective and existing customers remain cautious in their outlook. The strong order book does provides a reasonable level of confidence, that the Group will make further progress in the current financial year ending 30th September 2015.

We remain of the view that the Group's expanding suite of propriety software and expanding e-commerce offerings, supported by a robust balance sheet remains compelling.