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Sanderson Group (SND) AIM

INVESTMENT SUMMARY

- **The company has released results for the year to 30 September 2014 and these demonstrate another year of progress, driven by acquisitions. Catan Marketing Limited, trading as PRIAM, and One iota Limited have been well integrated. Given the scale of the latter, its strong performance has had a meaningful positive impact on the performance of the Group as a whole.**

- **Cash generation has been very strong and net cash at the period end was £6.16m. This allowed another significant increase in the dividend payout with a final dividend of 1.0p per share taking the total for the year to 1.8p (2013: 1.5p). This is an increase of 20% and although the progressive dividend policy should continue this is likely to be at a lower rate for the foreseeable future.**

- **A strong order book, which stood at £2.41m at the year end, means that there is a solid platform to build on in the coming years.**

- **Overall Sanderson remains well positioned. The business is being managed conservatively and the fact that recurring margin covers around 71% of overheads is reassuring. Net cash represents approximately 11.3p per share and stripping this out the shares trade on an undemanding multiple of prospective earnings, particularly given the nature 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 (%)
2013A	13.8	2.2	4.2	16.9	1.5	2.1
2014A	16.4	2.7	4.4	16.1	1.8	2.5
2015E	17.2	3.0	4.8	14.8	1.9	2.7
2016E	18.3	3.3	5.0	14.2	2.0	2.8

* - adjusted; ** - diluted adjusted

KEY DATA

Share Price:	**71p**
Prospective p/e ratio:	**14.8x**
Prospective net yield:	**2.7%**
Market Capitalisation:	**£38.4m**
Next Results Due (Interims):	**JUN**
Net Cash (at 30 September):	**£6.16m**
NAV per share:	**47.8p**

BULLET POINTS

- A solid set of final results has been posted, maintaining the sound track record which is being built
- Acquisitions have been integrated well and their benefit is being felt
- Strong net cash position and healthy balance sheet
- Progressive dividend policy maintained

Date of Report : 25 November 2014

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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.*

- *The sale of Sanderson RBS in January 2012 transformed the balance sheet, resulting into a net cash position. The most recent acquisition of One iota Limited was accompanied by a share placing, which raised £3.5m and ensured that a healthy cash balance was maintained. Strong cash generation led to net cash of £6.16m as at 30 September 2014.*

- *Order intake was strong last year at £8.70m versus £5.87m in the prior year and as at the period end the order book stood at £2.41m (2013: £1.94m). This no doubt takes some pressure off given that the broad economy remains relatively subdued.*

- *Although the vast majority of revenue comes from additional spend from the existing customer base, it is still pleasing to see that 17 new customers were gained (2013: 14 new customers) at an average initial contract value of £116k (2013: £119k).*

- *Gross margin was 84.9%, down from 87.6%. However, the Manufacturing division delivered two large infrastructure projects at a low margin and excluding these projects gross margin was 86.8%.*

- *The balance sheet is strong, with net cash as at 30 September of £6.16m. This means that a final dividend of 1.0p per share could be declared, taking the total for the year to 1.8p. This represents a 20% rise year on year and continues the progressive dividend policy which has been adopted.*

- *The company remains cautiously optimistic. It has always been sensibly managed and has an enviable track record of profitability. In the coming years the business as a whole should continue to take forward steps. With a strong order book and the bulk of overheads covered by recurring revenue streams the downside is relatively limited.*

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.

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 many household names, such as MandM Direct, Mothercare, Hotel Chocolat, Beaverbrooks and Scotts of Stow.

The group's solutions now primarily comprise 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 accounts for around two thirds of operating profit 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 66% of operating profit in the year to September 2014, with acquisitions driving growth. 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.

The acquisitions of Catan Marketing and One iota in 2013 have been well integrated and the latter in particular has had a significant positive impact.

Manufacturing

Manufacturing accounts for around a third of operating profit

This division accounted for 34% of operating profit last year, a figure which is likely to fall moving forwards. 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 businesses in this sector, which provides an opportunity for growth. The Sanderson food and drink processing business now represents 50% of the manufacturing business.

Acquisitions

The acquisition of One iota was significant relative to the size of the Group

One iota Limited, a leading provider of cloud-based multi-channel retail solutions, was acquired in October 2013, close to the start of the last financial year. The maximum aggregate consideration was £5.43m, made up of initial consideration of £3.13m and deferred consideration of up to £2.30m. One iota is based in Rossendale, Lancashire, close to Sanderson's catalogue, ecommerce and online sales business, and provides cloud-based, multi-channel solutions via mobile, tablet and in-store devices.

For the year ended 31 January 2013, One iota had unaudited turnover of £0.66m (2012: £0.50m) and profit before taxation of £195k (2012: £158k). As at 31 January 2013, One iota's net assets were £0.85m. For the seven months ended 31 August 2013, One iota had unaudited turnover of £0.61m and profit before taxation of £0.21m.

Revenue and profit both more than doubled

In the year to 30 September 2014 One iota more than doubled both revenue and profit versus figures for the year to 31 January 2013, its last full financial year prior to the acquisition. In September One iota received its largest order to date, valued at £400k.

Further acquisitions are a distinct possibility moving forwards

Sanderson will continue to assess potential acquisitions and although a conservative approach will be taken it will come as no surprise if 'bolt-on' acquisitions are completed.

Final Results

Results were solid, with a significant increase in revenue

In the year to 30 September revenue was up significantly at £16.41m (2013: £13.83m) although there was a fall in the gross margin to 84.9% (2013: 87.6%). This was explained by the delivery of two large infrastructure projects at low margin by the Manufacturing division. Operating profit before amortisation of acquisition-related intangibles, acquisition costs and share-based payment charges was £2.84m (2013: £2.22m). The value of the order book at the period end was £2.41m (2012: £1.94m).

The order book reached an impressive £2.41m

There was a strong net cash position at the year end

The final dividend was 1.0p per share, taking the total for the year to 1.8p

Net cash stood at £6.16m as at the period end (2013: £3.66m), representing approximately 11.3p per share. The balance sheet was in good shape and this meant that there was no problem with the progressive dividend policy being maintained. A final dividend of 1.0p per share has been declared, making a total of 1.8p for the year, up 20% on the payout in 2013. The final dividend is due to be paid on 20 March 2015, with the ex-dividend date being 5 March 2015. The progressive dividend policy is due to continue although growth is likely to be at a lower rate in the short to medium term.

Multi-channel retail continues to look interesting given its exposure to high-growth ecommerce

Multi-channel retail brought in revenue of £9.68m (2013: £7.23m) with continued strong growth in ecommerce businesses, as would be expected. There was again a decline in traditional mail order fulfilment but the contribution from One iota provided a significant boost. Double-digit growth continues to be generated in the ecommerce and mobile commerce markets.

Manufacturing has exposure to the UK food and drink processing market, which is growing

Although the order book was down it still stood at a reasonable level

Manufacturing continued to experience slow trading. However, on a more positive note, recently-launched Unity Express is showing promise. The part of the business focused on the food and drink processing sector is becoming increasingly important and last year accounted for 50% of divisional revenue (2013: 49%). Revenue for the Manufacturing division was £6.74m (2013: £6.59m) and operating profit was £952k (2013: £932k). Overall order intake was down to £2.89m (2013: £3.10m). The order book was also down to £926k (2013: £1.24k) but there are some good prospects in the pipeline.

Forecasts

Recurring business and strong balance sheet provide support

With a strong order book and 71% of overheads covered by recurring margin, the downside is limited. The business as a whole is conservatively managed in any case and the strong balance sheet, with plenty of net cash, is reassuring.

The ecommerce market presents a considerable opportunity

Looking forwards, the business as it is currently comprised should be able to deliver modest growth. In particular the Multi-channel retail division is exposed to a growing market and has an attractive offering. Although the traditional mail order fulfilment market remains tough, Sanderson has identified areas where growth can be generated and invested accordingly.

Profits are on an upward trend, which can continue

We believe that the company will improve profitability in both the current year and next, on the back of increased revenue. This should allow the company to edge up its dividend payout although the increases seen in recent years will be difficult to replicate.

Selective acquisitions could drive further value into the core business

We continue to believe that acquisitions could drive further value into the business, although there are undoubtedly opportunities to grow organically and these are likely to remain the main focus in the short term.

Valuation

Excluding cash, the value of the business is just £32m

Stripping out net cash of £6.16m, the company is valued at little more than £32m. Taking a long term view we continue to believe that this is modest given the potential size of the markets being addressed and current rates of growth.

A strong track record adds credibility

The business has a long track record of profitability and the way that the business is managed should ensure that this continues 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 lower P/E ratio than at the same stage in 2013

The shares trade on 14.8x prospective earnings for the current year, which is less than at the same stage last year. The impact of the most recent acquisitions should continue to be felt and there is real potential for organic growth.

Prospects

Sanderson's prospects remain solid

The future for Sanderson looks sound. The company has continued to build a track record and should ultimately benefit as and when the broader economy improves. It is focusing on some attractive niche areas and working with some customers who are developing in their own right.

Downside risk is being limited

As we have noted, the downside risk is being minimised and with recurring revenues covering such a significant proportion of overheads, the business is well positioned. The significant net cash position also means that the business is well funded to exploit any areas where investment is necessary.

The company has a long record of meeting or exceeding forecasts

Current forecasts look undemanding. Some rapidly developing markets are being covered and this should present opportunities, meaning that it should be well placed. To reiterate, we also feel that acquisitions will help deliver additional growth over the medium to long term. Sanderson has provided investors with very few nasty surprises over the years, having a long track record of at least meeting expectations. We believe that there is little reason to doubt that this will continue given the stable and consistent management.

Share Price Graph

Profit and Loss Year End 30 Sept	2012 (£m)	2013 (£m)	2014(E) (£m)	2015(E) (£m)
Revenue				
Manufacturing	6.2	6.6	6.9	7.2
Multi-channel retail	7.2	7.2	9.0	9.8
Total	**13.4**	**13.8**	**15.9**	**17.0**
Operating Profit				
Manufacturing	0.8	0.9	1.0	1.0
Multi-channel retail	1.1	1.1	1.5	2.0
Total	**1.9**	**2.0**	**2.5**	**3.0**
Movement in fair value of derivatives	0.0	0.0	0.0	0.0
Net finance costs	(0.2)	(0.0)	(0.0)	(0.0)
Exceptional finance charge	(0.2)	(0.0)	(0.0)	0.0
Profit before Tax	**1.5**	**2.0**	**2.5**	**3.0**
Tax	(0.2)	(0.3)	(0.2)	(0.5)
Profit after Tax	**1.3**	**1.7**	**1.6**	**2.5**
Av number of shares (m)	46.12	46.54	50.91	51.48
EPS (p)	**2.8**	**3.7**	**4.2**	**4.7**
DPS (p)	**1.2**	**1.5**	**1.6**	**1.7**

Ratios	2012	2013	2014(E)	2015(E)
Sales Growth (%)	**-4.9**	**3.4**	**15.2**	**6.9**
Operating Margin (%)	**14.3**	**16.1**	**15.7**	**17.6**
EPS Growth (%)	**173**	**32.1**	**13.5**	**11.9**
DPS Growth (%)	**60**	**25**	**6.7**	**6.3**
Dividend Cover (x)	**2.5**	**2.5**	**2.6**	**2.8**

Cash flow Year end 30 Sept	2012 £'000	2013 £'000
Profit for the period	2,406	1,691
Adjustments	(184)	725
Operating cash flow	**2,222**	**2,416**
Discontinued operations	(356)	-
Changes in working capital/provisions	(521)	(1,385)
	1,345	**1,031**
Interest paid	(703)	-
Income tax received	377	-
Net cash flow from operating activities	**1,019**	**1,031**
Purchase of assets	10,381	(660)
Investing cash flow - discontinued operations	(140)	-
Financing activities	(7,813)	(775)
Net Increase in cash and cash equivalents	**3,447**	**(404)**
Cash and cash equivalents at start of year	**619**	**4,066**
Cash and cash equivalents at end of year	**4,066**	**3,662**

Balance sheet Year End 30 September	2012 £'000	2013 £'000
Intangible assets	22,404	23,194
Other non-current assets	1,939	1,695
Total	**24,343**	**24,889**
Current assets	7,800	7,238
Current liabilities	(7,480)	(6,782)
	24,663	**25,345**
Non-current liabilities	(4,633)	(4,446)
Net Assets	**20,030**	**20,899**
Share Capital	4,352	4,380
Share Premium	4,205	4,302
Retained earnings	11,473	12,175
Shareholders funds	**20,030**	**20,899**

Ratios	2012	2013
NAV (p)	**46.0**	**47.7**
Gearing (%)	**n/a**	**n/a**

GENERAL INFORMATION

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FINANCIAL CALENDAR

Expected AGM Date:	3 March 2015
Ex-Dividend Date:	5 March 2015
Final Dividend Payment Date:	20 March 2015
Interim Results Period End:	31 March 2015
Interim Results Due:	June 2015
Next Year End:	30 September 2015

The above dates should only be used for guidance

Significant Shareholders

Ordinary shares of 10p each	Number	%
C Winn	11,786,924	21.8
Hargreave Hale	7,195,654	13.3
ISIS Equity Partners	4,818,257	8.9
Miton Capital Partners	4,454,985	8.2
AXA Framlington Asset Management	2,500,000	4.6
Helium Rising Stars Fund	2,394,753	4.4
Unicorn Asset Management	1,767,572	3.3

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