SMALL CAP SHARE COMMENT

Commissioned Commentary

SANDERSON GROUP (AIM:SND)

Share price 93p

Results significantly ahead of the prior year and also ahead of market expectations – it looks in great shape!

Date: **26th November 2018**

Sector: Software & Computer Services

Market Cap: c£56m

www.sanderson.com

The provider of digital technology solutions, innovative software and managed services for the retail, wholesale, supply chain logistics, food and drink processing and manufacturing market sectors has announced excellent results for the year ended 30 September 2018, significantly ahead of the prior year.

The target market for Sanderson products and services are primarily SMEs, with whom the Group fosters long-term relationships. These relationships result in a high proportion of sales arising from pre-contracted recurring revenue, complemented by incremental sales. This robust revenue stream typically accounts for around 90% of Group revenue.

Sanderson proprietary software is marketed and sold under a 'right to use' licence, with all sales, marketing, delivery, support and services carried out by the Group's own expert staff. Both on-premise and cloud-based solutions are available to customers on a subscription basis.

- Anisa acquisition

The acquisition of the Anisa Group on 23 November 2017, which we commented on in our **note here**, has significantly enhanced the size and strength of the ***Enterprise Division*** (see breakdown below).

Anisa specialises in the delivery of world-class integrated supply chain and enterprise resource planning ('ERP') solutions and on acquisition had around 250 customers who are provided with twenty-four hour support on a worldwide basis throughout the year. Anisa employs over 90 staff in offices across the UK and in smaller operations in Singapore and Australia.

- Full year results

Results for the year ended 30 September 2018 are significantly ahead of the prior year and also ahead of market expectations.

Income statement

Group revenue rose 49% to £32.05m (2017: £21.56m) and operating profit (before amortisation of acquisition-related intangibles, share-based payment charges and one-off non-recurring items) rose 33% to £5.18m (2017: £3.90m).

On a 'like-for-like' basis, excluding the acquisition, revenue rose to £22.97m (2017: £21.56m).

On a like-for-like basis, gross margin was 81%, reflecting the Group's continued emphasis and focus on the supply of Sanderson-owned proprietary software and services.

Pre-contracted recurring revenues increased to £17.61m (2017: £11.18m) accounting for 55% of total revenue (2017: 52%).

Like-for-like recurring revenues increased to £12.17m (2017: £11.18m). The Group continues to focus on building this revenue stream including growing subscription, cloud and managed services.

Dividend +13%
The progressive dividend policy has been maintained with a proposed 13% increase in the final dividend to 1.75 pence per share, bringing the total dividend for the year to 3.00 pence per share, an increase of 13% over the prior year. At the current share price this equates to a yield of 3.2%

Balance sheet

The structure of the balance sheet changed following the acquisition of Anisa. As part of the terms of the acquisition, the Group assumed a five-year term debt facility with an outstanding balance of £4.13m which, after scheduled repayments, reduced to £3.44m.

Net cash at the period end was £3.03m, comprising cash of £6.47m, less bank loans and overdrafts of £3.44m. This followed the Anisa acquisition in November 2017 and increased dividend payments of £1.67m.

The pension deficit reduced to £3.79m (207: £6.18m), largely due to the increase in interest rates and an increase in company contributions.

Operating cash inflow was £5.3m (2017: £4.5m) and free cash flow £4.1m after £956k (2017: £994k) of capitalised development expenditure and £216k (2017:£180k) of equipment purchases.

- Order book higher

The total order book at 30 September 2018 was £7.58m (2017: £5.79m). This includes the acquisition of Anisa and the remaining element of a large order gained in June 2017, which is being delivered 'on schedule'. The year-end order book on a like-for-like basis was £2.91m (2017: £2.67m).

The order book is also now better balanced across the Group's businesses and this, together the growth and high level of sales prospects, means there is a good level of confidence going into the current financial year.

- Divisional

Sanderson breaks down its business in terms of a ***Digital Retail Division*** and an ***Enterprise Division***. The Enterprise software division now includes the recently acquired **Anisa Supply Chain Logistics** business, with the remaining parts of the division comprising 2 market-focused businesses based on the ***Manufacturing sector and the Distribution and Logistics sector***.

The ***Digital Retail Division*** provides comprehensive solutions for ecommerce, mobile commerce and retail, including cloud-based store solutions and works with leading retailers such as Richer Sounds plc, JD Sports Fashion plc and Superdry.

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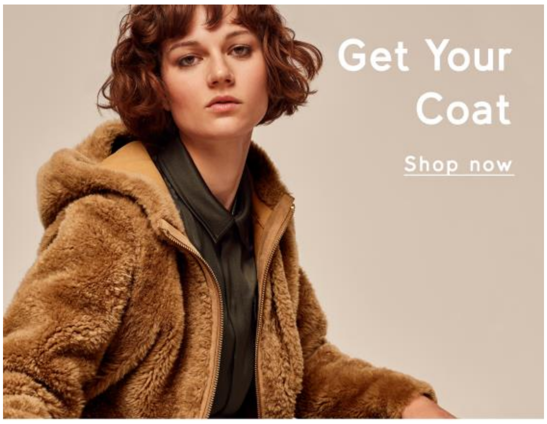
In the 12 months to 30 September 2018, revenue in Digital Retail grew over 20% to £8.82m (2017: £7.28m). Operating profit, adjusted for amortisation of acquisition-related intangibles, share-based payment charges and 'one-off' non-recurring items, grew by a third to £1.56m (2017: £1.18m).

The underlying year-end order book, excluding the remaining element of the large order gained in June 2017, grew 24% to £1.07m (2017: £0.86m).

Following a successful pilot scheme, a Phase One order has been secured with a iconic fashion brand Hugo Boss. A pilot project has also been secured with a leading retailer of formal wear to deploy instore assisted-sale mobile technology for enhanced customer service.

Demand for the Group's latest omni-channel solutions is strong, with additional new customers including luxury womenswear retailer, ME+EM, as well as large orders having been gained from existing customers including Richer Sounds plc and Beaverbrooks The Jewellers Limited.



While the UK retail market in general has been struggling, with the greater emphasis towards utilising online and mobile shopping channels, Sanderson's Digital business looks well-placed to benefit from the changing consumer shopping habits.

The ***Enterprise Division*** has benefited from increased investment in sales and marketing capability and has been significantly enhanced and strengthened by the acquisition of Anisa.

The division invested almost £3m in software product development, a key focus being the Enterprise-Wholesale business which successfully secured a number of new orders for the digital suite of products launched earlier in the year.

Towards the end of the financial year an innovative business intelligence product with enhanced capability was launched and this has generated a high level of early interest.

It's worth noting that the majority of development costs were expensed rather than capitalised.

Enterprise – Manufacturing

Businesses in the engineering, plastics, aerospace, electronics, print ('general manufacturing') and food and drink processing sectors represent the main areas of specialisation for this division. Activity in food and drink is a key driver, where the traceability of ingredients through the supply chain and compliance with regulatory standards, are key industry requirements and strong features of the Group's solution.

Four new customers were gained during the year (2017: six new customers), including Omega Ingredients Limited and Nitron Racing Systems Limited, with large orders gained from existing customers such as Adelie Foods Group Limited and Cereform Limited. Prospects continue to be healthy but sales cycles remain protracted.

Enterprise - Wholesale

Sanderson supplies solutions to the wholesale distribution, cash and carry and fulfilment sectors, as well as to the specialist warehousing and logistics markets.

Six new customers were gained during the year, the same as the previous year, with an average initial order value of £120,000 (2017: £89,000).

New customers include East N West Cash & Carry Limited and Windsor Foodservice, with major sales orders gained from several existing customers such as PRL Group and Pedigree Wholesale Limited.

Innovative digital solutions

Following the drive towards digital transformation, the Group launched an innovative suite of digital solutions in the wholesale industry which capitalise on the growing use of mobile devices. Management commented that the level of interest and prospects for the solutions are very positive.

Enterprise – Anisa Supply Chain Logistics

This business specialises in the delivery of world-class integrated supply chain and ERP solutions. Over 90 staff are employed in office locations across the UK and in smaller operations in Singapore and Australia, providing 250 customers with 24-hour, 365 days a year support on a worldwide basis.

The acquisition considerably enhances the range of solutions and services which Sanderson can now offer. In particular

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hosted managed services, delivered from their own dedicated, specialist data centre, provide an opportunity to exploit and accelerate market trends towards subscription and cloud-based options for solution delivery going forward.

The acquisition has made a good start as part of Sanderson. Eight new customers have been gained and more recently the Port of Dover Cargo Limited has appointed the Group to supply warehouse management and cargo terminal management software for its new refrigerated cargo terminal. This contract goes live in March 2019 – just in time to welcome the UK's exit from the European Union!

A number of exciting sales prospects are being developed and the customer base is very active with major orders from Moran Logistics Limited, Culina Group, DX plc and NHS Blood and Transplant during the year.

Enterprise Divisional revenue was £23.23m (2017: £14.28m). Operating profit (adjusted for amortisation of acquisition-related intangibles, share-based payment charges and 'one-off' non-recurring items) was £3.62m (2017: £2.71m).

On a like-for-like basis, having adjusted for the acquisition, revenue was flat at £14.14m (2017:£14.28m) with operating profit (adjusted for amortisation of acquisition-related intangibles, share-based payment charges and 'one-off' non-recurring items) of £2.49m (2017:£2.71m).

The business performance improved in the second half of the financial year ending 30 September 2018 and is expected to continue into the current financial year.

The divisional order book at the financial year-end was £5.36m (2017: £1.81m) and, excluding the acquisition, the underlying order book was £1.84m (2017: £1.81m).

- Outlook

Management commented that Sanderson is well positioned in its target markets and has good sales prospects, backed by a healthy order book. This provides a good level of confidence that, at this relatively early stage of the new financial year, the Group will once again deliver trading results which are, at least, in line with market expectations for the year ending 30 September 2019.

- Broker estimates

House broker forecasts for the Financial Year ending September 2019 are for sales up 7.5% to £34.4m, adjusted pre-tax profit up 12.5% to £5.4m and adjusted EPS up 5.2% to 8.0p.

The forecast 2019 dividend of 3.20p, covered 2.5x by adjusted earnings, equates to a yield of approx. 3.4% at the current share price.

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Sanderson has now assembled a software and services group supporting all elements of the supply chain, from manufacturing, through distribution, warehousing and retail.

The Group looks in great shape with organic growth planned from the fast expanding Digital Retail division and renewed growth impetus from the enlarged Enterprise division.

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