Sanderson Group (SND) AIM

INVESTMENT SUMMARY

- **Final results for the year ended 30 September 2016 provide a reminder of the ongoing progress the business is making. There have been double-digit increases in revenue, profit before tax, earnings and dividends.**

- **Sanderson looks set to make further progress given that sales order intake was up 20%. With recurring revenue accounting for half of total revenue and gross margin of 84%, there is both a strong base and potential for new business wins to feed through into improved profitability in future years.**

- **At the year end the order book had grown by over a quarter and this also suggests that there is a high probability of even better performance in the coming years.**

- **The cash balance as at 30 September 2016 was £4.34m, reflecting strong cash generation offset by £1.66m of deferred consideration for acquisitions and total dividend payments of £1.21m in the year.**

- **The company continues to make good progress and has proven its ability to generate organic growth. We believe that bolt-on acquisitions could add significant shareholder value in the coming years.**

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 (%)
2015A	19.2	3.2	4.9	14.4	2.1	3.0
2016A	21.3	3.4	5.5	12.8	2.4	3.4
2017E	21.8	3.6	5.6	12.6	2.6	3.7
2018E	23.2	3.8	5.8	12.2	2.8	4.0

* - adjusted; ** - diluted adjusted

KEY DATA

Share Price: 70.5p
Prospective p/e ratio: 12.6x
Prospective net yield: 3.7%
Market Capitalisation: £38.7m
Next Results Due (Interims): JUNE
Net Cash (30 September): £4.34m
NAV per share (30 September): 45.5p

BULLET POINTS

- Final results demonstrate ongoing progress
- Double-digit increases in revenue and profits
- Strong and improving order book
- Net cash position
- Progressive dividend policy
- Acquisitions may be on the horizon

Date of Report : 8 December 2016

www.brokerlink.co.uk

Executive Summary

- ***Sanderson Group is a software and IT services business specialising in digital technology and enterprise software for businesses operating in the retail, manufacturing, wholesale distribution and logistics sectors. The group develops long term relationships with its customers with the majority of product development being customer led and offering tangible benefits.***

- ***There are two divisions. The Digital Retail Division provides IT solutions to businesses operating in ecommerce, mobile commerce and retail sectors in the UK. The Enterprise Division is made up of two market focused businesses based on manufacturing, mainly covering the food and drink processing industries, and wholesale distribution and logistics.***

- ***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 2016 was £4.34m.***

- ***The balance sheet remains in good shape and 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, particularly given scope for further meaningful growth servicing ecommerce.***

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

Sanderson is a supplier of innovative software solutions and IT services, specialising in digital retail, manufacturing wholesale and logistics 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.

Digital Retail

Digital Retail is an interesting growth area and will be a focus for future investment, particularly in terms of ecommerce via mobile devices

This division is one of the two new strands to the business under the revised reporting structure. Revenues from this part of the business represent 30% of total revenue. Operating profit slipped to £0.89m last year versus £1.29m in the year to 30 September 2015. However, this reflects investment in management, sales and delivery capacity as the digital retail market is expected to continue to grow strongly.

Mobile enablement and deployment remains key to success in this area and Sanderson continues to innovate. This market is seen as being relatively immature and should provide some good opportunities over the longer term.

Enterprise

Enterprise is the largest of the two new reporting divisions

Accounting for around 70% of total revenue, this part of the business comprises two market-focused businesses which are based upon the manufacturing sector and the wholesale distribution and logistics sector. Revenue and operating profit increased to £14.92m (2015: £13.30m) and £2.80m (2015: £2.01m) respectively.

Businesses in general manufacturing such as engineering, plastics, aerospace, electronics and print and the food and drink processing sectors represent the main areas of specialisation for Sanderson in manufacturing markets. The company continues to invest in product development and in its sales and marketing capability. Traceability of products and ingredients through the food manufacturing and supply chain and the assurance of product compliance to the latest regulatory standards are a major benefit of Sanderson's solution.

Recurring revenue a significant positive feature

Recurring revenue represents 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 most recent acquisition, although this is now well bedded into the group

Following on from the acquisitions made in 2013, Proteus Software Limited, a supplier of specialist warehouse management solutions, was acquired in December 2014.

…further acquisitions likely at some stage

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

Final Results

Results were solid, with a strong increase in revenue

In the year ended 30 September 2016 revenue was £21.32m (2015: £19.18m) and the gross margin was slightly lower at 84%. Pre-contracted recurring revenues were £10.75m (2015: £9.77m), representing approximately 50% of total revenue. Operating profit increased to £3.69m (2015: £3.30m) and adjusted diluted earnings per share were 5.5p (2015: 4.9p).

In Digital Retail revenue was £6.40m (2015: £5.88m) and lower operating profit of £0.89m (2015: £1.29m) reflected the planned further investment in management, sales and delivery capacity to support continued rapid growth within the digital retail market.

Divisional revenue in Enterprise was £14.92m (2015: £13.30m) and operating profit increased to £2.80m (2015: £2.01m). The Enterprise division has a strong order book which was valued at £2.10m at the period end (2015: £1.43m).

There was net cash of £4.34m at the period end

Increased final dividend of 1.4p per share

Net cash at the year end was £4.34m (2015: £4.61m) after acquisition related cash consideration payments of £1.66m. The final dividend was lifted by 16% to 1.4p per share (2015: 1.2p), taking the total for the year from 2.1p to 2.4p.

Forecasts

Forecasts continue to look conservative

Sanderson bettered our previous forecast for full year revenue in the year to 30 September 2016 and profit was in line with expectations. The Digital Retail division should continue to benefit from interesting opportunities in the coming years, particularly in mobile.

Acquisitions could drive shareholder value

We believe that bolt-on acquisitions remain likely to drive further value into the business. The acquisitions completed most recently have made a positive contribution to date and there are some niche areas which the company could move into. Sanderson has net cash to make acquisitions should opportunities be presented moving forwards.

Sanderson has proven itself to be a solid business with sound prospects. The net cash position, equivalent to over a year of profit, and strong balance sheet provide support to the current share price. Although net assets slipped last year this is attributable to increased pension obligations. Exposure to ecommerce means that the current rating looks potentially too low.

Valuation

Relatively low p/e ratio

Given the net cash position the prospective p/e ratio of 12.6x for the year just ended looks low. Relative to other businesses servicing ecommerce in particular there is scope for an increase in the valuation of the business.

Strong track record

A strong track record has been built over the years and results continue to reassure investors. With organic growth being achieved and the possibility of earnings-enhancing acquisitions, the current valuation is easily justified.

Low market capitalisation may deter some institutional investors

The share price has fallen back considerably since its May peak. This appears to be due to broad stock market conditions rather than any issues on a micro level. There are a number of institutions on the register but the company perhaps still has too low a market capitalisation for some to take an interest at this stage.

Prospects

Solid long term prospects

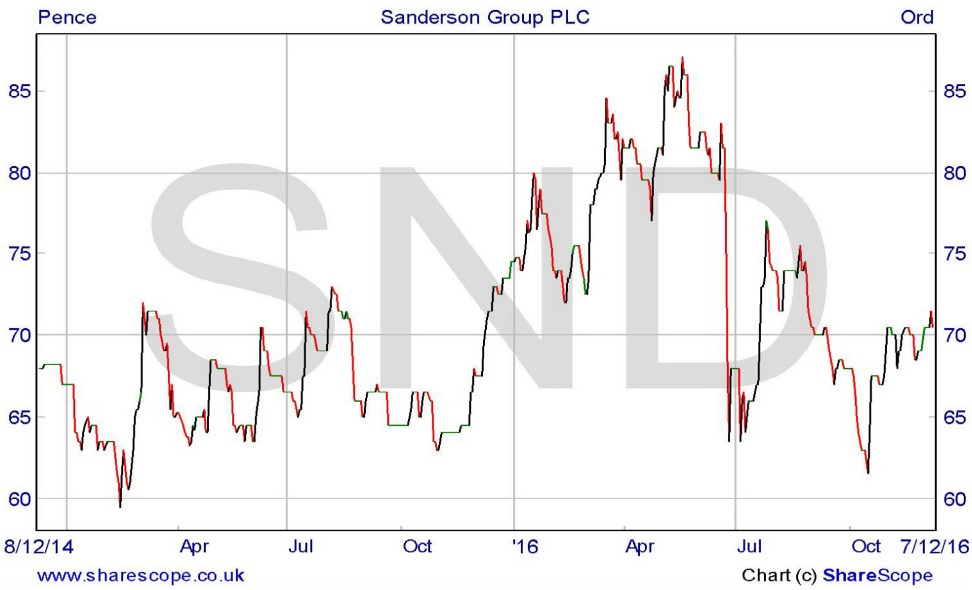
The long term story remains intact. The track record which is being built is impressive and the company is focusing on some attractive niche areas, working with customers who are also developing in their own right.

Limited downside

Downside risk is limited by the level of recurring revenues from existing customers which covers a significant proportion of overheads. High margins also mean that profit could rise significantly on the back of modest increases in revenue. The net cash position is meaningful. It leaves the business is well funded, allowing it to invest both in existing operations and acquisitions.

The long term opportunities open to Sanderson are attractive. The manner in which the business is managed should ensure that shareholder value is steadily built.

Share Price Graph



Profit and Loss Year End 30 Sept	2013 (£m)	2014 (£m)	2015 (£m)	2016 (£m)
Revenue				
Total	**13.8**	**16.4**	**19.2**	**21.3**
Operating Profit				
Total	**2.2**	**2.8**	**3.3**	**3.7**
Movement in fair value of derivatives	0.0	0.0	0.0	0.0
Net finance costs	(0.0)	(0.1)	(0.1)	(0.1)
Exceptional finance charge	(0.0)	(0.0)	(0.3)	(0.1)
Profit before Tax	**2.2**	**2.7**	**2.9**	**3.5**
Tax	(0.3)	(0.3)	(0.2)	(0.4)
Profit after Tax	**1.9**	**2.4**	**2.7**	**3.1**
Av number of shares (m)	46.12	54.19	55.86	56.30
EPS (p)	**4.2**	**4.4**	**4.9**	**5.5**
DPS (p)	**1.5**	**1.8**	**2.1**	**2.4**

Ratios	2013	2014	2015	2016
Sales Growth (%)	**3.0**	**18.8**	**17.0**	**11.1**
Operating Margin (%)	**15.9**	**17.1**	**17.2**	**17.3**
EPS Growth (%)	**50.0**	**4.8**	**11.4**	**12.2**
DPS Growth (%)	**25.0**	**20.0**	**16.7**	**14.3**
Dividend Cover (x)	**2.8**	**2.4**	**2.3**	**2.3**

Cash flow Year end 30 Sept	2015 £'000	2016 £'000
Profit for the period	1,867	2,427
Adjustments	1,781	1,909
Operating cash flow	**3,648**	**4,336**
Changes in working capital/provisions	(1,221)	(692)
	2,427	**3,644**
Interest paid	-	-
Income tax paid	(5)	-
Net cash flow from operating activities	**2,422**	**3,644**
Purchase of assets	(3,009)	(2,759)
Financing activities	(965)	(1,148)
Net Increase in cash and cash equivalents	**(1,552)**	**(263)**
Cash and cash equivalents at start of year	**6,159**	**4,607**
Cash and cash equivalents at end of year	**4,607**	**4,344**

Balance sheet Year End 30 September	2015 £'000	2016 £'000
Intangible assets	30,627	30,473
Other non-current assets	1,788	2,279
Total	**32,415**	**32,752**
Current assets	10,352	11,605
Current liabilities	(10,333)	(10,332)
	32,434	**34,025**
Non-current liabilities	(5,807)	(9,094)
Net Assets	**26,627**	**24,931**
Share Capital	5,460	5,485
Share Premium	9,023	9,056
Retained earnings/reserves	12,144	10,390
Shareholders funds	**26,627**	**24,931**

Ratios	2015	2016
NAV (p)	**48.8**	**45.5**
Gearing (%)	**n/a**	**n/a**

GENERAL INFORMATION

COMPANY DATA

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FINANCIAL CALENDAR

Expected AGM Date:	2 March 2017
Final Dividend Ex-div Date:	3 March 2017
Final Dividend Payment Date:	17 March 2017
Interim Results Due:	June 2017
Year End:	30 September 2017
Final Results Announcement:	November 2016

The above dates should only be used for guidance

Significant Shareholders

Ordinary shares of 10p each	%
C Winn	21.5
Hargreave Hale	14.7
Living Bridge	8.8
Miton Asset Management	7.8
Unicorn Asset Management	4.4
Brooks Macdonald Asset Management	4.4
ISPartners Investment Solutions	3.4

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