

Sanderson Group (SND)

AIM



INVESTMENT SUMMARY

- Interim results covering the six months ended 31 March 2017 demonstrate ongoing progress. Overall, double-digit revenue growth and high gross margins leave the company well positioned.
- Sanderson is managed conservatively and has again delivered strong cash conversion, which means that net cash was £4.51m as at 31 March, £1.12m higher than at the same stage a year earlier. This has allowed the interim dividend to be increased again.
- The Digital Retail division was the star performer again, delivering more than half the absolute growth in revenue despite representing less than a third of the overall business by revenue. We continue to believe that there are very interesting prospects for this segment of the business.
- The company continues to deliver solid results. The strength of the balance sheet should ensure that shareholder value is delivered in the coming years, organically and also potentially as a result of bolt-on acquisitions.
- The share price has outperformed in the recent past and although the shares trade on a higher multiple of earnings than has historically been the case this reflects the quality of the business as well as broad stock market trends.

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	17.9	2.1	2.4
2016A	21.3	3.4	5.5	15.9	2.4	2.7
2017E	21.8	3.6	5.6	15.6	2.6	3.0
2018E	23.2	3.8	5.8	15.1	2.8	3.2

* - adjusted; ** - diluted adjusted

KEY DATA

Share Price:	87.5p
Prospective p/e ratio:	15.6x
Prospective net yield:	3.0%
Market Capitalisation:	£48.1m
Next Results Due (Finals):	NOV
Net Cash (31 March):	£4.51m
NAV per share (31 March):	45.6p

BULLET POINTS

- Reassuring results for the six months to 31 March 2017 demonstrate ongoing progress
- Solid growth in revenue
- Improved net cash position
- Progressive dividend policy continues
- Acquisitions may be on the horizon and these could drive further shareholder value

Date of Report : 24 May 2017

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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 31 March 2017 was £4.51m.*
- *The balance sheet remains in good shape and a progressive dividend policy is in place. The interim dividend was increased from 1.0p per share to 1.1p.*
- *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

In January 2012 the group disposed of Sanderson RBS...

...acquisitions have followed

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, 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. In 2016 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.

Interim Results

Results were solid, with a double-digit increase in revenue

In the six months ended 31 March 2017 revenue rose from £9.86m to £10.90m. Revenue from pre-contracted licence and ongoing support services was £5.40m (2016: £5.19m), representing approximately 50% of total revenue. Adjusted diluted earnings per share were 2.4p (2016: 2.3p).

In Digital Retail revenue was £3.54m (2016: £2.95m), an increase of 20%. Operating profit was £0.34m (2016: £0.33m) reflected the planned further investment in management, sales and delivery capacity. This will support continued rapid growth within the digital retail market where there is, in our view, a very attractive opportunity to grow.

Divisional revenue in the Enterprise Software division was £7.36m (2016: £6.92m) and operating profit increased to £1.21m (2016: £1.15m). The Enterprise division has a strong order book which was valued at £1.93m at the period end versus £2.42m at an exceptionally high level a year earlier.

Net cash of £4.51m at the period end allowed an increased interim dividend

Net cash at the period end was £4.51m (2016: £3.39m). The interim dividend was lifted by 10% to 1.1p per share (2016: 1.0p). This is due to be paid on 18 August 2017.

Forecasts

Forecasts continue to look conservative

Sanderson bettered our 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 over the longer term. 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. Increased pension obligations impacted net assets last year but the underlying business is strong and continues to generate cash. The company's exposure to ecommerce appears to have finally been recognised in recent months and the rating the shares trade on has increased. However, taking the level of net cash into consideration there is scope for the valuation of the business to continue to rise.

Valuation

The recent rise in the company's share price looks justified. As we have pointed out over the years, relative to other businesses servicing ecommerce in particular the rating which the shares have traded on has been low.

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

The share price fell sharply last year as can be seen from the share price graph below, but this was mainly due to broad stock market conditions rather than any issues on a micro level. Since reaching its low point last October, the share price has rallied significantly and the latest results justify this share price increase. There are a number of institutions on the share register already, but as the market capitalisation moves up to the £50m mark others may also become attracted to the stock.

Prospects

The Sanderson story continues to look interesting. The track record which is being built is impressive and the company is focusing on some attractive niche areas. Interesting new customers in the first half of the current year included H B Clark & Co and Andertons Music Company.

Recurring revenues from existing customers cover a significant proportion of overheads. High margins mean that profit could rise significantly on the back of modest increases in revenue. The net cash position should not be overlooked, particularly given the level of cash relative to the market capitalisation. It leaves the business is well funded, allowing it to invest both in existing operations and acquisitions.

The long term opportunities open to Sanderson remain attractive. The business is managed conservatively and this should ensure that shareholder value is steadily built over the long term.

Share Price Graph



Recent strength in the company's share price is justified

Strong track record

Interesting term prospects

Recurring revenues limit undue risk

Conservative, reliable management

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)
Net cash flow from operating activities	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)
Net Assets	26,627	24,931
Non-current liabilities	(5,807)	(9,094)
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

Stockbrokers:

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Chairman
Ian Newcombe
Chief Executive
Adrian Frost
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FINANCIAL CALENDAR

Interim Dividend Ex-div Date:	3 August 2017
Interim Dividend Pay Date:	18 August 2017
Year End:	30 September 2017
Final Results Announcement:	November 2017
Expected AGM Date:	March 2018

The above dates should only be used for guidance

Significant Shareholders

Ordinary shares of 10p each

	%
C Winn	21.4
Hargreave Hale	14.7
Living Bridge	8.8
Miton Asset Management	7.7
Brooks Macdonald Asset Management	4.7
Unicorn Asset Management	4.4

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