Sanderson Group

Update
9th December 2016

In-line With Expectation Profits

Sanderson Group has announced its results for the 12-months ended 30th September 2016. Revenue came-in better than our expectations, increasing by 11% to £21.32m (2015: £19.18m), although adjusted operating profit was in-line with our expectations, increasing by 12% to £3.69m (2015: £3.30m). Another key highlight was a better than expected dividend payment of 2.4p (forecast of 2.3p), up by 14% on a year earlier. The board remains confident that the company will make further progress and deliver trading results which are at least in-line with market expectations for FY17. Accordingly, we have upgraded our FY17 forecasts and issued forecasts for FY18. We continue to classify the shares as a hybrid growth and income stock, with the shares offering investors exposure to the high-growth Enterprise Resource Planning software market as well as a decent prospective dividend yield of 4.11%.

Full-Year Results

Recurring revenue from pre-contractual licence and ongoing support services grew by 10% to £10.75m (2015: £9.77m), representing 50% of total revenue. Sales order intake increased by in excess of 20% to £12.26m (2015: £10.03m), 31% of which was gained from new customers, representing almost twice the level of the prior year. Gross margin remains strong at 84% (2015: 85%), reflecting continued focus on supplying its own proprietary products and services. Gross margins from recurring revenues covered 63% of total group overheads in FY16. Profit before tax increased by 37% to £2.78 million (2015: £2.03m). Group order book grew by in excess of 25% to £3.02 million (2015: £2.35m). Including the deferred payment in respect to businesses acquired in 2013 and 2014 (£1.66m) and the payment of dividends (£1.21m), cash balance as at period end was £4.34m (2015: £4.61m).

Financial forecasts

For FY17, we are forecasting revenue of £22.10m. We are assuming gross margins of 84.2%, leading to a gross profit forecast of £18.61m. We expect the group to continue its investment in product innovation, as well as sales & marketing, and are forecasting an adjusted EBIT of £3.89m. We are also forecasting a DPS of 2.60p. For FY18, we are forecasting revenue of £23.30m, gross profit of £19.62m and adjusted EBIT of £4.20m. We anticipate DPS of 2.9p.

Valuation

The shares are trading at a 33% discount to the Software & IT services sector on an EV/EBITDA basis (10.4x vs 15.5x). A key risk includes a deterioration in the economic environment.

Table: Financial overview

Year to 30th Sep.	2015A	2016A	2017E	2018E
Revenue (£'000)	19,182	21,320	22,100	23,300
PBT* (£`000)	2,913	3,441	3,720	4,031
EPS* (p)	5.05	5.64	5.46	5.94
Dividend (p)	2.10	2.40	2.60	2.90
Yield (%)	2.98%	3.40%	3.69%	4.11%

Source: GECR and company. *Notes: *Adjusted*

Key data

Share price	70.50p
52 week high/low	72.00p/69.00p
Primary exchange	AIM
EPIC	SND
Shares in issue	54.60 m
Market Cap	£38.7 m
Sector	Software & Computer Services

Share price chart

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Full-Year Results

Sanderson Group has announced its results for the 12-months ended 30th September 2016.

Revenue came-in better than expected, increasing by 11% to £21.32 million (2015: £19.18 million). Recurring revenue from pre-contractual licence and ongoing support services grew by 10% to £10.75 million (2015: £9.77 million), representing 50% of total revenue. Sales order intake increased by in excess of 20% to £12.26 million (2015: £10.03 million), 31% of which was gained from new customers, representing almost twice the level of the prior year.

Gross margin remains strong at 84% (2015: 85%), reflecting continued focus on supplying its own proprietary products and services. Gross margins from recurring revenues covered 63% of total group overheads in FY16.

Adjusted operating profit, which is stated before the amortisation of acquisition-related intangibles, share-based payment charges and acquisition-related and restructuring costs, was in-line with our expectations, increasing by 12% to £3.69 million (2015: £3.30 million). Profit before tax increased by 37% to £2.78 million (2015: £2.03 million).

Group order book grew by in excess of 25% to £3.02 million (2015: £2.35 million). Including the deferred payment in respect to businesses acquired in 2013 and 2014 (£1.66 million) and the payment of dividends (£1.21 million), cash balance as at period end was £4.34 million (2015: £4.61 million). Total dividend payment increased by in excess of 14% to 2.4p per share, which is better than expected (forecast of 2.3p).

Figure: Forecast comparison

	Actual (£'000)	GECR forecast (£'000)	Difference (%)
Total revenue	21,320	20,500	4.0%
Cost of sales	(3,399)	(3,075)	10.5%
Gross profit	17,921	17,425	2.8%
Operating costs*	(14,235)	(13,731)	3.7%
EBIT*	3,686	3,694	(0.2%)
EBITDA*	4,764	4,743	0.4%
PBT*	3,441	3,461	0.6%
PAT*	3,087	3,061	0.8%

Source: Company and GECR *Adjusted

In respect to its digital retail division, revenue increased by 8.8% to £6.40 million (2015: £5.88 million). Partly reflecting the planned investment in anticipation of continued rapid growth within the digital retail market, adjusted operating profit decreased to £0.89 million (2015: £1.29 million). A large new customer was gained in the final month of the year, with delivery of the offering during the current financial year (FY17). Order book at year-end was unchanged from a year earlier at £0.92 million (2015: £0.92 million).

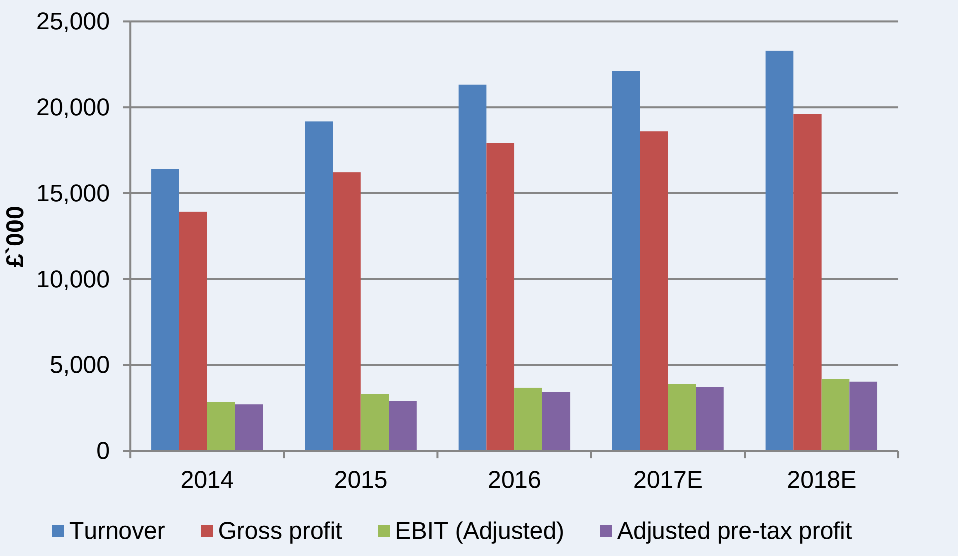
In respect to the enterprise software division, revenue increased by 12% to £14.92 million (2015: £13.30 million). Driven by an improvement in efficiency levels, adjusted operating profit increased by 39% to £2.80 million (2015: £2.01 million). Order book increased by more than 40% to £2.10 million. The manufacturing business gained seven new customers at an increased average order value of £185,000 (2015: £59,000). Within the wholesale, distribution and logistics sectors, thirteen new customers were gained (2015: 8 customers) at an average initial order value of £160,000 (2015: £46,000) during the year.

We note that there has been no noticeable impact on the business following Britain's decision to leave the EU. The board added that it is confident that the company will make further progress and deliver trading results which are at least in-line with market expectations for FY17.

Forecasts

The strategy of Sanderson is to achieve sustained growth by further building and developing its businesses operating within the multi-channel retail and manufacturing target markets. The digital retail opportunity, in particular, provides exposure to a market sector which is experiencing rapid growth. Whilst the group will continue to invest across all of its businesses, particular emphasis will be placed on further developing the range of offerings for its fast growing digital retail businesses, for the food and drink processing sector and for entry level systems in the manufacturing division. Mobile solutions continue to be developed across all of the group's target markets. To augment organic growth, selective acquisition opportunities will continue to be considered.

Figure: Revenue, gross profit, EBIT and PBT profile

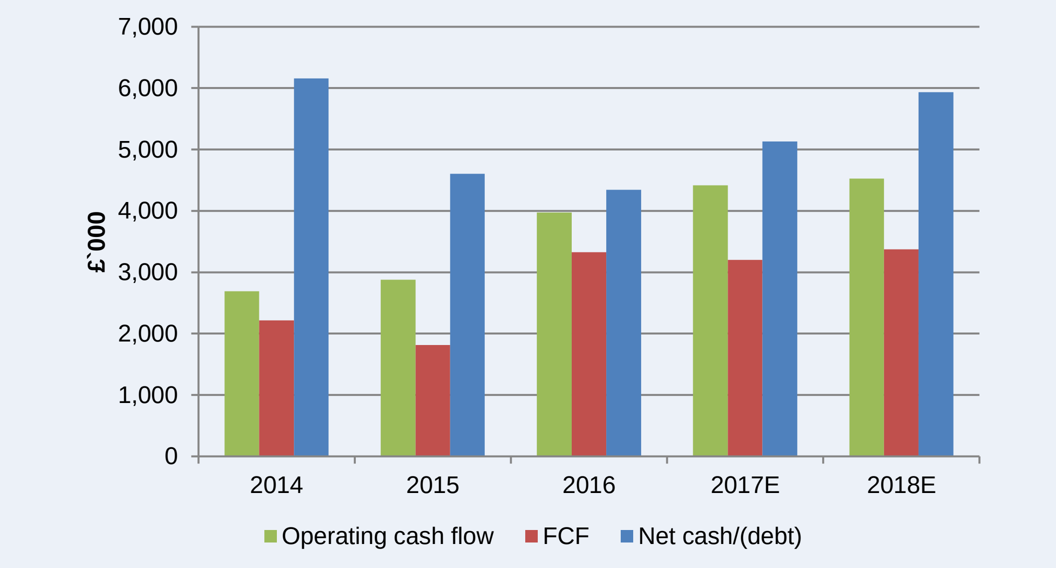


Source: Company and GECR

For FY17, we are forecasting revenue of £22.10m. With a large amount of higher margin products expected to be sold, we are assuming gross margins of 84.2%, leading to a gross profit forecast of £18.61m. With new product development accounting for over £4m of new sales over the last 5 years, we expect the group to continue its investment in product innovation, as well as sales & marketing, and are forecasting an adjusted EBIT of £3.89m. We are forecasting an interest charge of £200k, representing the notional (non-cash) charge on the pension deficit as required by IAS19, leading to an adjusted PBT of £3.64m. We are forecasting a DPS of 2.60p.

For FY18, we are forecasting revenue of £23.30m. As mentioned above, we expect a large proportion of higher margin products to be sold, and are therefore forecasting a gross profit of £19.62m. With further product innovation and sales & marketing investments anticipated, we are forecasting an adjusted EBIT of £4.20m and adjusted PBT of £4.03m. We anticipate DPS of 2.9p.

Figure: Operating cash flow, FCF and net cash



Source: Company and GECR

Valuation

We continue to be impressed by the high level of recurring revenues, which cover two-thirds of business overheads. A strong and growing range of products and services, a growing presence in the multi-channel retail and manufacturing markets, the strengthened balance sheet and strong cash generation augur well for Sanderson. The shares are trading at a 43% discount to the Software & IT services sector on an EV/EBITDA basis (9.0x vs 14.2x). A key risk includes a deterioration in the economic environment.

Appendix

Figure: P&L forecasts

Year end: 30th Sept.	2014	2015	2016	2017E	2018E
Revenue (£'000)	16,411	19,182	21,320	22,100	23,300
EBITDA (£'000)	2,813	3,559	4,251	5,033	5,344
Depreciation and amortisation (£'000)	(765)	(1,138)	(1,225)	(1,225)	(1,225)
Operating profit (£'000)	2,048	2,421	3,026	3,808	4,119
Other income (£'000)	0	0	0	0	1
Net interest (£'000)	(132)	(138)	(153)	(173)	(173)
PBT -reported (£'000)	1,916	2,031	2,781	3,635	3,946
Impairment of acquired intangibles (£'000)	(387)	(483)	(513)	0	0
Non-recurring items/exceptionls (£'000)	(404)	(399)	(147)	(85)	(85)
PBT - normalised (£'000)	2,707	2,913	3,441	3,720	4,031
Taxation (£'000)	(318)	(164)	(354)	(727)	(789)
Minorities & preference dividends (£'000)	0	0	0	0	0
Discontinued/assets held for sale (£'000)	0	0	0	0	0
Net Income - normalised (£'000)	2,389	2,749	3,087	2,993	3,241
Attributable profit (£'000)	1,598	1,867	2,427	2,908	3,156
EPS - reported (p)	3.1	3.4	4.4	5.3	5.8
EPS (norm., cont.) – FD (p)	4.4	4.9	5.5	5.3	5.8
DPS (p)	1.8	2.1	2.4	2.6	2.9
Average number of group shares - FD (m)	54.2	55.9	56.3	56.3	56.1
Average number of group shares (m)	51.9	54.4	54.8	54.8	54.6

Source: Company and GECR

Figure: Cash flow forecasts

Year end: 30th Sept.	2014	2015	2016	2017E	2018E
Profit for the period	1,598	1,867	2,427	2,908	3,156
Depreciation & amortisation	765	1,138	1,225	1,225	1,225
Other cash and non-cash movements	551	643	684	985	1,047
Change in working capital	(224)	(771)	(362)	(700)	(600)
Operating cash flow	2,690	2,877	3,974	4,418	4,829
Pension contribution	(360)	(450)	(330)	(360)	(600)
Interest Paid	0	(5)	0	0	0
Tax paid	(2)	0	0	(600)	(300)
Cash utilised by non-recurring items	0	(310)	(62)	0	0
Cash flow from operations	2,328	2,112	3,582	3,458	3,929
Maintenance capex	(113)	(296)	(254)	(254)	(254)
Free cash flow	2,215	1,816	3,328	3,204	3,675
Expansionary capex	0	0	0	0	1
Other financials	(652)	(515)	(783)	(857)	(858)
Acquisitions	(2,146)	(1,936)	(1,660)	(135)	(135)
Disposals	0	0	0	0	0
Net share issues	3,953	118	58	0	0
Dividends paid	(873)	(1,035)	(1,206)	(1,424)	(1,582)
Change in net cash	2,497	(1,552)	(263)	788	1,101
Net cash/(debt)	6,159	4,607	4,344	5,132	6,233
FCFPS - FD (p)	4.1	3.3	5.9	5.7	6.6

Source: Company and GECR

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