Sanderson Group

Update
30th November 2017

Full-Year Results Point to A Positive Outlook

Sanderson Group has announced its results for the 12 months ended 30th September 2017. Key highlights include revenue growth of 1.1%, adjusted operating profit growth of 5.7% and better than expected net cash of £6.18 million. The software and IT services business added that it is well positioned in its target markets, and that it has a good level of confidence that it will make further progress and deliver trading results that are, at least, in-line with market expectations for FY18. With the results in-line with our expectations, we maintain our forecasts for FY18. We also introduce forecasts for FY19, and 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 4.16%.

Full-Year Results

Revenue increased by 1.1% to £21.56 million (FY16: £21.32 million), and pre-contracted recurring revenue increased by 4% to £11.18 million (FY16: £10.75 million), representing 52% of total revenue (FY16: 50%). Sales order intake grew by 12% to £13.69 million (FY16: £12.26 million), reflecting the continual investment in sales and marketing. The order book at period end was £5.79 million (FY16: £3.02 million) and that includes a significant new order from an existing customer, which is scheduled for delivery over the course of the next two financial years. Gross margin reduced by 2pp to 82% (FY16: 84%), and, impressively, the gross margin from recurring revenues covered 67% of total group overheads in the financial year, up from 63% a year earlier. Adjusted operating profit increased by 5.7% to £3.9 million (FY16: £3.69 million). Non-recurring items totalled £0.49 million, and they relate to potential acquisitions, the consolidation of office premises with internal reorganisation and changing of CFO. Final dividend increased by 11% to 1.55p (FY16: 1.4p), leading to a total dividend for the year of 2.65p (FY16: 2.4p), which is well covered by basic adjusted EPS of 6.4p (FY16: 5.6p).

Financial forecasts

For FY18, we continue to forecast adjusted EBITDA of £6.1m on revenue of £30.4m. We maintain our DPS forecast of 2.9p. For FY19, we forecast adjusted EBITDA of £6.6m on revenue of £33.2m. We anticipate DPS of 3.20p. A key risk to our forecasts includes a deterioration in the economic environment.

Valuation

The shares trade at a 61% discount to its peers on an EV/EBITDA basis (6.7x vs 17.1x), according to Bloomberg.

Table: Financial overview

Year to 30th Sep.	2016A	2017	2018E	2019E
Revenue (£'000)	21,320	21,559	30,400	33,200
PBT* (£`000)	2,928	3,658	4,731	5,227
Dilutive EPS* (p)	4.57	6.86	6.36	6.93
Dividend (p)	2.40	2.60	2.90	3.20
Yield (%)	3.12%	3.38%	3.77%	4.16%

Source: GECR and company.
*Notes: *Adjusted for exceptionals and share-based payments.*

Key data

Share price	77.00p
52 week high/low	90.00p/62.50p
Primary exchange	AIM
EPIC	SND
Shares in issue	55.07 m
Market Cap	£42.72 m
Sector	Software & Computer Services

Share price chart

Important: All disclaimer information can be found on the last page of this document. Please note that this publication has been commissioned by the company to which this publication relates and therefore it cannot be considered independent. The contents of this report, which has been prepared by and is the sole responsibility of MIL, have been approved by Eastwood Anglo Corporate Finance Limited solely for the purposes of section 21(2) of the Financial Services and Markets Act 2000.

Full-Year Results

Sanderson Group has announced its full-year results. For the 12 months ended 30th September 2017, revenue increased by 1.1% to £21.56 million (FY16: £21.32 million), and pre-contracted recurring revenue increased by 4% to £11.18 million (FY16: £10.75 million), representing 52% of total revenue (FY16: 50%). Sales order intake grew by 12% to £13.69 million (FY16: £12.26 million), reflecting the continual investment in sales and marketing. The order book at period end was £5.79 million (FY16: £3.02 million) and that includes a significant new order from an existing customer, which is scheduled for delivery over the course of the next two financial years.

Gross margin reduced by 2pp to 82% (FY16: 84%), and, impressively, the gross margin from recurring revenues covered 67% of total group overheads in the financial year, up from 63% a year earlier.

Adjusted operating profit increased by 5.7% to £3.9 million (FY16: £3.69 million). Non-recurring items totalled £0.49 million, and they relate to potential acquisitions, the consolidation of office premises with internal reorganisation and changing of CFO.

Net cash balance increased to £6.18 million (FY16: £4.34 million), which is well ahead of market expectations. Final dividend increased by 11% to 1.55p (FY16: 1.4p), leading to a total dividend for the year of 2.65p (FY16: 2.4p), which is well covered by basic adjusted EPS of 6.4p (FY16: 5.6p). The final dividend, once approved, will be paid on 16th March 2018, to shareholders on the registry at the close of business on 2nd March 2018.

Digital Retail Division

Revenue from its digital retail division grew by 13.8% to £7.28 million (FY16: £6.40 million), and adjusted operating profits increased by a third to £1.18 million (FY16: £0.89 million). The order book at year end was £3.99 million (FY16: £0.92 million). The group added that it is well-positioned to take advantage of the growth in the digital retail market, with a number of developing sales prospects, active pilot projects and strengthening partnerships with existing customers.

Enterprise Division

Following an exceptional performance in the prior year, the enterprise division saw revenue decline by 4% to £14.28 million (FY16: £14.92 million) and adjusted operating profit decrease by 3% to £2.71 million (FY16: £2.80 million). Order book decreased by 14% to £1.81 million (FY16: £2.10 million). The group added that while sales cycles remain protracted, prospects are good.

The enterprise division consists of two main business areas: manufacturing, and wholesale distribution and logistics. The manufacturing business gained six new customers (FY16: seven new customers), and the wholesale distribution and logistics business gained six new customers (FY16: thirteen new customers), at an average initial order value of £89,000 (FY16: £160,000). The company added that sales prospects within the wholesale distribution and logistics focused business are strong, and are ahead of this time last year, and that improved levels of growth and profit are now anticipated following its investment in post-acquisition restructuring and a new management team.

Strategy and outlook

Continual investment in the development of its software and services was made during the period, in particular in its mobile and ecommerce offerings within the digital retail market and UK food and drink processing and wholesale distribution sectors. The group said that it is well positioned in its target markets, and that it has a good level of confidence that it will make further progress and deliver trading results that are, at least, in-line with market expectations for FY18. Selective complementary acquisitions continue to be under consideration, the group added.

Forecasts

We expect to see further accelerated growth being achieved in the ecommerce market, fuelled by the development of mobile commerce. We also expect to see growth coming from the food and drink processing sector within the UK. So, while Sanderson continues to invest across all of its business, we expect particular attention being placed on developing its offering in these areas. Furthermore, while selective acquisition opportunities will continue to be considered to augment organic growth, we anticipate the focus now is on delivering on target results and on making the Anisa, PRIAM and One iota acquisitions successful.

We have essentially maintained our forecasts for FY18 while providing numbers for FY19. For FY18, we forecast revenue of £30.40m. Assuming gross margin is maintained at 82%, we estimate a gross profit forecast of £24.93m. 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 adjusted PBT of £4.73m. We keep our DPS forecast unchanged at 2.90p.

For FY19, we are forecasting revenue of £33.20m. Assuming gross margin is maintained at 82%, we estimate a gross profit forecast of £27.22m With further product innovation and sales & marketing investments anticipated, we are forecasting an adjusted PBT figure of £5.23m. We anticipate DPS of 3.20p.

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 trade at a 61% discount to peers on an EV/EBITDA basis (6.7x vs 17.1x), according to Bloomberg. The shares are trading at a 43% discount to the Software & IT services sector on an EV/EBITDA basis (9.0x vs 14.2x). The prospective yield of 4.2% is also attractive. A key risk includes a deterioration in the economic environment.

Appendix

Figure: P&L forecasts

Year end: 30th Sept.	2015	2016	2017	2018E	2019E
Revenue (£'000)	**19,182**	**21,320**	**21,559**	**30,400**	**33,200**
EBITDA (£'000)	**3,559**	**4,251**	**4,165**	**6,591**	**7,087**
Depreciation and amortisation (£'000)	(1,138)	(1,225)	(1,285)	(1,463)	(1,563)
Operating profit (£'000)	**2,421**	**3,026**	**2,880**	**5,128**	**5,524**
Other income (£'000)	0	0	0	0	0
Net interest (£'000)	(138)	(153)	(165)	(482)	(382)
PBT -reported (£'000)	**2,031**	**2,781**	**2,713**	**4,646**	**5,142**
Impairment of acquired intangibles (£'000)	(483)	(513)	(491)	(550)	(550)
Non-recurring items/exceptionls (£'000)	(399)	(147)	(945)	(85)	(85)
PBT - normalised (£'000)	**2,430**	**2,928**	**3,658**	**4,731**	**5,227**
Taxation (£'000)	(164)	(354)	154	(929)	(1,028)
Minorities & preference dividends (£'000)	0	0	0	0	0
Discontinued/assets held for sale (£'000)	0	0	0	0	0
Net Income - normalised (£'000)	2,266	2,574	3,812	3,802	4,199
Attributable profit (£'000)	1,867	2,427	2,867	3,717	4,114
EPS - reported (p)	3.4	4.4	5.2	6.4	7.0
EPS (norm., cont.) – FD (p)	4.1	4.6	6.9	6.4	6.9
DPS (p)	2.1	2.4	2.6	2.9	3.2
Average number of group shares - FD (m)	55.9	56.3	55.6	59.8	60.6
Average number of group shares (m)	54.4	54.8	55.0	58.3	59.1

Source: Company and GECR.

Important Information