

Sanderson Group

Update
1st June 2017

Interims In Line With Expectations

Sanderson Group has announced its interim results for the period ended 31st March 2016. The results are in line with expectations, with revenue and adjusted operating profit increasing by 11% and 5%, respectively. The software and IT services company stated that it is confident in making further progress and delivering trading results for the full-year (ended 30th September 2017) in line with market expectations. Accordingly, we reiterate our forecasts for the full year and continue to classify the shares as a hybrid growth and income stock, with the shares providing exposure to both the high-growth enterprise resource planning software market and a decent dividend yield of 3.7%.

Interims

Revenue increased to £10.90 million (H1 FY16: £9.86 million), and adjusted operating profit (stated before amortisation of acquisition-related intangibles, share-based payment charges and acquisition-related costs) increased by 5% to £1.55 million (H1 FY16: £1.47 million). Gross margin decreased by 4 percentage points to 82% (H1 FY16: 86%), reflecting an increase in sales of its non-proprietary offerings. Recurring revenues increased by 4.0% to £5.40 million (H1 FY16: £5.19 million), representing 50% of total revenue. Period-end order book was £2.78 million (H1 FY16: £3.20 million). Sales order intake decreased slightly to £5.81 million (FY16: £6.02 million), but remained at a high level. Net cash increased by 33% to £4.51 million (H1 FY16: £3.39 million). Dividend increased by 10% to 1.1p per share (H1 FY16: 1.0p). CFO Adrian Frost will be leaving the company later in the year. After speaking with Mr. Frost, we note that the move is for personal reasons.

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

We continue to be impressed by the high level of recurring revenues, a growing range of offerings, and strong balance sheet and cash generation. The shares are trading at a 39% discount to the Software & IT services sector on an EV/EBITDA basis (9.28x vs 15.3x) (source: Stockopedia). A key risk includes a deterioration in the economic environment.

Key data

Share price	77.75p
52 week high/low	90.00p/61.00p
Primary exchange	AIM
EPIC	SND
Shares in issue	55.01 m
Market Cap	£42.78 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.

Table: Financial overview

Year to 30 th 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
Dilutive EPS* (p)	4.92	5.48	5.32	5.78
Dividend (p)	2.10	2.40	2.60	2.90
Yield (%)	2.70%	3.09%	3.34%	3.73%

Source: GECR and company.

Notes: *Adjusted for exceptionals

Interims

Sanderson Group announced interim results for the six months ended 31st March 2017.

Revenue increased by 11% to £10.90 million (H1 FY16: £9.86 million). Adjusted operating profit (stated before amortisation of acquisition-related intangibles, share-based payment charges and acquisition-related costs) increased by 5% to £1.55 million (H1 FY16: £1.47 million). Gross margin decreased by 4 percentage points to 82% (H1 FY16: 86%), reflecting an increase in sales of its non-proprietary offerings. Recurring revenues increased by 4.0% to £5.40 million (H1 FY16: £5.19 million), representing 50% of total revenue. Period-end order book was £2.78 million (H1 FY16: £3.20 million). Sales order intake decreased slightly to £5.81 million (FY16: £6.02 million), but remained at a high level. Net cash increased by 33% to £4.51 million (H1 FY16: £3.39 million). Dividend increased by 10% to 1.1p per share (H1 FY16: 1.0p).

In respect to its Digital Retail division, revenue increased by 20% to £3.54 million (1H FY16: £2.95 million), but increased investment meant operating profits were more-or-less unchanged at £0.34 million (H1 FY16: £0.33 million). Sales order intake increased by 50%, and order book increased by 8% to £0.84 million (H1 FY16: £0.78 million).

The other main division, Enterprise software, saw revenue increase by 6% to £7.36 million (H1 FY16: £6.92 million), and operating profit increase by 5% to £1.21 million (H1 FY16: £1.15 million). Order book decreased slightly to £1.93 million (H1 FY16: £2.42 million), but still remained at a healthy level. Within the Enterprise Software division, the manufacturing subdivision saw revenue decrease slightly to £3.15 million (H1 FY16: £3.25 million) as it gained 4 new customers at an average order value of £143,000. Recurring revenue now represents 59% of total divisional revenue and covers more than three quarters of divisional overheads. Wholesale distribution and logistics, the other subdivision of enterprise software division, saw revenue increase by 15% to £4.21 million (H1 FY16: £3.66 million) as it also gained 4 new customers.

In respect to its group strategy, the core focus remains on further improving the mobile and ecommerce offerings in the Digital Retail division and strengthening offerings in Enterprise Software division, in particular in Food and Drink processing. A number of acquisition targets continue to be considered as the group looks to augment its solid level of organic growth. Following 17 years at the company, CFO Adrian Frost will be leaving the company later in the year.

The company said that it is confident in making further progress and delivering trading results in-line with market expectations for the current financial years (FY17).

Forecasts

We have maintained our forecasts on the back of the announcement and continue to forecast revenue of £22.10 million for FY17. Maintaining a gross margin of 84% gives a gross profit of £18.61 million. We expect the group to continue its investment in product innovation, as well as sales & marketing, and continue to forecast an adjusted EBIT of £3.89m and adjusted PBT of £3.72m. We are forecasting DPS of 2.60p.

For FY18, we are forecasting revenue of £23.30 million and gross profit of £19.62 million. With further product innovation and sales & marketing investments anticipated, we are forecasting an adjusted EBIT of £4.20 million and adjusted PBT of £4.03 million. We anticipate DPS of 2.9p, but note that this could be higher if targets are hit and cash flows remain strong. We've also increased tax payable to £600k from £425k on management guidance following working through the 2017 payment on account calculation.

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 digital retail and enterprise markets, the strengthened balance sheet and strong cash generation augur well for Sanderson. The shares are trading at a 39% discount to the Software & IT services sector on an EV/EBITDA basis (9.28x vs 15.3x) (source: Stockopedia), and offer an attractive prospective yield of 3.7%.

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/exceptionals (£'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

*FD stands for fully diluted.

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	(530)	(600)
Cash utilised by non-recurring items	0	(310)	(62)	0	0
Cash flow from operations	2,328	2,112	3,582	3,528	3,629
Maintenance capex	(113)	(296)	(254)	(254)	(254)
Free cash flow	2,215	1,816	3,328	3,274	3,375
Expansionary capex	0	0	0	0	0
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)	858	800
Net cash/(debt)	6,159	4,607	4,344	5,202	6,003
FCFPS - FD (p)	4.1	3.3	5.9	5.8	6.0

Source: Company and GECR

*FD stands for fully diluted.

Figure: Balance sheet

Year end: 30th Sept.	2014	2015	2016	2017E	2018E
Property plant and equipment	294	469	524	579	634
Intangible assets	28,514	30,627	30,473	30,319	30,165
Investments and other non-current assets	1,145	1,319	1,755	1,755	1,755
Cash and equivalents	6,159	4,607	4,344	5,202	6,003
Other current assets	4,932	5,745	7,261	7,261	7,261
Total assets	41,044	42,767	44,357	45,116	45,818
Total debt	0	0	0	0	0
Preference shares	0	0	0	0	0
Other long term liabilities	(6,598)	(5,807)	(9,094)	(9,094)	(9,094)
Other current liabilities	(8,629)	(10,333)	(10,332)	(9,632)	(9,032)
Total liabilities	15,227	16,140	19,426	18,726	18,126
Net assets	25,817	26,627	24,931	26,390	27,692
Shareholder's equity	25,817	26,627	24,931	26,500	28,159
Minority interests	0	0	0	0	0
Total equity	25,817	26,627	24,931	26,390	27,692
Net working capital	1,355	1,646	2,482	3,182	3,782
NAV per share (p)	47.6	47.7	44.3	46.9	49.4

Source: Company and GECR

Important Information

GECR is a trading name of Master Investor Limited ("**MIL**"). MIL is not authorised or regulated by the Financial Conduct Authority ("**FCA**"). 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 ("**EACF**") solely for the purposes of section 21(2) of the Financial Services and Markets Act 2000. EACF, whose registered office is Burnell Arms, Winkburn, Newark, Nottinghamshire, NG22 8PQ. EACF is authorised and regulated by the FCA and its firm reference number is 193023. EACF is acting for MIL and not for any other person and will not be responsible for providing the protections provided to clients of EACF nor for advising any other person in connection with the contents of this report and, except to the extent required by applicable law, including the rules of the FCA, owes no duty of care to any other such person. No reliance may be placed on EACF for advice or recommendations with respect to the contents of this report and, to the extent it may do so under applicable law, EACF makes no representation or warranty to the persons reading this report with regards to the information contained in it.

MIL provides professional equity research services and the companies researched pay a fee in order for this research to be made available. This report has been commissioned by the subject company and prepared and issued by MIL for publication in the United Kingdom only. It has not been prepared in accordance with the legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This report may contain forecasts, estimates of future share prices and future valuations ("**forecasts**"), which by their nature involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future and are not guarantees of future performances. The actual results, performance or achievements of the company or developments in the sector in which the company operates may differ materially from the future results, performance or achievements or sector developments expressed or implied by the forecasts contained in this report. The forecasts contained in this report speak only as at the date of this report. MIL undertakes no obligation to update or revise publicly the forecasts contained in this report to reflect any change in expectations or to reflect events or circumstances occurring or arising after the date of this report.

All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable; however, MIL does not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of MIL at the time of publication, and any estimates are those of MIL and not of the company concerned unless specifically sourced otherwise.

This report is provided for information purposes only and is not a solicitation or inducement to buy, sell, subscribe or underwrite securities. MIL does not make investment recommendations. Any valuation given in this report is the theoretical result of a study of a range of possible outcomes and not a forecast of a likely share price. MIL does not undertake to provide updates to any opinions or views expressed in this document.

MIL does not hold any positions in the securities mentioned in this report. MIL or its affiliates may perform services or solicit business from any of the companies mentioned in this report.

The price and value of securities can go down as well as up, and so you could get back less than you invested. In addition, the level of marketability of the securities mentioned in this report may result in significant trading spreads and sometimes may lead to difficulties in opening and/or closing positions. Past performance is not a guide to future performance. Information in this report cannot be relied upon as a guide to future performance.

Before purchasing any securities referred to in this report, persons reading this report should make sure that they fully understand and accept the risks of investing in the company which is the subject of this report. Before making any investment decisions, potential investors should consult an independent financial adviser as to the suitability of the securities referred to in this report to the person concerned.