SMALL CAP SHARE COMMENT
Commissioned Commentary

SANDERSON GROUP (AIM:SND)

Share price 112p

Date: **24th May 2018**
Sector: **Software & Computer Services**
Market Cap: c£67m
www.sanderson.com

A positive first half and better-balanced order book bodes well for the future

The software and IT services business specialising in digital retail technology and enterprise software has announced interim results for the six months ending 31 March 2018.

The target market for Sanderson products and services are primarily SMEs, with whom the Group fosters long-term relationships. These relationships result in a high proportion of sales arising from pre-contracted recurring revenue, complemented by incremental sales. This robust revenue stream typically accounts for around 90% of Group revenue.

Sanderson proprietary software is marketed and sold under a 'right to use' licence, with all sales, marketing, delivery, support and services carried out by the Group's own expert staff. Both on-premise and cloud-based solutions are available to customers on a subscription basis.

- Anisa acquisition

The acquisition of the Anisa Group on 23 November 2017, which we commented on in our **note here**, has significantly enhanced the size and strength of the Sanderson Enterprise Division. Anisa specialises in the delivery of world-class integrated supply chain and enterprise resource planning ('ERP') solutions and on acquisition had around 250 customers who are provided with twenty-four hour support on a worldwide basis throughout the year. Anisa employs over 90 staff in offices across the UK and in smaller operations in Singapore and Australia.

The acquisition of Anisa considerably enhances the range of solutions and services which Sanderson can now offer customers. In particular, managed services provide an opportunity to exploit and to accelerate expected market trends towards subscription and cloud-based options for product delivery going forward.

Long term commitment from Anisa management

Following the acquisition, Anisa directors hold shares representing 4.77% of the issued share capital of Sanderson and in turn, Mr David Renshaw, the Chief Executive of Anisa, owns shares, representing 3.48% of Sanderson share capital. All of the consideration shares are subject to a three year lock-in expiring on 23 November 2020, highlighting their long term commitment to the enlarged business.

- Interim results

Interim results for the six months ended 31 March 2018 were slightly ahead of previous management's expectations.

Income statement

Group revenue increased 34% to £14.61m (H1 2017: £10.9m) and operating profit (before the amortisation of acquisition-related intangibles, share-based payment charges, acquisition-related and restructuring costs) increased 34% to £2.08m (H1 2017: £1.55m).

On a 'like-for-like' basis, excluding the acquisition, revenue rose to £11.08m (H1 2017: £10.9m) and operating profit grew over 12% to £1.74m (H1 2017: £1.55m).

Gross margins continue to run at a high level of over 80% and the all-important pre-contracted recurring revenues increased to above £8.25m (2017:£5.4m). On a 'like-for-like' basis, excluding the impact of the Anisa, acquisition pre-contracted recurring revenues ended the first half of the financial year at £5.99m compared with £5.4m for 2017. **The focus remains on building recurring revenues including growing subscription, cloud and managed services revenues.**

Dividend

The progressive dividend policy has been maintained with the interim dividend lifted 14% to 1.25p per share (2017: 1.10p).

Balance sheet

Operating cash inflow was £1.67m (2017: £1.62m) and free cash flow £1.22m after £321k (2017: £87k) of capitalised development expenditure.

Net cash at the period end was £1.39m. This followed the Anisa acquisition in November 2017, which was satisfied from the Group's own cash resources, by the assumption of Anisa's utilised five-year repayable term debt facility of £4.12m and by the issue of 3,990,653 Sanderson shares (locked-in until November 2020). The Group's cash balance at 31 March 2018, excluding the loan facility, was £5.06m (31 March 2017: £4.51m).

We understand the Group is in discussion with the scheme actuary and trustees regarding the annual pension funding requirement. It is likely contributions will increase but are expected to remain within an affordable level.

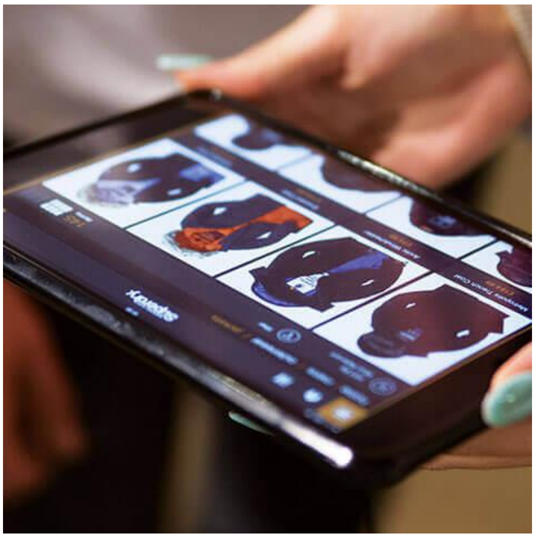
- Order book higher

The value of the Group order book measured on a 'like-for-like' basis at the end of March 2018, stood at £3.22m (2017: £2.78m), being over 16% ahead of the comparable order book value at the end of March 2017. Management commented how the order book is now much better balanced and is now at a more manageable level across the Group's businesses. The total order book, which now includes the acquisition and reflects the remaining element of the large order gained in June 2017, was £8.61m at 31 March 2018.

- Divisional

Sanderson breaks down its business in terms of a ***Digital Retail Division*** and an ***Enterprise Software Division***. The Enterprise software division now includes the recently acquired Anisa business, with the remaining parts of the division comprising 2 market-focused businesses based on the ***Manufacturing sector and the Wholesale Distribution and Logistics sector***.

The ***Digital Retail Division*** provides comprehensive solutions for ecommerce, mobile commerce and retail, including cloud-based store solutions and works with leading retailers such as JD Sports and Superdry.



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In six-months to 31 March 2018, revenue in Digital Retail grew over 20% to £4.25m (2017: £3.54m). Operating profit almost doubled to £0.7m (2017: £0.34m) and the order book at 31 March 2018 stood at £3.42m (2017: £0.84m). This includes the remaining element of a large order gained in June 2017 to be delivered over the next 15 months. Excluding this large order, the order book was up by over 50% compared with the order book at 31 March 2017.

Following a successful pilot scheme, a Phase One order has been secured with a 'well-known global iconic fashion brand' (not named). Sales prospects remain strong with pilot schemes for a number of prospective customers being planned for initial deployment in the current financial year.

Sales orders were gained from a number of customers including Richer Sounds, Thorntons, Beaverbooks and Scotts of Stow.

The ***Enterprise Division*** has benefited from increased investment in sales and marketing capability and has been significantly enhanced and strengthened by the acquisition of Anisa.

Enterprise – Manufacturing

Businesses in the engineering, plastics, aerospace, electronics, print ('general manufacturing') and food and drink processing sectors represent the main areas of specialisation for this division. Activity in food and drink is a key driver, where the traceability of ingredients through the supply chain and compliance with regulatory standards, are key industry requirements and strong features of the Group's solution.

Profit from this part of the business was up on the comparable period with large orders from existing customers, included Newly Weds Foods and Adelie Foods.

Enterprise - Wholesale Distribution and Logistics

Sanderson supplies solutions to the wholesale distribution, cash and carry and fulfilment sectors, as well as to the specialist warehousing and logistics markets. Management commented that businesses which focus on the wholesale distribution and fulfilment sector remained very profitable. The Group launched a suite of digital solutions in the wholesale industry at the end of the last financial year offering the opportunity to improve and increase productivity. This is designed to capitalise on digital transformation and the growing use of mobile devices in the sector.

Enterprise – Anisa Supply Chain Logistics

The results statement commented that Anisa has made a good start as part of Sanderson and several exciting sales prospects are being developed, including a major UK port, where a scoping exercise is currently underway for a new supply chain system. New orders were secured from several customers including Moran Logistics, a market leader in multi-temperature food logistics, Culina and DHL Supply Chain.

Enterprise Divisional revenue and operating profit increased to £10.36m (2017:£7.36m) and £1.38m (2017: £1.21m) respectively.

The Enterprise division order book at 31 March 2018, was valued at £5.19m (2017: £1.93m).

With strong recurring revenue, a good order book and a growing list of sales prospects, the Enterprise division enters the second half of the financial year well positioned for further progress.

- Outlook

Having been strengthened by the Anisa acquisition, Sanderson has a large order book, robust recurring revenue and a healthy balance sheet.

Management confirmed at having "a good level of confidence that Sanderson will make significant further progress during the current financial year ending 30 September 2018."

- Broker estimates

House broker forecasts for the Financial Year ending September 2018 are for adjusted EPS of 6.4p and 6.9p for FY 2019.

The forecast 2018 dividend of 2.9p, covered over 2x by adjusted earnings, equates to a yield of approx. 2.6% at the current share price.

We are impressed how Sanderson has now assembled a software and services group supporting all elements of the supply chain, from manufacturing, through distribution, warehousing and retail.

A very positive first half of the year and the better-balanced order book bodes well for the future.

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63-81 High Street.
Rickmansworth, Herts WD3 4DZ
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