

# ISR Company Research

## Small cap ERP solutions vendors Ready for the next phase?

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K3 Business Technology Group and Maxima Holdings are research client of IS Research Ltd

**Analyst | Ian Spence**

**T** +44 (0)1256 768833

**E** [ian.spence@is-research.co.uk](mailto:ian.spence@is-research.co.uk)



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## Contents

<b>Introduction</b>	<b>1</b>
<b>Investment summary</b>	<b>2</b>
<b>K3 Business Technology</b>	<b>4</b>
<b>Maxima Holdings</b>	<b>6</b>
<b>Sanderson Group</b>	<b>8</b>

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### **IS Research Ltd**

The Granary, Home Farm  
Ridge Lane, Rotherwick  
Hampshire, RG27 9AX

T +44 (0) 1256 768833

E [info@is-research.co.uk](mailto:info@is-research.co.uk)

[www.is-research.co.uk](http://www.is-research.co.uk)

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IS Research was founded by Ian Spence in 2007. Ian has been involved in researching and advising companies in the UK technology sector for over 15 years and was voted TechMARK analyst of the year in 2004 and again in 2008 making him the only analyst to win twice and the only independent analyst to be recognised in this way.

The business was founded on Megabuyte. Originally a free blog, our market intelligence service is now available to subscribers only and is now read daily by many of the sector's leading CEOs, investors and advisers.

From this firm foundation we went on to launch our Equity Research service. Our blend of high quality, genuinely independent research combined with intelligent distribution has led to rapid growth for this element of the business.

Our tight customer relationships have also enabled us to provide a range of complementary consulting services including investor relations, transaction support services and peer group analysis.

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# Ready for the next phase?

Having made a good living from the supporting legacy products and offering the occasional upgrade, the small group of quoted UK based mid-market ERP solutions companies face a changing future. As cloud computing becomes increasingly commonplace, mid market companies will look to upgrade their enterprise applications. Whilst this represents an opportunity for the companies covered in this note, it also represents a threat. As their clients migrate onto newer technology, success will be determined by the strength of relationship with the leading mid-market ERP vendors, SaaS capabilities and strong vertical market focus.

In this note we assess the readiness of K3 Business Technology, Maxima and Sanderson for this fundamental change in the market by looking at their strategic positioning and financial performance. We then overlay this onto current valuations to establish which stock provides the greatest potential upside.

## K3 Business Tech. - Company basics

RIC	KBT
Share price £	0.83
Market cap £m	21.2
Net cash £m	(13.0)
Enterprise value £m	34.2

## K3 Business Technology Group

Put simply, we see K3 as the best prepared of the three companies under coverage for the changes ahead but it is also the cheapest stock of the three. In terms of strategic positioning, K3 has a clear vertical market strategy and strong partnerships with leading ISVs, especially Microsoft. In our view, the only chink in its strategic positioning is an underdeveloped managed services capability. On financials, K3 delivers stronger organic growth and significantly higher margins than Maxima and Sanderson. Despite this positioning, K3 trades on just 6x current year EV/NOPAT, a 50% discount to Maxima and Sanderson. To bring K3 up to an equivalent valuation would imply a fair value for the shares of 140p.

## Maxima Holdings - Company basics

RIC	MXM
Share price £	0.98
Market cap £m	24.4
Net cash £m	(15.5)
Enterprise value £m	39.9

## Maxima Holdings

Maxima has suffered a number of setbacks over the last 18 months, most recently with news that QAD was not going to renew its exclusive distribution agreement. This led to a 20% profit downgrade but was actually good news for Maxima on a strategic level. Despite these setbacks, we believe that Maxima is making progress with its strategic positioning following the appointment of a new CEO earlier this year. For us, areas of focus for development should be vertical market strategy and cross selling the strong managed services capability. At 9x EV/NOPAT, Maxima looks fairly valued but the shares could push on if potential strategic improvements are delivered.

## Sanderson Group - Company basics

RIC	SND
Share price £	0.16
Market cap £m	6.7
Net cash £m	(10.5)
Enterprise value £m	17.3

## Sanderson Group

Sanderson has a long track record in the manufacturing sector and some embedded customer relationships. However, in our view, it has the weakest strategic positioning of the three companies under review. Whilst Sanderson has a clear vertical market strategy, it has underinvested in its products and they are now looking increasingly uncompetitive. In the retail sector, Sanderson does not own its IP and we fear that its key partner in retail has the potential to eat its lunch. Despite its relatively weak strategic positioning, Sanderson's shares trade at a significant premium to K3 and on a par with Maxima. Consequently, we see risk to the downside although this should be mitigated by the dividend yield.

# Investment summary

## Strategic positioning

### Product & service strategy

Whilst the group of companies under review continues to support their own ERP applications, their future lies as strategic partners to the leading mid-market ERP vendors. Whilst the partner organisations at the enterprise level are purely implementation organisations, in the mid-market, partners have the opportunity to develop their own software IP around the core ERP applications. This is particularly true of the Microsoft channel.

Against this background, the companies covered in this note will need to not only align themselves to one or more of the mid-market ERP vendors but also have the development capability to create tailored applications for different vertical markets which sit on top of the core ERP applications. Ploughing their own furrow in product development in competition with the leading ERP vendors is no longer an option.

### Vertical market focus

From our comments above it is clear that one of the key factors in a successful product strategy is clear vertical market focus. As small cap ERP vendors move away from their own products, they will need to differentiate themselves through vertical market expertise. This expertise can be in the form of domain knowledge and, more importantly, software applications specifically tailored to a particular vertical which run on top of the core ERP applications from the leading vendors.

### SaaS readiness

The mid market is arguably the key battle ground for SaaS. However, whereas in the SME market, vendors can promote a single instance of their software in a 'pure' SaaS model, mid market vendors are more likely to be asked to host existing, often heavily tailored applications. Access to both SaaS expertise and infrastructure (either directly or through partnership) is an increasingly critical success factor.

### Sales capability

None of the above attributes are any good if there is not an effective sales team to sell the solutions. One critical success factor as the product strategy develops from owned products to a partner strategy is a well thought through sales strategy for upselling new applications into the legacy base.

**Table 1: Competitive positioning**

	<b>K3 Business Tech.</b>	<b>Maxima</b>	<b>Sanderson</b>
Product strategy	Strong	Improving	Weak
Vertical market focus	Strong	Improving	Strong
SaaS readiness	Improving	Strong	Weak
Sales capabilities	Strong	Improving	Weak
<b>Overall</b>	<b>Strong</b>	<b>Improving</b>	<b>Weak</b>

Source: ISR

In Table 1 we have rated our three companies' product strategies and we can see that we assess K3 as having the strongest competitive position, Maxima's is showing significant improving following its recent management change but we believe that Sanderson lags behind. For more detail on our assessment, please go to the individual company profiles.

## Investment summary

### Financial performance

Financial performance is clearly a fundamental part of assessing the effectiveness of a company's management and its strategy. In table 2 below, we have summarised some of the key metrics for each of the three companies under consideration.

**Table 2: Key Performance Indicators**

	K3 Business Tech.	Maxima	Sanderson
<b>Revenue breakdown</b>			
Recurring revenue	41%	56%	49%
Sales to existing customers	43%	na	38%
Sales to new customers	16%	na	13%
<b>Last fiscal year</b>			
Year ended	Dec-08	May-09	Sep-08
Headline revenue growth	10%	21%	52%
Organic growth*	-3%	-10%	-8%
Operating margins	20%	15%	14%
Adjusted PBT growth	25%	-20%	-5%
Adjusted EPS growth	17%	-20%	7%
<b>Current fiscal year</b>			
Year ended	Dec-09	May-10	Sep-09
Headline revenue growth	-3%	-6%	-4%
Organic growth	-3%	-6%	-4%
Operating margins	19%	11%	9%
Adjusted PBT growth	0%	-29%	-45%
Adjusted EPS growth	0%	-30%	-45%
<b>Cash flow &amp; investment (3yr avg)</b>			
Cash conversion	82%	77%	88%
Capex/Depreciation	144%	136%	98%
<i>*ISR estimates</i>			

Source: ISR, Companies

We can see from the table that growth rates are expected to be broadly the same for each company in the current year but K3 continues to enjoy significantly stronger margins. Cash conversion is broadly similar for the three companies but K3 and Maxima seem to have been investing more heavily in their business whilst Sanderson seems only to have been maintaining its capex relative to depreciation.

### Valuation

Table 3 below shows the relative valuations for the three companies under consideration. Given the level of debt in all three businesses, PE ratios do not provide a fair guide to valuation and we prefer to look at EV/NOPAT instead. On that basis we can see that K3 trades on a significant discount to the two peers which seems particularly unjustified given the relative strength of its assessment in our other two categories. Sanderson, by comparison looks relatively overvalued.

**Table 3: Current year valuations**

	Price £	Mkt cap £m	EV £m	EV/sales x	EV/NOPAT x	PER x	Yield %
K3 Business Tech	0.83	21.2	29.9	0.8	6.1	4.8	0.6
Maxima	0.98	24.4	38.1	0.7	9.0	7.0	4.6
Sanderson	0.16	6.7	15.4	0.6	8.9	6.1	2.9

Source: ISR, companies, Morningstar

# K3 Business Technology Group\*

Put simply, we see K3 as the best prepared of the three companies under coverage for the changes ahead but it is also the cheapest stock of the three. In terms of strategic positioning, K3 has a clear vertical market strategy and strong partnerships with leading ISVs, especially Microsoft. In our view, the only chink in its strategic positioning is an underdeveloped managed services capability. On financials, K3 delivers stronger organic growth and significantly higher margins than Maxima and Sanderson. Despite this positioning, K3 trades on just 6x current year EV/NOPAT, a 50% discount to Maxima and Sanderson. To bring K3 up to an equivalent valuation would imply a fair value for the shares of 140p.

## K3 Business Tech. - Company basics

RIC	KBT
Share price £	0.83
Market cap £m	21.2
Net cash £m	(13.0)
Enterprise value £m	34.2

K3 provides software and related services to the manufacturing sector in the UK and the retail sector in the UK and Northern Europe

## K3 Business Technology - Estimates and valuation

Year end Dec	Financials					Valuation			
	Rev £m	Adj PBT £m	Adj EPS p	DPS p	Net cash £m	EV/sales x	EV/NOPAT x	PER x	Yield
2007 A	34.1	4.7	14.8	0.5	-13.4	1.0	8.6	5.6	0.6%
2008 A	37.6	5.9	17.2	0.5	-13.0	0.9	6.7	4.8	0.6%
2009 E	36.4	5.9	17.2	0.5	-8.7	0.8	6.1	4.8	0.6%
2010 E	36.4	6.2	17.1	0.5	-4.1	0.7	5.1	4.9	0.6%

Source: ISR, Companies, Morningstar

## Strategic positioning

In our view, K3 has the strongest overall strategic positioning of the three companies. Whilst it is still supporting its own products, new product development is being directed at applications build around partner ISVs. Whilst, in its manufacturing business, K3 has a strong relationship with Syspro, Microsoft is the group's key strategic ISV partner. K3 was one of the first UK partners to put serious development effort in Microsoft CRM and its proposition in the retail sector is based around the Microsoft Dynamics platform.

From a vertical market perspective, K3 has a strong focus on retail and manufacturing. Our only criticism of K3's product strategy is that its infrastructure and managed services offering is not as developed as it might be. However, we understand from conversations with management that this is a weakness which management is seeking to address both organically and, possibly, by acquisition.

## Financial performance

K3 has delivered better organic growth levels than both Maxima and Sanderson despite the fact that it generates less of its revenue from existing customers. We attribute this success to superior product positioning and sales execution. Particularly in its Manufacturing business, K3 has a high developed sales methodology for upselling existing users onto newer versions of its technology. K3 also leads the pack on its margins and we attribute this to a greater level of new licence sales in its business mix. K3's cash conversion has been adequate and it has invested in growth.

## Valuation

Despite being the best positioned for the changes ahead, K3 has the lowest valuation of our three stocks. For the year to December, the shares trade on an EV/NOPAT of just 6x which is a 50% discount Maxima and Sanderson. Putting K3 on a par with the other two would imply a fair value for the shares of 150p.

## K3 Business Tech - Strategic positioning

Product strategy	Strong
Vertical market focus	Strong
SaaS readiness	Improving
Sales capabilities	Strong
<b>Overall</b>	<b>Strong</b>

Source: ISR

\* K3 Business Technology Group is an equity research client of I S Research Ltd

## K3 Business Technology Group

K3 Business Technology - KPIs		K3 Business Technology Group – Detailed financials				
		Dec-06 A	Dec-07 A	Dec-08 A	Dec-09 A	Dec-10 A
<b>Revenue breakdown</b>						
Recurring revenue	41%					
Sales to existing customers	43%					
Sales to new customers	16%					
<b>Last fiscal year</b>						
Year ended	Dec-08					
Headline revenue growth	10%					
Organic growth*	-3%					
Operating margins	20%					
Adjusted PBT growth	25%					
Adjusted EPS growth	17%					
<b>Current fiscal year</b>						
Year ended	Dec-09					
Headline revenue growth	-3%					
Organic growth	-3%					
Operating margins	19%					
Adjusted PBT growth	0%					
Adjusted EPS growth	2%					
<b>Cash flow (3yr avg)</b>						
Cash conversion	82%					
Capex/Depreciation	144%					
*ISR estimates						
		<b>Profit &amp; Loss</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
		Revenue £m	27.3	34.1	37.6	36.4
		Adj EBITDA £m	3.4	6.3	7.9	7.6
		Adj EBIT £m	2.9	5.8	7.3	6.9
		Reported PBT	2.6	3.7	3.9	3.7
		PBT before excepts and AAG	2.6	4.6	5.8	5.8
		Fully adj PBT	2.7	4.7	5.9	5.9
		NOPAT £m	2.0	4.0	5.1	4.9
		Reported EPS	9.5	13.1	11.7	11.0
		EPS before excepts and AAG	10.0	14.3	16.9	16.9
		Fully adjusted EPS p	10.3	14.8	17.2	17.2
		Dividend per share p	0.0	0.5	0.5	0.5
		<b>Cash flow &amp; Balance sheet</b>				
		Operating cash flow	2.2	6.2	6.4	7.6
		Free Cash Flow	1.7	2.5	2.9	4.2
		FCF per share p	9.6	11.0	11.9	17.5
		Capex	-0.3	-0.6	-1.3	-1.0
		Acquisitions	-1.5	-16.6	-0.3	0.0
		Net cash flow	0.4	-14.3	1.7	3.8
		Shares issued	0.0	0.3	0.0	0.0
		Net cash	0.7	-13.4	-13.0	-8.7
		<b>Metrics</b>	<b>FY-07</b>	<b>FY-08</b>	<b>FY-09</b>	<b>FY-10</b>
		Revenue growth		24.9%	10.2%	-3.3%
		Adj EBITDA growth		85.7%	26.9%	-3.6%
		Adj EBIT growth		97.4%	27.6%	-5.5%
		Adj PBT growth		77.9%	25.3%	0.4%
		Adj EPS growth		43.9%	16.5%	-0.3%
		Dividend growth		#DIV/0!	0.0%	0.0%
		Adj EBIT margins	10.7%	16.9%	19.5%	19.1%
		Operating cash conversion	66%	100%	80%	100%
		Capex/Depreciation	75%	131%	226%	143%
		<b>Valuation</b>	<b>FY-07</b>	<b>FY-08</b>	<b>FY-09</b>	<b>FY-10</b>
		EV/sales	0.7	1.0	0.9	0.8
		EV/EBITDA	6.1	5.5	4.3	3.9
		EV/NOPAT	10.0	8.6	6.7	6.1
		PER	8.1	5.6	4.8	4.8
		Dividend yield	0.0%	0.6%	0.6%	0.6%
		FCF yield	11.6%	13.3%	14.4%	21.1%

Source: ISR, Company, Morningstar

# Maxima Holdings\*

Maxima has suffered a number of setbacks over the last 18 months, most recently with news that QAD was not going to renew its exclusive distribution agreement. This led to a 20% profit downgrade but was actually good news for Maxima on a strategic level. Despite these setbacks, we believe that Maxima is making progress with its strategic positioning following the appointment of a new CEO earlier this year. For us, areas of focus for development should be vertical market strategy and cross selling the strong managed services capability. At 9x EV/NOPAT, Maxima looks fairly valued but the shares could push on if potential strategic improvements are delivered.

## Maxima Holdings - Company basics

RIC	MXM
Share price £	0.98
Market cap £m	24.4
Net cash £m	(15.5)
Enterprise value £m	39.9

Maxima provides enterprise software, implementation and infrastructure services to mid-market companies in the UK.

## Maxima Holdings - Estimates and valuation

Year end May	Financials					Valuation			
	Rev £m	Adj PBT £m	Adj EPS p	DPS p	Net cash £m	EV/ sales x	EV/ NOPAT x	PER x	Yield
2008 A	46.7	8.9	24.7	5.6	-8.5	0.7	4.8	4.0	5.7%
2009 A	56.6	7.1	19.8	4.5	-15.5	0.7	6.9	4.9	4.6%
2010 E	53.0	5.0	13.9	4.5	-13.7	0.7	9.0	7.0	4.6%
2011 E	54.6	5.4	15.0	4.5	-11.8	0.7	8.2	6.5	4.6%

Source: ISR, Companies, Morningstar

## Strategic positioning

Maxima has been more acquisitive than the other two companies and has thereby created a more diverse mix of products and services. Whilst this has created some integration issues for Maxima, it has also given it the strongest infrastructure platform with which to address the SaaS agenda. With regard to product strategy, even after recently being dropped by QAD, Maxima has the broadest set of partners including SAP, Oracle and Microsoft. However, we feel that Maxima currently has the weakest vertical market strategy. Maxima does have a presence in multiple verticals but it hasn't developed specific propositions. One notable exception to this is Maxima's MAXcel product which is a Microsoft Dynamics based product specifically designed for the construction and facilities management sector. Conversations with Maxima's management suggest that MAXcel is the template for the company's product development strategy into other verticals.

## Financial performance

Maxima has the weakest organic growth of the group but this is, in large part, due to a couple of specific factors. In the year to May 2009, Maxima lost a significant contract and, in the current year, will lose around £3.5m in revenue following the termination of the QAD partnership. Prior to the recent QAD announcement, we were forecasting flat organic growth for Maxima. Unfortunately for Maxima, the lost business was high margin work and so profits have suffered disproportionately. As a result, margins have come down substantially from over 20% in 2008 to 11% in the current year. That said, part of this margin reduction has also been due to investment in the group sales and marketing which we see as a positive step. Maxima's cash flow has been the weakest of the three but has still been adequate and we are comfortable with the levels of investment in the business.

## Valuation

At 9x EV/NOPAT, Maxima is valued at a par with Sanderson but at a significant premium to K3. Whilst we see Sanderson as overvalued given the challenges it faces in its business, we see Maxima as fairly priced. Notwithstanding the recent disappointment with QAD and subsequent downgrades, we see good underlying progress at Maxima and this should be rewarded with an improved rating over time.

## Maxima Holdings - Strategic positioning

Product strategy	Improving
Vertical market focus	Improving
SaaS readiness	Strong
Sales capabilities	Improving
<b>Overall</b>	<b>Improving</b>

Source: ISR

\* Maxima Holdings is an equity research client of I S Research Ltd

## Maxima Holdings

Maxima Holdings - KPIs		Maxima Holdings – Detailed financials				
		May-07 A	May-08 A	May-09 A	May-10 E	May-11 E
<b>Revenue breakdown</b>						
Recurring revenue	56%					
Sales to existing customers	na					
Sales to new customers	na					
<b>Last fiscal year</b>						
Year ended	May-09					
Headline revenue growth	21%					
Organic growth*	-10%					
Operating margins	15%					
Adjusted PBT growth	-20%					
Adjusted EPS growth	-20%					
<b>Current fiscal year</b>						
Year ended	May-10					
Headline revenue growth	-6%					
Organic growth	-6%					
Operating margins	11%					
Adjusted PBT growth	-29%					
Adjusted EPS growth	-30%					
<b>Cash flow (3yr avg)</b>						
Cash conversion	77%					
Capex/Depreciation	136%					
*ISR estimates						
		<b>Profit &amp; Loss</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
		Revenue £m	31.8	46.7	56.6	53.0
		Adj EBITDA £m	6.6	10.2	8.9	6.8
		Adj EBIT £m	6.3	9.7	8.3	6.0
		Reported PBT	4.2	5.2	-9.6	1.4
		PBT before excepts and AAG	5.7	8.8	7.0	4.6
		Fully adj PBT	5.8	8.9	7.1	5.0
		NOPAT £m	4.4	6.8	5.8	4.2
		Reported EPS	18.7	14.8	-36.8	4.1
		EPS before excepts and AAG	22.2	24.3	19.6	12.8
		Fully adjusted EPS p	22.8	24.7	19.8	13.9
		Dividend per share p	5.2	5.6	4.5	4.5
		<b>Cash flow &amp; Balance sheet</b>				
		Operating cash flow	4.2	8.8	7.2	5.3
		Free Cash Flow	1.4	5.8	3.5	3.1
		FCF per share p	7.6	23.0	13.9	12.4
		Capex	-0.3	-0.8	-0.9	-1.0
		Acquisitions	-15.3	-6.1	-8.5	0.0
		Net cash flow	-14.6	-2.0	-6.7	1.8
		Shares issued	11.1	0.1	0.1	0.0
		Net cash	-6.6	-8.5	-15.5	-13.7
		<b>Metrics</b>	<b>FY-07</b>	<b>FY-08</b>	<b>FY-09</b>	<b>FY-10</b>
		Revenue growth	66.0%	46.9%	21.3%	-6.4%
		Adj EBITDA growth	86.3%	54.2%	-12.6%	-23.2%
		Adj EBIT growth	86.3%	54.8%	-14.7%	-27.1%
		Adj PBT growth	77.6%	52.7%	-20.1%	-29.4%
		Adj EPS growth	46.9%	8.4%	-19.6%	-29.6%
		Dividend growth	30.0%	7.7%	-19.6%	0.0%
		Adj EBIT margins	19.7%	20.7%	14.6%	11.4%
		Operating cash conversion	64%	87%	81%	78%
		Capex/Depreciation	83%	171%	153%	125%
		<b>Valuation</b>	<b>FY-07</b>	<b>FY-08</b>	<b>FY-09</b>	<b>FY-10</b>
		EV/sales	1.0	0.7	0.7	0.7
		EV/EBITDA	4.7	3.2	4.5	5.6
		EV/NOPAT	7.1	4.8	6.9	9.0
		PER	4.3	4.0	4.9	7.0
		Dividend yield	5.3%	5.7%	4.6%	4.6%
		FCF yield	7.8%	23.6%	14.2%	12.7%

Source: ISR, companies

Source: ISR, Company, Morningstar

# Sanderson Group

Sanderson has a long track record in the manufacturing sector and some embedded customer relationships. However, in our view, it has the weakest strategic positioning of the three companies under review. Whilst Sanderson has a clear vertical market strategy, it has underinvested in its products and they are now looking increasingly uncompetitive. In the retail sector, Sanderson does not own its IP and we fear that its key partner in retail has the potential to eat its lunch. Despite its relatively weak strategic positioning, Sanderson's shares trade at a significant premium to K3 and on a par with Maxima. Consequently, we see risk to the downside although this should be mitigated by the dividend yield.

## Sanderson Group - Company basics

RIC	SND
Share price £	0.16
Market cap £m	6.7
Net cash £m	(10.5)
Enterprise value £m	17.3

Sanderson Group provides business management software and related services to companies in the process manufacturing and retail sectors.

## Sanderson Group - Estimates and valuation

Year end Sep	Financials					Valuation			
	Rev £m	Adj PBT £m	Adj EPS p	DPS p	Net cash £m	EV/sales x	EV/NOPAT x	PER x	Yield
2007 A	18.2	3.1	4.3	2.7	-11.7	1.0	8.5	3.6	17.4%
2008 A	27.6	3.0	4.6	1.4	-10.5	0.6	6.4	3.4	9.0%
2009 E	26.5	1.7	2.6	0.5	-8.6	0.6	8.9	6.1	2.9%
2011 E	27.6	2.1	3.3	0.5	-6.8	0.5	7.1	4.7	2.9%

Source: ISR, Companies, Morningstar

## Strategic positioning

For us, Sanderson has the weakest overall product positioning of the three companies in the group. Whilst it has a strong base of customers in the manufacturing sector to which it has been successful in selling add-on modules, it is largely ploughing its own furrow rather than partnering with the leading ERP vendors. In our view, this represents a serious flaw in Sanderson's product strategy which, over time, is likely to lead to its products becoming increasingly uncompetitive.

On the retail side of the business, Sanderson does not own its own applications which is not an issue in itself. However, Sanderson's key ISV partner in retail is Torex Retail which also has a substantial implementation capability itself. Whilst Sanderson's strong customer relationships have largely insulated it from competitive pressure from Torex so far, we wonder how long it will be before Torex starts to eat into Sanderson's piece of the pie.

## Financial performance

Sanderson had enjoyed a solid, if unexciting, financial track record. However, the company over extended its balance sheet with the 2007 acquisition of Retail Business Solutions although, a cost cutting exercise, a substantial cut in the dividend and a refinancing of its debt has put the balance back onto a firmer footing.

At a time when the paradigm shift towards cloud computing necessitates additional product investment, Sanderson's very limited R&D capitalised, just 1% of revenue and 60% of depreciation in fiscal 2008, suggests underinvestment in product development. With a weak product strategy we believe that Sanderson will struggle to return to meaningful levels of organic growth as we come out of the recession.

## Valuation

On an EV/NOPAT, Sanderson currently trades on a par with Maxima at 9x and at a significant premium to K3. Given our belief that Sanderson has the weakest strategic positioning of the three companies, we believe that it should trade on a discount to the other two. Consequently, we view the shares as overvalued although they are supported to some extent by the current dividend yield of 3%.

## Sanderson Grp - Strategic positioning

Product strategy	Weak
Vertical market focus	Strong
SaaS readiness	Weak
Sales capabilities	Weak
<b>Overall</b>	<b>Weak</b>

Source: ISR

## Sanderson Group

Sanderson Group - KPIs		Sanderson Group – Detailed financials					
<b>Revenue breakdown</b>			Sep-06 A	Sep-07 A	Sep-08 A	Sep-09 E	Sep-10 E
Recurring revenue	49%						
Sales to existing customers	38%						
Sales to new customers	13%						
<b>Last fiscal year</b>							
Year ended	Sep-08						
Headline revenue growth	52%						
Organic growth*	-8%						
Operating margins	14%						
Adjusted PBT growth	-5%						
Adjusted EPS growth	7%						
<b>Current fiscal year</b>							
Year ended	Sep-09						
Headline revenue growth	-4%						
Organic growth	-4%						
Operating margins	9%						
Adjusted PBT growth	-45%						
Adjusted EPS growth	-45%						
<b>Cash flow (3yr avg)</b>							
Cash conversion	88%						
Capex/Depreciation	98%						
*ISR estimates							
		<b>Profit &amp; Loss</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
		Revenue £m	15.9	18.2	27.6	26.5	27.6
		Adj EBITDA £m	3.6	3.8	4.3	2.7	2.9
		Adj EBIT £m	3.4	3.5	3.8	2.5	2.7
		Reported PBT	2.2	1.9	0.9	-1.3	0.7
		PBT before excepts and AAG	2.5	2.6	2.9	1.7	2.1
		Fully adj PBT	3.1	3.1	3.0	1.7	2.1
		NOPAT £m	2.2	2.2	2.7	1.7	1.9
		Reported EPS	4.5	2.1	4.1	-2.0	1.2
		EPS before excepts and AAG	3.6	3.4	4.5	2.6	3.3
		Fully adjusted EPS p	4.6	4.3	4.6	2.6	3.3
		Dividend per share p	2.6	2.7	1.4	0.5	0.5
		<b>Cash flow &amp; Balance sheet</b>					
		Operating cash flow	2.6	3.1	4.9	2.7	2.9
		Free Cash Flow	1.6	1.9	2.6	2.0	1.9
		FCF per share p	3.6	4.3	5.8	4.4	4.3
		Capex	-0.4	-0.2	-0.3	-0.3	-0.3
		Acquisitions	-1.7	-10.2	-0.5	0.0	0.0
		Net cash flow	-1.3	-9.2	1.1	1.8	1.7
		Shares issued	0.0	0.0	0.0	0.0	0.0
		Net cash	-2.5	-11.7	-10.5	-8.7	-7.0
		<b>Metrics</b>	<b>FY-06</b>	<b>FY-07</b>	<b>FY-08</b>	<b>FY-09</b>	<b>FY-10</b>
		Revenue growth		14.3%	51.7%	-3.8%	4.2%
		Adj EBITDA growth		6.3%	13.4%	-36.9%	9.9%
		Adj EBIT growth		2.0%	10.4%	-36.0%	11.0%
		Adj PBT growth		0.6%	-5.3%	-44.6%	28.5%
		Adj EPS growth		-7.1%	6.9%	-44.5%	28.5%
		Dividend growth		3.8%	-48.1%	-67.9%	0.0%
		Adj EBIT margins	21.4%	19.1%	13.9%	9.2%	9.9%
		Operating cash conversion	72%	80%	112%	100%	100%
		Capex/Depreciation	189%	47%	58%	104%	104%
		<b>Valuation</b>	<b>FY-06</b>	<b>FY-07</b>	<b>FY-08</b>	<b>FY-09</b>	<b>FY-10</b>
		EV/sales	0.6	1.0	0.6	0.6	0.5
		EV/EBITDA	2.6	4.8	4.0	5.6	4.5
		EV/NOPAT	4.1	8.5	6.4	8.9	7.1
		PER	3.3	3.6	3.4	6.1	4.7
		Dividend yield	16.8%	17.4%	9.0%	2.9%	2.9%
		FCF yield	23.1%	28.0%	37.1%	28.4%	27.5%

Source: ISR, companies

Source: ISR, Company, Morningstar

**I S Research Ltd**

The Granary, Home Farm  
Ridge Lane, Rotherwick  
Hampshire, RG27 9AX

T +44 (0) 1256 768833

E [info@is-research.co.uk](mailto:info@is-research.co.uk)

[www.is-research.co.uk](http://www.is-research.co.uk)



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