



Annual Report and Financial Statements **2006**

K3 BUSINESS TECHNOLOGY GROUP PLC

# K3 Business Technology Group plc

## Contents

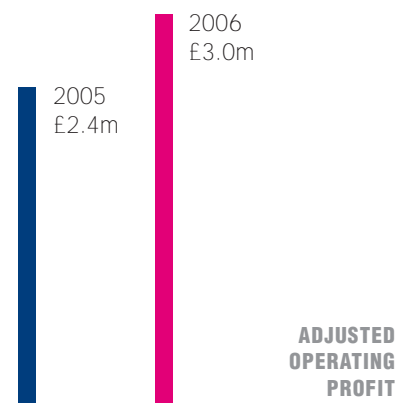
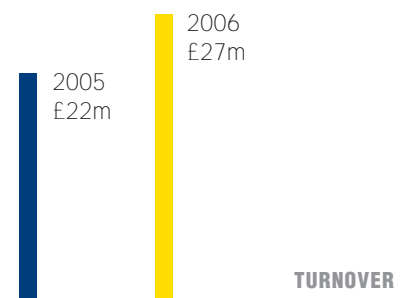
Highlights	1
Current directors and advisers	2
Chairman's statement	4
Operational review	8
Financial review	10
Directors' report	12
Board report on corporate governance including remuneration	14
Directors' responsibilities	22
Independent auditors' report	23
Consolidated profit and loss account	24
Consolidated statement of total recognised gains and losses	25
Consolidated balance sheet	26
Company balance sheet	27
Consolidated cash flow statement	28
Statement of accounting policies	29
Notes to financial statements	32
Five year summary	56
Notice of annual general meeting	58

**FINANCIAL HIGHLIGHTS**

	<b>2006</b>	<b>2005</b>
	<b>£000</b>	<b>As restated £000</b>
Turnover	27,346	22,029
Operating profit	763	604
Adjusted operating profit <sup>1</sup>	3,046	2,408
Increase in shareholders' funds	1,571	3,805
Cash inflow from operating activities	2,218	4,267
Loss per share	(1.7p)	(1.8p)
Adjusted earnings per share <sup>2</sup>	11.5p	11.2p

**TRADING HIGHLIGHTS**

- Excellent progress made during the year demonstrates the benefits of the balanced business model.
- Period of consolidation and investment:
  - Significant investment in the Retail Software Division, where recruitment lifted staff numbers to 134 from 95;
  - Integration of the two manufacturing software businesses, IEG and Walton, which will reduce the cost base.
- New business pipeline is very encouraging.
- Board views the group's prospects for 2007 very positively.



1 Calculated before amortisation of goodwill and intangibles of £2.20m (2005: £1.75m) and share option costs of £0.09m (2005: £0.05m).

2 Calculated before amortisation of goodwill and intangibles of £2.20m (2005: £1.75m), share option costs of £0.09m (2005: £0.05m) and loss on disposal of operations including the related tax charge of £0.11m (2005: £0.14m).

## Current Directors and Advisers

### Thomas Adam Milne (Chairman) age 59

Tom was appointed as Chairman on 24 May 2006. He has substantial experience in the retail software sector and in developing successful software companies in this sector. He was the founder director of Riva Group plc, one of the first true Microsoft Windows retail software houses in the UK. He floated the company on the USM in 1988 and continued growing the business until his retirement in 1993. He then went on to found Metabet Limited which developed electronic point of sale terminals for betting shops which were adopted by several major bookmakers, including Coral Group. In recent years Tom has maintained an active interest in the retail software sector.

### Per Johan Claesson (non-executive) age 55

Johan was appointed a director in March 2001. He is a Swedish national whose principal business interests are in property development and real estate and is a director of a number of listed companies. He has a controlling interest in and is Chairman of Claesson and Anderzen AB ("C&A").

### Nigel Andrew Makeham (Chief Executive) age 52

Andy was appointed Chief Executive in March 2001. He has over 20 years experience running or working in IT companies, most recently with Kewill Systems plc where he was a divisional sales and marketing director.

### David John Bolton FCA (Chief Finance Officer) age 55

David was appointed Chief Finance Officer of the group in September 1998. Having qualified as a chartered accountant in the mid-1970s with Ernst and Young, he has held various finance positions in quoted and unquoted companies, most notably BTR where he spent 12 years.

**Current Directors:**

DJ Bolton  
PJ Claesson (non-executive)  
NA Makeham  
TA Milne (Chairman)

**Company Secretary:**

DJ Bolton

**Registered Office:**

Linden Business Centre, Linden Road, Colne,  
Lancashire, BB8 9BA

**Nominated Advisor:**

Daniel Stewart & Company plc, Becket House,  
36 Old Jewry, London, EC2R 8DD

**Auditors:**

BDO Stoy Hayward LLP, Commercial Buildings,  
11-15 Cross Street, Manchester, M2 1WE

**Solicitors:**

Berwin Leighton Paisner LLP, Adelaide House,  
London Bridge, London, EC4R 9HA  
Addlestone Keane, Carlton Tower, 34 St Pauls Street,  
Leeds, LS1 2QB

**Bankers:**

Royal Bank of Scotland plc, 3/4 Syer House,  
Stafford Court, Stafford Park 1, Telford,  
Shropshire, TF3 3BD

**Registrars:**

Capita Registrars, Northern House, Woodsome Park,  
Fenay Bridge, Huddersfield, HD8 0LA

**Registered Number:**

2641001

## Chairman's Statement

**OVERVIEW**

Results for the year to 31 December 2006 show that K3 continues to make excellent progress. Group sales have increased by 24% to £27.35m and adjusted operating profit<sup>1</sup> has risen by 27% to £3.05m.

Over the year, our focus was on integration and investment. Having made three acquisitions during the 18 month period to June 2005, it was important to ensure the businesses were effectively consolidated and that the Retail Software Division, in particular, remains well positioned for growth over the next few years. We see a significant growth opportunity for the Retail Software business and therefore over the course of the year invested heavily in the division, adding new staff and reorganising the operations to concentrate on core sectors. Our investment in new people has continued into the first half of the new financial year.

Multi-channel retail is also an important growth sector for K3, and to date this has predominantly been serviced by sales of our Elucid multi-channel retail solution. Elucid is not a Microsoft product, and is designed for the smaller multi-channel retailer, and this restricts the sales opportunities for the product. We have thus taken the decision to extend the functionality of our core Microsoft Dynamics Retail solution to incorporate the facilities previously offered by Elucid to provide an integrated and more scalable solution with broader appeal. This development will fall largely in the first half of 2007 and is expected to yield revenues in the second half. The Elucid business unit has thus become non-core to the future of K3 and, in February 2007, we agreed the sale of Elucid for a total of £1.36m in cash.

**K3 continues to make excellent progress**

In the second half, we took the decision to merge both our manufacturing software operations. This process should be completed by the end of the first half of the current financial year.

Our two core businesses, the Retail Software Division and the Manufacturing Software Division, form a solid base from which to move forward. Our strategy remains that of the balanced model. The Manufacturing Software Division offers steady, recurring income and predictable profits<sup>3</sup> and cash flow generation while the Retail Software Division offers strong growth prospects.



There are good opportunities for K3 looking ahead. We are the largest supplier of manufacturing software in the UK and there is scope to consolidate further in this marketplace. We are also well placed to develop as the largest Microsoft Dynamics reseller. We continue to seek appropriate acquisitions that fulfil our strict criteria. In December 2006, we acquired a stake in SiRVIS IT plc, the IT infrastructure business, with a view to extending K3's product and service offerings. Unfortunately we were not able to agree terms which we considered to be reasonable with the board of that company. We have therefore disposed of the majority of that stake, at the same price at which it was acquired. We will continue to consider other acquisition opportunities but only where K3's shareholder value can be enhanced.

This year, because of the investment we are making in the business in first half of the new financial year, results for the year as a whole will be more significantly weighted towards the second half. The Board continues to remain very positive about the outlook for 2007.

<sup>1</sup> Calculated before amortisation of goodwill and intangibles of £2.20m (2005: £1.75m) and share option costs of £0.09m (2005: £0.05m).

<sup>3</sup> Calculated before amortisation of goodwill and intangibles of £1.16m (2005: £0.73m) and share option costs of £0.04m (2005: £0.03m).

Group turnover for the year to 31 December 2006 increased by 24% to £27.35m from £22.03m last year



## FINANCIAL RESULTS

Group turnover for the year to 31 December 2006 increased by 24% to £27.35m from £22.03m last year. The increase partly reflected the first full year's contribution from Information Engineering, the manufacturing software business we acquired in June 2005. A comparison of second half results shows progress on a like-for-like basis and sales in the second half increased by 15% from £12.69m to £14.61m. This reflected the particularly strong growth in the Retail Software Division, where sales in the second half rose by 36%.

Adjusted operating profit<sup>1</sup> for the year rose by 27% to £3.05m (2005: £2.41m). After amortisation of goodwill of £2.20m (2005: £1.75m) and share option costs in line with FRS20, Share-based payments, of £0.09m (2005: £0.05m), the operating profit was £0.76m (2005: £0.60m), an increase of 26% on last year.

Adjusted profit before tax<sup>1</sup> rose by 37% to £2.78m (2005: £2.03m) and adjusted earnings per share<sup>2</sup> were 11.5p (2005: 11.2p). Earnings per share growth was impacted by a fund raising in the second half. After taking into account amortisation of goodwill and intangibles of £2.20m (2005: £1.75m) and share option costs of £0.09m (2005: £0.05m), profit before taxation more than doubled to £0.50m (2005: £0.23m) and the loss per share was 1.7p (2005: loss of 1.8p).

At 31 December 2006, the Group held a cash balance of £2.27m (2005: £0.87m). At that date, the balance of the bank loan of £1m drawn down in December 2005 was £0.69m.

## DIVIDEND

The Directors do not propose to pay a dividend (2005: Nil). However, as stated in the interim results, following the Company's successful application to the High Court for the requisite confirmation of the cancellation of the share premium account in July 2006, the Directors plan to make a dividend payment in respect of the 2007 results if appropriate.



<sup>1</sup> Calculated before amortisation of goodwill and intangibles of £2.20m (2005: £1.75m) and share option costs of £0.09m (2005: £0.05m).

<sup>2</sup> Calculated before amortisation of goodwill and intangibles of £2.20m (2005: £1.75m), share option costs of £0.09m (2005: £0.05m) and loss on disposal of operations including the related tax charge of £0.11m (2005: £0.14m).

## INTERNATIONAL FINANCIAL REPORTING STANDARDS

As reported in our interim results, the Group is required to adopt International Financial Reporting Standards (IFRS) for the year ended 31 December 2007. A project is currently in progress to identify the likely impact of IFRS upon the Group's results. It is envisaged that this project, including the financial restatement of previously reported results, will be completed during the first half of 2007. One notable impact will be the removal of the requirement to systematically amortise goodwill held within the balance sheet which will instead be subject to an annual impairment review.

## REVIEW OF OPERATIONS

### Retail Software Business

The division performed extremely well, with sales increasing by 30% over the year to £16.44m from £12.66m last year and adjusted operating profit<sup>4</sup> rising by 34% to £1.63m (2005: £1.22m). Sales in the second half of the year were particularly strong, increasing by 36% to £8.65m from £6.36m in same period in 2005. This excellent performance reflects both our additional investment in the division and our strategy to focus on building our presence within key retail sectors, our 'verticalisation strategy'. Over the course of 2006, we secured new orders amounting to £8.60m (2005: £7.53m)

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we secured new orders amounting to £8.60m



4 Calculated before amortisation of goodwill and intangibles of £0.95m (2005: £0.95m) and share option costs of £0.03m (2005: £0.02m).

Our investment over the year in the division has been significant and encompassed product development, business development and sales and marketing. While the investment is already showing returns, as expected, it impacted on margins in the second half. We are making further investment in the division in the first half of the current financial year and are particularly encouraged by the strength of the new business pipeline in the second quarter of 2007.

### Distribution Software Business

The Distribution Software Division, based on our Elucid product, continued to show good progress in 2006 with revenues growing by 14% to £2.06m (2005: £1.80m). Last year's adjusted operating loss<sup>5</sup> of £0.08m was converted into an adjusted operating profit<sup>6</sup> of £0.08m, reflecting continued improvement in margins and productivity.

During the course of 2006, we took the strategic decision to dispose of the Elucid business in order to concentrate on multi-channel and warehouse management software sales opportunities for larger retail customers. This is better serviced by our Microsoft Dynamics based retail solution rather than the 'stand-alone' Elucid product. We are therefore extending the functionality of our Microsoft Dynamics offering to create an integrated solution for the mid range retailer and, in February 2007, agreed the sale of Elucid to Sanderson Group plc for £1.36m in cash.

### Manufacturing Software Business

Revenues from our Manufacturing Software Division increased by 17% to £8.85m (2005: £7.57m). This reflected the first full year contribution from Information Engineering, which we acquired in June 2005. Sales in the second half of the year declined slightly to £4.90m (2005: £5.33m), largely the result of some reduction in the new business sales at the Walton-based business.

## We are encouraged by the pipeline and view the prospects for 2007 with confidence

Adjusted operating profit<sup>6</sup> for the year increased by 6% to £1.34m (2005: £1.27m). In the second half adjusted operating profit<sup>7</sup> rose by 39% to £1.03m (2005: £0.74m) reflecting the impact of the annual licence fee billings.

Since the year end, we have taken the decision to channel all our new business sales of SYSPRO through Information Engineering, and have also taken the opportunity to bring our two manufacturing software businesses closer together and reduce the cost base accordingly.

We are encouraged by the pipeline and view the prospects for 2007 with confidence.

## OUTLOOK

The results for 2006 continue to demonstrate the strength of our balanced business model. The Retail Software Division has shown strong sales growth whilst the Manufacturing Software Division continues to demonstrate highly sustainable profitability and strong cash generation. Having spent the last year successfully integrating and consolidating the acquired businesses, we are now actively seeking further complementary acquisitions in our core markets to continue to build critical mass.

We continue to view the Group's prospects for 2007 very positively.

**Tom Milne**

Chairman

5 Calculated before amortisation of goodwill and intangibles of £0.09m (2005: £0.08m) and share option costs of £0.01m (2005: £0.01m).

6 Calculated before amortisation of goodwill and intangibles of £1.16m (2005: £0.73m) and share option costs of £0.04m (2005: £0.03m).

7 Calculated before amortisation of goodwill and intangibles of £0.57m (2005: £0.56m) and share option costs of £0.02m (2005: £0.02m).

# Operational Review

## INTRODUCTION

2006 was a year of consolidation and investment following two key acquisitions and a smaller acquisition made over the course of eighteen months from April 2004.

Results for the year are excellent, with revenues growing by 24% to £27.35m (2005: £22.03m) and adjusted operating profits<sup>8</sup> increasing by 27% to £3.05m (2005: £2.41m). While part of this was due to the full year benefit of Information Engineering acquired in June 2005, it is encouraging to note that the like-for-like revenues in the second half showed growth of 15% to £14.61m (2005: £12.69m) while like-for-like adjusted operating profit<sup>9</sup> rose by 10% to £1.71m (2005: £1.55m).

This is a particularly encouraging performance taking into account the level of investment we have made in our Retail Software Division, with the creation of new vertical market business units. It confirms the strength of our well-balanced business model which delivers a mix of safe recurring licence income in the Manufacturing Software Division and high growth opportunities in Retail Software Division.

As part of our consolidation process, in February 2007, we agreed the sale of our Distribution Software Business, Elucid, which we viewed as no longer core to our future strategy. Going forward, we intend to focus on the mid-tier retail sector and our Microsoft Dynamics solution will encompass a multi-channel and warehouse management offering for this marketplace.

We continue to pursue our goal to become the UK's market leading supplier of Microsoft-based supply chain management solutions to small and medium sized companies. In 2007, we expect to expand our footprint within the Retail and Manufacturing software sectors. We have also identified potential acquisition targets in both the manufacturing and retail markets which would complement our existing offerings for these sectors.

The Board considers the key performance indicators by which it measures performance of its divisions to be turnover and operating profit adjusted for goodwill amortisation and share option costs.

## RETAIL SOFTWARE BUSINESS

2006 was another year of dramatic growth. In early 2006, we embarked on a programme of 'verticalisation' whereby we refocused our activities to concentrate on sectors where we can build a significant presence. We now have sector specific business units in Breweries/Drinks, Food, Household Goods and Fashion. This has required significant investment, predominantly in additional high calibre resource, but also in marketing to underpin the exciting opportunities we believe are available to us. I am pleased to say that the initial results from this investment are encouraging.

Whilst revenues grew by 30%, year on year, sales in the second half increased by 36% over the same period last year. All new vertical units contributed and a total of 18 new customers were signed with an average order value of £0.48m. Notable new customers included Beales Department Store, US-based GameStop Corp., one of the world's largest video game retailers (with an implementation spanning the UK, USA and Pacific Rim), and Musgrave Group, Ireland's largest food and grocery distributor.

Adjusted operating profits<sup>10</sup> for the year grew by 34% to £1.63m (2005: £1.22m). However our increased investment adversely impacted on the underlying margin at the adjusted operating profit<sup>11</sup> level in the second half which was 7% compared to 12% in the same period in 2005.

As a result of our investment, the number of people employed in our Retail Software Division increased from 95 to 134 during 2006. We have been extremely fortunate in being able to attract some very high calibre

8 Calculated before amortisation of goodwill and intangibles of £2.20m (2005: £1.75m) and share option costs of £0.09m (2005: £0.05m).

9 Calculated before amortisation of goodwill and intangibles of £1.09m (2005: £1.07m) and share option costs of £0.05m (2005: £0.04m).

10 Calculated before amortisation of goodwill and intangibles of £0.95m (2005: £0.95m) and share option costs of £0.03m (2005: £0.02m).

11 Calculated before amortisation of goodwill and intangibles of £0.47m (2005: £0.48m) and share option costs of £0.02m (2005: £0.01m).

staff and this will help to underpin our future growth plans. We are committing further investment over the first half of the new financial year.

Our product development roadmap for 2007 includes the continued development of mid-range multi-channel functionality, for which we already have customers identified. Revenues from these projects should start to flow during the second half of 2007.

## DISTRIBUTION SOFTWARE BUSINESS

Revenues grew by 14% to £2.06m (2005: £1.80m) and improved margins and consultancy productivity helped the business deliver an adjusted operating profit<sup>12</sup> for the year of £0.08m (2005: adjusted operating loss<sup>12</sup> of £0.08m).

The sale of the business in February 2007 allows us to focus on the larger customer opportunities within the retail space whilst using the funds received to invest in further acquisition opportunities.

## MANUFACTURING SOFTWARE BUSINESS

The acquisition of Information Engineering in 2005 brought with it distribution rights for SYSPRO, one of the world's market leading manufacturing Enterprise Resource Planning solutions. SYSPRO provides a compelling new business product as well as offering a natural upgrade solution for our existing customers.

The programme to migrate existing long term manufacturing customers to SYSPRO started well, with three major upgrades achieved in the year (MicroFiltex, GMI and SMC), and we remain hopeful of this momentum continuing in 2007. Over the course of the year, we secured a total of 14 new SYSPRO deals worth £1.34m. These included Avio Import S.p.A, the Italian distributor of aerospace fasteners, and Radical Motorsport, the UK racing car manufacturer.

The success of our 13 site implementation for the Doncaster Group led to a second order worth £0.5m for

SYSPRO Business Analytics, a new 'business intelligence' software module that is proving much in demand from both new and existing customers.

2006 also saw the development of a new SYSPRO Mobile Technology solution, written by Information Engineering, using the latest Visual Studio development tools. This was successfully trialled in the UK and is now being distributed throughout Syspro's worldwide distributor network. Early results are encouraging with three sales in the UK, and 25 sales in Canada to date.



We have now decided to focus all new business sales of SYSPRO from Information Engineering, and the cost base of our Walton business unit has been reduced as duplicate sales and marketing has been eliminated.

With Microsoft's support, our Walton business unit developed a multi-currency add-on module for Microsoft CRM, and distributors for this have now been appointed in the USA, Australia, Poland, Belgium, Denmark, and Germany.

K3 remain the largest supplier of manufacturing solutions to the SME market in the UK, and with our newly invigorated manufacturing division, market leading products, substantial customer base and strong pipeline, we believe 2007 will deliver another strong performance.

**Andy Makeham**

Chief Executive

<sup>12</sup> Calculated before amortisation of goodwill and intangibles of £0.09m (2005: £0.08m) and share option costs of £0.01m (2005: £0.01m).

## Financial Review

### GROUP RESULTS

- Full year turnover on continuing activities increased to £27.35m from £22.03m in 2005. This reflected the full year impact of the acquisition of Information Engineering acquired in June 2005 together with continued growth in the retail software business.
- The group registered an adjusted operating profit<sup>13</sup> of £3.05m (2005: £2.41m).
- Operating profit for the year was £0.76m (2005: £0.60m).
- The amortisation of goodwill of £2.20m (2005: £1.75m) includes amortisation of Retail over eight years and in respect of the ERP businesses, Elucid and Information Engineering which is over a period of ten years.
- The loss for the year was £0.31m (2005: loss of £0.27m).
- Adjusted earnings per share<sup>14</sup> was 11.5p (2005: 11.2p).
- Loss per share was 1.7p (2005: loss per share of 1.8p).
- The directors do not propose to pay a dividend (2005: £nil).

### BALANCE SHEET

- Fixed assets decreased from £16.35m to £15.69m reflecting a full year's amortisation of goodwill in respect of IEG. Development costs and intellectual property included within intangible assets increased by £0.23m due to the capitalisation of development costs, offset by £0.12m of amortisation of those costs. Additions to tangible fixed assets were £0.25m and depreciation was £0.33m with £0.1m of assets disposed of. Investments in 2006 of £1.40m relate to a 29.93% stake in SIRVIS IT plc.
- Net current liabilities of £2.61m (2005: £3.11m) include £4.54m of deferred income relating to licence and support charges billed but not yet recognised as income (2005: £4.17m).
- The cash in hand at 31 December 2006 was £2.27m (2005: £0.87m), and bank loans were £0.69m (2005: £1.00m).
- Shareholders' funds increased by £1.57m reflecting share capital issued of £1.60m in respect of a placing of 1.56m shares in October 2006 (net of costs of £0.03m) and £0.23m in respect of a placing in December 2006, together with the loss for the year of £0.31m, currency differences of £0.02m, the credit to equity for equity-settled share-based payments of £0.09m and the purchase of treasury shares of £0.02m under the employee share ownership plan.

<sup>13</sup> Calculated before amortisation of goodwill and intangibles of £2.20m (2005: £1.75m) and share option costs of £0.09m (2005: £0.05m).

<sup>14</sup> Calculated before amortisation of goodwill and intangibles of £2.20m (2005: £1.75m), share option costs of £0.09m (2005: £0.05m), and loss on disposal of operations including the related tax charge of £0.11m (2005: £0.14m).

## CASH FLOW

- The group's cash inflow in the year was £1.39m (2005: inflow of £0.47m).
- The group's inflow from operating activities in the year was £2.22m (2005: £4.27m).
- Net interest amounted to a cash outflow of £0.24m (2005: £0.28m).
- Capital expenditure less disposal proceeds was £0.34m (2005: £0.11m).
- Net cash outflow on acquisitions and disposals was £1.46m (2005: £5.15m) including £1.40m for the investment in SiRVIS IT plc and the payment of deferred consideration of £0.04m (2005: £1.69m).
- A placing of 1,550,000 shares at £1.05 in October 2006 and of 196,552 shares at £1.16 in December 2006 generated a cash inflow after costs of £1.83m.
- The group repaid £0.31m during the year of the bank loan of £1m which was negotiated in December 2005 and which is repayable over three years, together with £0.26m in respect of finance leases (2005: £0.47m).

## RISK MANAGEMENT AND TREASURY

- The group operates clearly established treasury procedures as part of its overall accounting procedures. These are summarised in the Accountability and Audit section of the Board Report on Corporate Governance on pages 18 to 20.

### David Bolton

Chief Finance Officer

The directors present their annual report on the affairs of the group, together with the financial statements and auditors' report, for the year ended 31 December 2006.

## PRINCIPAL ACTIVITIES

The principal activities of the group and the company are the supply of computer software and consultancy.

The subsidiary undertakings principally affecting the profits or net assets of the group in the year are listed in note 12 to the financial statements.

## BUSINESS REVIEW

The consolidated results of the year are shown on page 24.

Further details of the group's performance during the year and expected future developments are contained in the operating and financial reviews.

The group's financial risk management objectives and policies are disclosed in the Board Report on Corporate Governance on pages 14 to 21.

## RESULTS AND DIVIDENDS

The audited financial statements for the year ended 31 December 2006 are set out on pages 24 to 55.

The group's loss for the year after taxation was £0.31m (2005: loss of £0.27m).

No dividend will be paid (2005: £nil).

## DIRECTORS

The directors who served during the year were as follows:

DJ Bolton

PJ Claesson

RE Dorset (resigned 16 February 2007)

NA Makeham

GB Matthews (resigned 24 May 2006)

TA Milne (appointed 24 May 2006)

Mr NA Makeham retires by rotation and offers himself for re-election.

## SUPPLIER PAYMENT POLICY

The company's policy, which is also applied by the group, is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment. Trade creditors of the company at 31 December 2006 were equivalent to 65 (2005: 62) days' purchases, based on the average daily amount invoiced by suppliers during the year.

## CHARITABLE AND POLITICAL CONTRIBUTIONS

Charitable contributions during the year amounted to £936 (2005: £800). There were no political contributions during the year or prior year.

## SUBSTANTIAL SHAREHOLDINGS

On 12 March 2007, the company had been notified, in accordance with sections 198 to 208 of the Companies Act 1985, of the following interests in the ordinary share capital of the company.

Name of holder	Number	Percentage Held
PJ Claesson	3,961,448	20.3%
Blackrock Group	1,165,660	6.0%
Altenberg Reval AS	840,000	4.3%
Garpenbergs Intressenter AB	800,000	4.1%
F&C Asset Management plc	796,552	4.1%
Marlborough Fund Managers	790,000	4.1%
DJ Bolton	762,300	3.9%
NA Makeham	749,139	3.8%
Pennsylvania State Employees' Retirement System	732,763	3.8%
G Wigglesworth	699,033	3.6%

## DISABLED EMPLOYEES

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the group continues and that appropriate training is arranged. It is the policy of the group that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

## EMPLOYEE CONSULTATION

The group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the group. This is achieved through informal discussions between management and other employees at a local level.

## FINANCIAL INSTRUMENTS

Details of the use of financial instruments by the company and its subsidiary undertakings are shown in note 16 and on page 18 and 19 of the Board Report on Corporate Governance.

## POST BALANCE SHEET EVENTS

These are detailed in note 29 of the financial statements.

## AUDITORS

All of the current directors have taken all of the steps that they ought to have taken to make themselves aware of any information needed by the company's auditors for the purposes of their audit and to establish that the auditors are aware of the information. The directors are not aware of any relevant audit information of which the auditors are unaware.

The Notice of Annual General Meeting contains a resolution to re-appoint BDO Stoy Hayward LLP as auditors for the ensuing year.

Linden Business Centre  
Linden Road  
Colne  
Lancashire, BB8 9BA

By order of the Board

**DJ Bolton**

Secretary

12 March 2007

## Board Report on Corporate Governance

The Board supports the principles of good governance. In fulfilling their responsibilities, the directors believe that they govern the company in the best interests of the shareholders, whilst having due regard to the interests of the stakeholders in the group including, in particular, customers, employees and suppliers. Although as a company quoted on AIM it is not required to comply with the provisions of the July 2003 FRC Combined Code on Corporate Governance, the directors intend to comply with the provisions of the Combined Code in so far as they consider it appropriate having regard to the size of the group and have decided to provide corporate governance disclosures comparable with those required of a listed company.

### THE BOARD

The group is headed by an effective board which meets on a monthly basis and is supplied in a timely manner with information of a quality to enable it to discharge its duties. The board has determined those matters which are retained for board sanction and those matters which are delegated to the executive management of the business. The types of decisions which are to be taken by the Board are:

- approval of the financial statements and profit plans for the group;
- approval of any unbudgeted plans in accordance with prescribed authority levels;
- approval of all shareholders' circulars and announcements;
- approval of the appointment or termination of advisors to the group;
- the purchase or sale of any business or subsidiary;
- any new borrowings, facilities and related guarantees;
- any asset purchase or lease, hire purchase facility or rental agreement over prescribed authority limits;
- any donation to a political party, or any charitable donation exceeding £250.

The Board held meetings during each month of 2006 although meetings in alternate months are attended by executive directors only. All meetings were attended by all the directors except that Mr Matthews was unable to attend the meeting in April and Mr Claesson was unable to attend the meeting in June.

The Board has established three standing sub-committees to assist in the discharge of corporate governance responsibilities. They are the nominations committee, remuneration committee and audit committee. The roles of each of the committees, their members and activities during the year are covered separately within this report.

During 2006, the Board comprised the Chairman, three executive and one non-executive directors, details of whom are included on page 2. The composition of the Board is designed to provide an appropriate balance of group, industry and general commercial experience and is reviewed as required to ensure that it remains appropriate to the nature of the group's activities.

The roles of the Chairman and Chief Executive are distinct. The office of Chairman was held by Mr GB Matthews until his resignation on 24 May 2006 and has since that date been held by Mr TA Milne. The office of Chief Executive is held by Mr NA Makeham.

Appointments to the Board are the responsibility of the Nominations Committee.

### Nomination Committee

The Nominations Committee comprises the Chairman, Mr GB Matthews until 24 May 2006 and then Mr TA Milne from that date, and the non-executive director, Mr PJ Claesson, and the Chief Executive, Mr NA Makeham, and is chaired by the Chairman. Meetings are arranged as necessary and none were held during the year. The committee is responsible for nominating candidates (both executive and non-executive) for the approval of the Board to fill vacancies or appoint additional persons to the Board. Its terms of reference are available upon request and are placed on the company's website.

All directors receive induction on joining the Board covering the group's operations, goals and strategy, and their responsibilities as directors of the group. The company supports the directors in developing their knowledge and capabilities.

The directors have established a procedure, agreed by the Board, for directors in the furtherance of their duties to take independent professional advice, if necessary, at the company's expense.

The Combined Code requires that the Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. However, no formal evaluation was conducted during the year although informal evaluation of the performance of the individual executive directors was conducted by the Chairman.

All directors are subject to election by shareholders at the first opportunity after their appointment. All directors are required to submit themselves for re-election at least every three years. The terms and conditions of appointment of the non-executive director are available for inspection upon request.

## REMUNERATION REPORT

### Remuneration Committee

The Remuneration Committee comprises the Chairman, Mr GB Matthews until 24 May 2006 and then Mr TA Milne from that date, and the non-executive director, Mr PJ Claesson, and is chaired by the Chairman. It reviews the remuneration and contractual arrangements of the executive directors. The remuneration of the Chairman and the non-executive director is determined by the Board as a whole, based on a review of the current practices in other companies. The committee met once during the year and the meeting was attended by both members of the committee. The terms of reference are available upon request and are placed on the company's website.

### Remuneration

The salaries of the executive directors are determined after giving full consideration to the best practice provisions and after a review of the performance of the individual. It is the aim to reward directors competitively; consideration is, therefore, given to the median remuneration paid to senior management of comparable public companies. No director is involved in deciding his own remuneration.

Each of the executive directors has a service contract providing 12 months notice.

## Board Report on Corporate Governance continued

## Directors' Interests

The directors who held office at 31 December 2006 had the following interests in the shares of the company.

	Ordinary shares of 25p each 31 December 2006	Ordinary shares of 25p each 1 January 2006 (or at the date of appointment)
	Number	Number
TA Milne	225,000	100,000
NA Makeham	749,139	599,139
DJ Bolton	762,300	612,300
RE Dorset	13,186	13,186
PJ Claesson	3,961,448	3,591,448

None of the directors had any interests in the shares of other group companies. Between 31 December 2006 and 12 March 2007, there have been no changes in the interests of the directors.

## Directors' Share Options

Aggregate emoluments disclosed above do not include any amounts for the value of options to acquire ordinary shares in the company granted to or held by the directors. Details of the options are as follows:

Name of director	1 January 2006	Granted	Exercised	31 December 2006	Exercise price	Gains on exercise 2006	Gains on exercise 2005
NA Makeham	200,000	-	-	200,000	75p	-	-
NA Makeham	50,000	-	-	50,000	62.5p	-	-
NA Makeham	60,000	-	-	60,000	100p	-	-
NA Makeham	50,000	-	-	50,000	94p	-	-
DJ Bolton	51,272	-	-	51,272	98.5p	-	-
DJ Bolton	50,000	-	-	50,000	75p	-	-
DJ Bolton	40,000	-	-	40,000	62.5p	-	-
DJ Bolton	60,000	-	-	60,000	100p	-	-
DJ Bolton	50,000	-	-	50,000	94p	-	-
RE Dorset	20,000	-	-	20,000	75p	-	-
RE Dorset	20,000	-	-	20,000	67.5p	-	-
RE Dorset	40,000	-	-	40,000	62.5p	-	-
RE Dorset	80,000	-	-	80,000	100p	-	-
RE Dorset	50,000	-	-	50,000	94p	-	-
TA Milne	-	103,626	-	103,626	101.5p	-	-

The options for each of the above directors are exercisable as follows:

NA Makeham	DJ Bolton	RE Dorset	TA Milne	Exercise Price	Exercisable if market price reaches at least
66,667	16,667	-	-	75p	100p
66,667	16,667	6,667	-	75p	125p
66,666	16,666	6,667	-	75p	150p
-	-	6,666	-	75p	175p
-	27,664	-	-	98.5p	100p
-	15,808	-	-	98.5p	125p
-	7,800	-	-	98.5p	150p
-	-	6,667	-	67.5p	125p
-	-	6,667	-	67.5p	150p
-	-	6,666	-	67.5p	175p
16,667	13,333	13,333	-	62.5p	100p
16,667	13,333	13,333	-	62.5p	125p
16,666	13,334	13,334	-	62.5p	150p
20,000	20,000	26,667	-	100p	125p
20,000	20,000	26,667	-	100p	150p
20,000	20,000	26,666	-	100p	175p

In addition, the directors hold options which are exercisable if the growth of earnings per share (eps) over the three year period from the financial year in which the options were granted achieves the following:

NA Makeham	DJ Bolton	RE Dorset	TA Milne	Exercise Price	Growth in eps is at least
12,500	12,500	12,500	-	94p	15%
12,500	12,500	12,500	-	94p	20%
25,000	25,000	25,000	-	94p	25%
-	-	-	25,907	101.5p	15%
-	-	-	25,906	101.5p	20%
-	-	-	51,813	101.5p	25%

In respect of Messrs Makeham, Bolton and Dorset, the three year period is that ending on 31 December 2007 and for Mr Milne is that ending on 31 December 2008.

Mr PJ Claesson is interested in warrants for 25p ordinary shares held by companies associated with him as follows:

Company	Number of warrants	Exercise price
CA Fastigheter AB	200,000	90p
Johan & Marianne Claesson AB	400,000	90p

Details of exercise periods of both the share options and the warrants are given in note 18 to the financial statements.

The market price of the ordinary shares at 31 December 2006 was 116p and the range during the year was 83.78p to 118.5p.

No director exercised share options during the current or previous year.

### Directors' Pension Entitlements

The company makes contributions to defined contribution schemes for each of the executive directors. Part of the remuneration of the Chairman is paid into a defined contribution scheme. There are no pension entitlements for the non-executive director.

### Directors' Indemnity Cover

All directors benefit from qualifying third-party indemnity provisions in place during the financial year and at the date of this report.

## ACCOUNTABILITY AND AUDIT

### Financial Reporting

The Board recognises its responsibility to present a balanced and understandable assessment of the group's position and prospects, both within its interim and annual financial statements and in other price-sensitive public reports. The statement of the directors' responsibility in preparing the financial statements is made on page 22.

### Going Concern

After making enquiries, the directors have formed a judgement, at the time of approving the financial statements, that there is a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. For this reason the directors continue to adopt the going concern basis in preparing the financial statements.

### Internal Control

The Board recognises its ultimate accountability for maintaining an effective system of internal control which is appropriate in relation to both the scope and nature of the group's activities. The system covers all controls including:

- financial;
- operational;
- compliance; and
- risk management.

The responsibility for managing risks on a day to day basis lies with the executive directors.

The principal risks which the group faces can be categorised as follows:

#### *Strategic*

Changes in the business environment influence the group's development in terms of the strategies which it pursues and the products and services it offers. These changes may stem from market competition or economic and technological advancement.

#### *Business environment*

The group's customer base is mainly in the retail, distribution and manufacturing sectors and mainly in the United Kingdom. The environment in which the group offers its products and services is, therefore, dependent on the economic and other circumstances affecting these business sectors.

#### *Financial*

Whilst all risks may be considered to have a financial impact, the management of the group's financial resources represents a key area of focus. Financial risks are faced in ensuring sufficient funds are available to meet financial commitments as and when they fall due and protecting the group's financial strength against adverse movements in financial markets.

- **Credit risk** – The group's credit risk is primarily attributable to its trade debtors. The amounts presented in the balance sheet are net of allowances for doubtful debts, estimated by the group's management based on prior experience and their assessment of the current economic environment. The group operates in three key markets and hence the credit risk is concentrated to some extent on retail, manufacturing and distribution customers. The group manages credit risk by ensuring that outlays by the group are matched with receipts from customers where possible and by tight control over contractual terms.

- **Currency risk** – The group's currency risk is primarily attributable to its trade debtors where certain customers are billed in US Dollars or Euros where these are not the functional currency of the group company. Where possible the risk is hedged by amounts payable in those currencies. The group's currency risk arising from its net investment overseas is not regarded as significant.
- **Price risk** – The group does not have any financial instruments which are exposed to price risk.
- **Liquidity and cash flow** - The group does have deferred consideration and a bank loan with set payment dates. The group ensures that it has sufficient funds to meet its obligations or commitments associated with its financial instruments by monitoring cash flow as part of its day to day control procedures and also more strategically to ensure that financing is in place with manageable repayment periods and that appropriate facilities are available to be drawn upon when the need arises.
- **Interest rate** - Interest rate risk arises from the extent to which the group holds interest rate sensitive assets or is exposed to interest rate sensitive liabilities. The group maintains a balance of fixed and floating interest rates on its financing to manage this exposure.

#### *Operational*

These risks, which are inherent in all business activities, are those which mainly result from the potential breakdown of individual business units or the group's control of its human, physical and operating resources. The potential financial or reputational loss arising from failures in internal controls, flaws or malfunctions in computer systems and poor product design or delivery all fall within this category.

There is an ongoing process for identifying, evaluating and managing the significant issues faced by the group which has been in place throughout the year and up to 12 March 2007. It has been regularly reviewed by the Board and it accords with the Turnbull guidance.

The Board and senior management have a clear and consistent understanding of the key risks facing the business. Whilst they recognise that it is not possible to eliminate risk completely, they have established an infrastructure of controls, systems, staff and processes which aim to minimise the likelihood of risks occurring or reduce the impact should they do so. The key elements of this infrastructure which enable the Board to review the effectiveness of the system of internal controls are as follows:

- establishment of a formal management structure, including the specification of matters reserved for decision by the Board;
- setting and reviewing the strategic objectives of the group;
- Board involvement in the setting and review of the annual budget;
- the regular review of the group's performance compared with budget and forecasts;
- pre and post investment appraisal of capital expenditure;
- integrity and competence of personnel as part of the control environment; and
- group reporting instructions and procedures including delegation of authority and authorisation levels, segregation of duties and other control procedures, and standardised accounting policies.

The Board and senior management are aware that any significant operational matters which raise cause for concern may have arisen because of or give rise to material internal control issues. There is a process in place whereby any member of management who becomes aware of an internal control issue can bring this to the attention of the Chief Finance Officer. There were no such issues raised during the year under review.

The Board acknowledges its responsibility for the group's system of internal control and for reviewing its effectiveness. The Board is committed to operating comprehensive processes to manage the key risks which face the business. They have established a framework of

policies, systems and procedures to ensure that the nature and extent of the risk undertaken is commensurate with the commercial returns and, where necessary, to ensure prudent risk-taking to protect shareholder value. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable but not absolute assurance against material misstatement or loss.

#### Audit Committee

The Audit Committee comprises the Chairman, Mr GB Matthews until 24 May 2006 and then Mr TA Milne from that date, and the non-executive director, Mr PJ Claesson, and is chaired by the Chairman. The committee met twice during the year and meetings were attended by both members of the committee. The role of the Audit Committee is to consider the appointment of the auditors, audit fees, scope of audit work and any resultant findings. It reviews external audit activities, monitors compliance with statutory requirements for financial reporting and reviews the half year and full year financial statements before they are presented to the Board for approval. The Chief Executive, Chief Finance Officer and external auditors attend meetings of the Audit Committee by invitation. The committee is also required to review the effectiveness of the group's internal control systems, to review the group's statement on internal control systems prior to endorsement by the Board and to consider, from time to time, the need for a "risk sub-committee" to assist in monitoring the group's internal control systems. Its terms of reference are available upon request and are placed on the company's website.

The Audit Committee considers and determines relevant action in respect of any control issues raised by the auditors. Given the size of the group and the close day to day control exercised by the executive directors and senior management, no formal internal audit department is considered necessary.

#### RELATIONS WITH SHAREHOLDERS

The company seeks to maintain good communication with shareholders. The executive directors make presentations to institutional shareholders covering the interim and full year results. Whilst most shareholder contact is with the executive directors, the Chairman and the non-executive director are available to meet major shareholders if requested to do so. The views of major shareholders are obtained through direct face-to-face contact and analysts' or brokers briefings.

The Board considers the AGM to be an important opportunity to communicate with shareholders and encourages their participation. The company despatches the notice of AGM, with explanatory notes describing items of special business, at least 21 working days before the meeting. All shareholders have the opportunity formally or informally to put questions to the company's AGMs. All directors attend the AGM and the Chairman of the Audit, Remuneration and Nominations Committees is available to answer questions from shareholders. At each AGM the Chairman advises shareholders of the proxy voting details on each of the resolutions which is dealt with on a show of hands.

## AUDITORS' REMUNERATION

Fees for services provided by the auditors have been as follows:

	2006 £000	2005 £000
Audit services		
• Statutory audit	44	42
Further assurance services:		
Tax services		
• Advisory services	12	-
Other services		
• Other services	14	13
	70	55

During the year, the auditors provided non-audit services in relation to the adoption of the International Financial Reporting Standards in 2007 and tax advice in connection with the company's EIS/VCT status and tax planning for the group as a whole. The Board considered the proposed non-audit services in advance to ensure that it was satisfied that neither the nature nor the scale of the non-audit services would impair the auditors' objectivity and independence.

## COMPLIANCE WITH THE COMBINED CODE

Whilst the group is not required to comply with the provisions of the Combined Code, it has given considerable attention to the provisions set out therein. The group has not complied with all provisions required for listed companies, principally as it does not consider these appropriate given the size and nature of the group. However, the directors confirm that throughout the year ended 31 December 2006 the group has been in compliance with the Code provisions set out in Section 1 of the July 2003 FRC Combined Code on Corporate Governance, with the following exceptions:

- No director has been identified as a senior independent director. There is no alternative route for shareholders to raise their concerns other than the normal channels of the chairman, chief executive or chief finance officer. The directors consider this to be appropriate for the size of the group at present. (A.1.2) (A.3.3)
- The Chairman's performance has not been appraised by the non-executive director, nor have there been meetings of the non-executive directors as there is only one non-executive director. (A.1.3)
- The group has only one non-executive director, Mr PJ Claesson, who is not considered independent due to the size of his shareholding. (A.3.1) (A.3.2)
- The Nominations Committee, Remuneration Committee and Audit Committee each include only one non-executive director and he is not considered to be independent. (A.4.1) (B.2.1) (C.3.1)
- The Board has not conducted a performance evaluation of the Board, its committees or its individual directors although informal evaluation of the executive directors has been conducted by the Chairman. (A.6.1)
- The directors have not conducted a formal and documented review of the effectiveness of the group's system of internal controls during the year ended 31 December 2006. (C.2.1)
- The non-executive director has not met with major shareholders during 2006, although he was available to do so if requested. (D.1.1)

## Directors' Responsibilities

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice. Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group as at the end of the financial year and of the profit or loss of the group for that period.

In preparing the financial statements, the directors are required to: select suitable accounting policies and then apply them consistently; make judgements and estimates that are reasonable and prudent; state whether applicable accounting standards have been followed; and prepare the financial statements on a going concern basis unless it is inappropriate to presume that the company and the group will continue in business.

### OTHER MATTERS

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for the system of internal control, for safeguarding the assets of the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Financial statements are published on the company's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the company's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

## TO THE SHAREHOLDERS OF K3 BUSINESS TECHNOLOGY GROUP PLC

We have audited the group and parent company financial statements (the "financial statements") of K3 Business Technology Group plc for the year ended 31 December 2006 which comprise the Consolidated Profit and Loss Account, the Consolidated and Company Balance Sheets, the Consolidated Cash Flow Statement, the Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

### Respective Responsibilities of Directors and Auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Companies Act 1985 and whether the information given in the Directors' Report is consistent with those financial statements. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the annual report and consider whether it is consistent with the audited financial statements. This other information comprises of the Chairman's Statement, Operating Review, Financial Review, the Directors' Report and the Board Report on Corporate Governance. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Our report has been prepared pursuant to the requirements of the Companies Act 1985 and for no other purpose. No person is entitled to rely on this report unless such a person is a person entitled to rely upon this report by virtue of and for the purpose of the Companies Act 1985 or has been

expressly authorised to do so by our prior written consent. Save as above, we do not accept responsibility for this report to any other person or for any other purpose and we hereby expressly disclaim any and all such liability.

### Basis of Audit Opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

### Opinion

In our opinion the financial statements:

- the group financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's affairs as at 31 December 2006 and of its loss for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 31 December 2006;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

## BDO Stoy Hayward LLP

Chartered Accountants and Registered Auditors

Manchester

12 March 2007

## Consolidated Profit and Loss Account

FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 Continuing £000	2005 Continuing £000
Turnover	1	27,346	22,029
Cost of sales		(10,641)	(8,136)
<b>Gross profit</b>		16,705	13,893
Selling and distribution costs		(5,102)	(4,122)
Administrative expenses		(10,840)	(9,167)

<b>Operating profit before amortisation of goodwill and intangibles and share option costs</b>		3,046	2,408
Amortisation of goodwill and intangibles		(2,198)	(1,752)
Share option costs		(85)	(52)

<b>Operating profit</b>		763	604
Loss on disposal of operations	2	-	(90)
<b>Profit on ordinary activities before finance charges</b>		763	514
Finance charges (net)	3	(262)	(287)
<b>Profit on ordinary activities before taxation</b>	4	501	227
Tax on profit on ordinary activities	7	(810)	(493)
<b>Loss for financial year</b>	19	(309)	(266)

## Loss per share

	Notes	Total	Total
<b>Basic</b>	9	(1.7p)	(1.8p)
<b>Diluted</b>	9	(1.7p)	(1.8p)

All activities arise from continuing activities apart from the loss on disposal of operations.

## Consolidated Statement of Total Recognised Gains and Losses

FOR THE YEAR ENDED 31 DECEMBER 2006

	2006	2005
	£000	As restated £000
Loss for the financial year	(309)	(266)
Currency translation on difference on foreign currency net investments	(15)	(1)
<b>Total recognised gains and losses relating to the year</b>	<b>(324)</b>	<b>(267)</b>
Prior year adjustment (as explained in note 19)	(83)	
Total gains and losses recognised since last annual report and financial statements	(407)	

## Consolidated Balance Sheet

AS AT 31 DECEMBER 2006

	Notes	2006 £000	2005 As restated £000
<b>Fixed assets</b>			
Development costs and intellectual property	10	273	162
Goodwill	10	13,604	15,682
Intangible fixed assets		13,877	15,844
Tangible assets	11	416	508
Investments	12	1,398	-
		15,691	16,352
<b>Current assets</b>			
Debtors	13	8,778	6,596
Cash at bank and in hand		2,267	874
		11,045	7,470
<b>Creditors: Amounts falling due within one year</b>	14	(13,654)	(10,583)
<b>Net current liabilities</b>		(2,609)	(3,113)
<b>Total assets less current liabilities</b>		13,082	13,239
<b>Creditors: Amounts falling due after more than one year</b>	15	(711)	(2,439)
<b>Net assets</b>		12,371	10,800
<b>Capital and reserves</b>			
Called-up share capital	18	4,872	4,435
Share premium account	19	1,388	7,813
Other reserve	19	6,070	6,070
Profit and loss account	19	41	(7,518)
<b>Equity shareholders' funds</b>	21	12,371	10,800

The financial statements on pages 24 to 55 were approved and authorised for issue by the board of directors on 12 March 2007 and signed on its behalf by:

**NA Makeham**

Director

12 March 2007

**DJ Bolton**

Director

## Company Balance Sheet

AS AT 31 DECEMBER 2006

	Notes	2006 £000	2005 As restated £000
<b>Fixed assets</b>			
Development costs and intellectual property	10	224	-
Goodwill	10	6,940	2,239
Intangible fixed assets		7,164	2,239
Tangible assets	11	367	88
Investments	12	8,782	14,199
		16,313	16,526
<b>Current assets</b>			
Debtors	13	6,677	2,021
Cash at bank and in hand		2,127	544
		8,804	2,565
<b>Creditors: Amounts falling due within one year</b>	14	(12,427)	(6,471)
<b>Net current liabilities</b>		(3,623)	(3,906)
<b>Total assets less current liabilities</b>		12,690	12,620
<b>Creditors: Amounts falling due after more than one year</b>	15	(711)	(2,309)
<b>Net assets</b>		11,979	10,311
<b>Capital and reserves</b>			
Called-up share capital	18	4,872	4,435
Share premium account	19	1,388	7,813
Other reserve	19	5,946	5,946
Profit and loss account	19	(227)	(7,883)
<b>Equity shareholders' funds</b>		11,979	10,311

The financial statements on pages 24 to 55 were approved and authorised for issue by the board of directors on 12 March 2007 and signed on its behalf by:

**NA Makeham**

Director

12 March 2007

**DJ Bolton**

Director

## Consolidated Cash Flow Statement

FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 £000	2005 £000
Net cash inflow from operating activities	22	2,218	4,267
Returns on investments and servicing of finance	23	(235)	(279)
Taxation	23	26	(80)
Capital expenditure and financial investment	23	(335)	(106)
Acquisitions and disposals	23	(1,456)	(5,153)
<b>Cash inflow (outflow) before financing</b>		<b>218</b>	<b>(1,351)</b>
Financing	23	1,175	1,822
<b>Increase in cash in the year</b>	<b>24</b>	<b>1,393</b>	<b>471</b>

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year with the exception of the adoption of FRS20, Share-based payments, which was adopted on 1 January 2006.

#### Basis of accounting

The financial statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards.

#### Basis of consolidation

The group financial statements consolidate the financial statements of K3 Business Technology Group plc and its subsidiary undertakings drawn up to 31 December each year. The results of subsidiaries acquired or sold are consolidated for the periods from or to the date on which control passed. Acquisitions are accounted for under the acquisition method.

#### Intangible assets - goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life, which is between eight and ten years. Provision is made for any impairment.

Negative goodwill is similarly included in the balance sheet and is credited to the profit and loss account in the periods in which the acquired non-monetary assets are recovered through depreciation or sale. Negative goodwill in excess of the fair values of the non-monetary assets acquired is credited to the profit and loss account in the periods expected to benefit.

As disclosed in notes 10 and 12 the group has hived up the trade and assets of a subsidiary undertaking into the parent undertaking at book value. This results in the investment in a subsidiary which has no trade and hence provision would normally be made against

that investment under UK GAAP. The company has however applied a true and fair override as allowed under the Companies Act 1985 and transferred an amount equal to the accounting impairment from investments to goodwill. The Board feels that this more accurately reflects the fact that in substance there has been no loss of value to the company. Had the investment been written down in strict accordance with UK GAAP, this would have resulted in a provision, in the parent undertaking only, of £709,000 (2005: £nil) which is now being amortised over the remaining useful economic life of nine years.

#### Intangible assets - research and development

Research expenditure is written off as incurred. Development expenditure is also written off, except where the directors are satisfied as to the technical, commercial and financial viability of individual projects. In such cases, the identifiable expenditure is deferred and amortised over the period during which the group is expected to benefit. This period is between two and ten years. Provision is made for any impairment.

#### Intangible assets - intellectual property

Intellectual property is included at cost and depreciated in equal annual instalments over a period of five years which is its estimated useful economic life. Provision is made for any impairment.

#### Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets, at rates calculated to write off the cost of each asset on a straight-line basis over its expected useful life, as follows:

Plant and machinery,	
office equipment and fixtures	20-33% per annum
Motor vehicles	25% per annum

## Statement of Accounting Policies continued

### Investments

Fixed asset investments are shown at cost less provision for impairment. In the company balance sheet, for investments in subsidiaries acquired for consideration including the issue of shares qualifying for merger relief, cost is measured either by reference to the nominal value or the fair value of the shares where appropriate. Any premium is ignored when the nominal value is used.

### Taxation

Current tax, including UK corporation tax, is provided at the amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that resulted in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the group's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured at the average tax rates that are expected to apply in the period in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

### Turnover

Turnover is calculated net of value added tax and represents the total amount receivable by the group in respect of the sale of software licences, customised software, hardware and fees derived from installation, consultancy, training and support.

Income from the sale of software licences, customised software, hardware and installation is recognised upon delivery to a customer or on completion of contractual milestone performance obligations. Income from training and consultancy is recognised on performance of the service. Income from support is generally invoiced in advance, termed 'deferred income', and taken to income in equal monthly instalments over the relevant periods.

### Pension costs

For defined contribution schemes the amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

### Foreign currency

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction or, if hedged, at the forward contract rate. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date or, if appropriate, at the forward contract rate.

The results of overseas operations are translated at the average rates of exchange during the year and the balance sheet is translated into sterling at the rate of exchange ruling at the balance sheet date. Exchange differences which arise from the translation of the opening net assets and results of foreign subsidiary undertakings are taken to reserves.

## Leases

Assets held under finance leases and other similar contracts, which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and are depreciated over the shorter of the lease terms and their useful lives. The capital elements of future lease obligations are recorded as liabilities, while the interest elements are charged to the profit and loss account over the period of the lease to produce a constant rate of charge on the balance of capital repayments outstanding. Hire purchase transactions are dealt with similarly, except that assets are depreciated over their useful lives.

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

## Share based payment

The group has applied the requirements of FRS20, Share-based payments. In accordance with the transitional provisions, FRS20 has been applied to all grants of equity instruments after 7 November 2002 that were unvested at 1 January 2006. For 2005, the change of policy has resulted in a net increase in the loss for the year of £52,000 and in 2006 the net increase in the loss was £85,000. The share-based expense has been included in administrative expenses in the profit and loss account with the credit entry to equity.

Where share options are awarded to employees, the fair value of the options at the date of grant is charged to the profit and loss account over the vesting period. Non-market vesting conditions are taken into account by adjusting the number of equity instruments expected to vest at each balance sheet date so that, ultimately, the cumulative amount recognised over the vesting period is based on the amount that eventually vest. Market vesting conditions are factored into the fair value of the options granted. As long as all other vesting conditions are satisfied, a charge is made irrespective of whether the market vesting conditions are satisfied. The cumulative expense is not adjusted for failure to meet a market vesting condition.

When the terms and conditions of the options are modified before they vest, the increase in the fair value of the options, measured immediately before and after the modification, is also charged to the profit and loss account over the remaining vesting period.

Fair value is measured by use of a trinomial lattice model. The expected life used in the model has been adjusted, based on the directors' best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

## Notes to Financial Statements

## 1 Segment information

Classes of business

	Retail software business		Distribution software business		Manufacturing software business		Group	
	2006	2005	2006	2005	2006	2005	2006	2005
	£000	£000	£000	£000	£000	£000	£000	£000
Turnover - sales to third parties	16,434	12,661	2,063	1,803	8,849	7,565	27,346	22,209
Segment profit before amortisation of goodwill and share option costs	1,628	1,219	76	(80)	1,342	1,269	3,046	2,408
Goodwill amortisation	(945)	(945)	(89)	(82)	(1,164)	(725)	(2,198)	(1,752)
Share option costs	(34)	(16)	(13)	(9)	(38)	(27)	(85)	(52)
Operating profit (loss)	649	258	(26)	(171)	140	517	763	604
Loss on disposal of operations							-	(90)
Finance charges (net)							(262)	(287)
Profit on ordinary activities before tax							501	227
Segment net assets	4,522	5,743	1,132	787	4,398	5,138	10,052	11,668
Unallocated net assets							2,319	(868)
Net assets							12,371	10,800

The unallocated net assets are the investment in SiRVIS IT plc and net financing assets.

The distribution segment, represented by Elucid, has been disposed of after the year end. The Group is extending the functionality of the Microsoft Dynamics offering to create an integrated solution for the mid range retailer in this market segment.

Geographical segments:

The destination of turnover by geographical market is as follows:

	2006 £000	2005 £000
United Kingdom	23,914	19,513
Rest of Europe	2,051	2,321
Rest of World	1,381	195
	27,346	22,029

Turnover, profit and net assets of the group are attributable to United Kingdom operations, except for turnover of £1,098,000 (2005: £1,120,000), profit of £352,000 (2005: £236,000) and net assets of £765,000 (2005: £427,000) which originated from operations in the Republic of Ireland.

## 2 Loss on disposal of operations

The loss on disposal of operations in 2005 of £90,000 relates to further unanticipated costs incurred regarding the disposal in 2004 of the manufacturing software operation based at Crewe to Azur Group Limited. The profit on disposal of this operation recognised in 2004 was £1,248,000.

## 2 Loss on disposal of operations continued

During the year a further charge of £106,000 has been made as a result of a reduction in capital losses available to offset against the gain made on the disposal of this operation, and this has been included within taxation.

## 3 Finance charges (net)

	2006 £000	2005 £000
Interest payable and similar charges:		
Bank loans and overdrafts	98	48
Finance leases and hire purchase contracts	65	78
Other interest	65	70
On related party balances	55	99
	283	295
Less: investment income:		
Interest receivable and similar income	(21)	(8)
	262	287

## 4 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging (crediting):

	2006 £000	2005 £000
Depreciation and amounts written off tangible fixed assets		
- owned	186	195
- held under finance leases and hire purchase contracts	143	146
(Profit) loss on disposal of tangible fixed assets	(27)	33
Research and development		
- amortisation of deferred expenditure	118	28
Amortisation of goodwill and intangibles	2,080	1,724
Operating lease rentals		
- plant and machinery	219	166
- other	379	291
Auditors' remuneration for audit services		
- group	44	42
- company	28	18

In addition to the above, amounts payable to BDO Stoy Hayward LLP by the company and its UK subsidiary undertakings in respect of non-audit services were £26,000 (2005: £13,000) (see page 21 for further analysis).

## Notes to Financial Statements continued

## 5 Staff costs

The average monthly number of employees (including executive directors) was:

	Group		Company	
	2006 Number	2005 Number	2006 Number	2005 Number
Consultants and programmers	111	88	58	28
Sales and distribution	32	27	19	17
Administration	74	67	49	23
	217	182	126	68

Their aggregate remuneration comprised:

	Group		Company	
	2006 £000	2005 £000	2006 £000	2005 £000
Wages and salaries	10,930	8,857	6,416	3,116
Social security costs	1,204	1,006	722	362
Other pension costs (see note 27)	338	197	183	109
	12,472	10,060	7,321	3,587

## 6 Directors' remuneration, interests and transactions

### Aggregate remuneration

The total amounts for directors' remuneration and other benefits were as follows:

	2006 £000	2005 £000
Emoluments	573	657
Contributions to personal pension schemes	84	33
	657	690

The aggregate emoluments of the highest paid director were £187,650 (2005: £231,902) and company pension contributions of £12,800 (2005: £10,800) were made to a money purchase scheme on his behalf.

### Number of directors

	2006 Number	2005 Number
Retirement benefits are accruing to the following number of directors under:		
Money purchase schemes	4	3

Directors' interests and share options are disclosed in the Remuneration Report on pages 15 to 18.

## 7 Tax on profit on ordinary activities

The tax charge (credit) comprises:

	2006 £000	2005 £000
<b>Current tax</b>		
UK corporation tax	620	304
Foreign tax	51	35
	671	339
Adjustments in respect of prior years	83	(17)
<b>Total current tax charge</b>	754	322
<b>Deferred tax</b>		
Origination and reversal of timing differences	48	(73)
Utilisation of tax losses	-	263
Adjustments in respect of previous years	8	(19)
<b>Total deferred tax charge (see note 17)</b>	56	171
<b>Total tax on profit on ordinary activities</b>	810	493

The differences between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows.

	2006 £000	2005 As restated £000
<b>Profit on ordinary activities before tax</b>	501	227
Tax on group profit on ordinary activities at standard UK corporation tax rate of 30% (2005: 30%)	150	68
Effects of:		
Expenses not deductible for tax purposes	643	347
Capital allowances in excess of depreciation	(28)	10
Movement on short term timing differences	16	2
Utilisation of tax losses	(37)	(41)
Lower rates of taxation on overseas earnings	(73)	(47)
Adjustment in respect of previous periods	83	(17)
<b>Group current tax charge for the year</b>	754	322

The group earns its profits primarily in the UK. Therefore the tax rate used for tax on profit on ordinary activities is the standard rate for UK corporation tax, currently 30%.

The group's planned level of capital investment is expected to remain at similar levels of investment. Therefore, it expects to be able to claim capital allowances in excess of depreciation in future years at a similar level to the current year.

## Notes to Financial Statements continued

**8 Profit (loss) attributable to K3 Business Technology Group plc**

As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the parent company.

The loss for the financial year dealt with in the financial statements of the parent company, K3 Business Technology Group plc, was £477,000 (2005: loss of £367,000).

**9 (Loss) earnings per share**

The calculations of loss per share are based on the loss for the financial year and the following numbers of shares.

	2006 Number of shares	2005 Number of shares
Weighted average number of shares:		
For basic earnings per share	18,075,153	14,999,027
Exercise of share options	87,053	154,501
For diluted earnings per share	18,162,206	15,153,528

The alternative earnings per share calculations have been computed because the directors consider that they are useful to shareholders and investors. These were based on the following profits (losses) and the above number of shares.

	Earnings (losses) £000	2006 Per share amount Basic & diluted p	Earnings (losses) As restated £000	2005 Per share amount Basic As restated p	Per share amount Diluted As restated p
(Loss) earnings per share (eps)	(309)	(1.7)	(266)	(1.8)	(1.8)
Effect of amortisation of goodwill and intangibles	2,198	12.1	1,752	11.7	11.6
Effect of share option costs	85	0.5	52	0.4	0.4
Eps before amortisation of goodwill and intangibles and share option costs	1,974	10.9	1,538	10.3	10.2
Exceptional items (net of tax)	*106	0.6	*140	0.9	0.9
Eps per share before amortisation of goodwill and intangibles, share option costs and exceptional items	2,080	11.5	1,678	11.2	11.1

\* Relates to loss on disposal of the manufacturing software operation based at Crewe of Enil (2005: £90,000) on which the tax charge was £106,000 (2005: £50,000) due to adjustments to the amounts of capital losses available to offset against the gain.

The basic and diluted loss per share are the same as the effect of share options is anti-dilutive.

## 10 Intangible fixed assets

	Development costs and intellectual property £000	Group Goodwill £000	Total £000	Development costs and intellectual property £000	Company Goodwill £000	Total £000
<b>Cost</b>						
At 1 January 2006	190	18,853	19,043	-	3,721	3,721
Additions	229	-	229	184	-	184
Transfers	-	-	-	-	5,520	5,520
Adjustments	-	2	2	-	-	-
Intra-group transfers	-	-	-	46	-	46
At 31 December 2006	419	18,855	19,274	230	9,241	9,471
<b>Amortisation</b>						
At 1 January 2006	28	3,171	3,199	-	1,482	1,482
Charge for the year	118	2,080	2,198	6	819	825
At 31 December 2006	146	5,251	5,397	6	2,301	2,307
<b>Net book value</b>						
At 31 December 2006	273	13,604	13,877	224	6,940	7,164
At 31 December 2005	162	15,682	15,844	-	2,239	2,239

The additions to goodwill in the company arose on the transfer of the trade and net assets of K3 Landsteinar Limited and Miracle Hindsight Limited to the parent company on 1 July 2006. (See note 12).

The net adjustments of £2,000 during the year relate to a reassessment of the fair value of the assets acquired from IEG in 2005 and of the estimated deferred consideration payable together with further costs of the acquisition.

## Notes to Financial Statements continued

## 11 Tangible fixed assets

	Group				Company			
	Short leasehold property	Plant, office equipment & fixtures	Motor vehicles	Total	Short leasehold property	Plant, office equipment & fixtures	Motor vehicles	Total
	£000	£000	£000	£000	£000	£000	£000	£000
<b>Cost</b>								
At 1 January 2006	107	594	213	914	-	568	26	594
Additions	88	161	-	249	-	92	-	92
Disposals	-	(89)	(24)	(113)	-	(89)	(12)	(101)
Intra-group transfers	-	-	-	-	195	364	213	772
At 31 December 2006	195	666	189	1,050	195	935	227	1,357
<b>Depreciation</b>								
At 1 January 2006	33	326	47	406	-	487	19	506
Charge for the year	59	179	91	329	33	115	27	175
Disposals	-	(89)	(12)	(101)	-	(89)	(12)	(101)
On intra-group transfers	-	-	-	-	59	203	148	410
At 31 December 2006	92	416	126	634	92	716	182	990
<b>Net book value</b>								
At 31 December 2006	103	250	63	416	103	219	45	367
At 31 December 2005	74	268	166	508	-	81	7	88
Leased assets included above:								
<b>Net book value</b>								
At 31 December 2006	103	21	62	186	103	21	42	166
At 31 December 2005	74	-	151	225	-	-	7	7

## 12 Fixed asset investments

	Group		Company	
	2006 £000	2005 £000	2006 £000	2005 £000
Subsidiary undertakings	-	-	7,384	14,199
Other investments	1,398	-	1,398	-
	1,398	-	8,782	14,199

## 12 Fixed asset investments continued

### *Other investments*

Other investments in the group and company relate to a 29.93% interest held SirViS IT plc, an AiM listed company acquired in December 2006. Although the company owns 29.93% of the issued share capital it has accounted for the investment as a trade investment as the directors do not consider that they exert significant influence over SIRViS IT. This is because it has no active involvement in or influence over the direction of SIRViS IT and, in particular, it has no representation on the board.

	Group £000	Company £000
<b>Cost</b>		
At 1 January 2006	17	-
Additions	1,398	1,398
At 31 December 2006	1,415	1,398
<b>Provisions for impairment</b>		
At 1 January and 31 December 2006	17	-
<b>Net book value</b>		
At 31 December 2006	1,398	1,398
At 31 December 2005	-	-

	Group		Company	
	2006 £000	2005 £000	2006 £000	2005 £000
Listed investments included above	1,398	-	1,398	-

The market value at 31 December 2006 is equal to the book value.

### *Subsidiary undertakings*

The parent company and the group have investments in the following subsidiary undertakings, which principally affected the profits or net assets of the group. To avoid a statement of excessive length, details of investments which are not significant have been omitted.

\*K3 Landsteinar Limited

\*K3 Landsteinar (Ireland) Limited

\*Miracle Hindsight Limited

\*K3 Information Engineering Limited

K3 Information Services Limited

Integrated Manufacturing Software Limited

\*K3 Business Technology Group Trustees Company Limited

\*Held directly by K3 Business Technology Group plc

## 12 Fixed asset investments continued

### *Subsidiary undertakings continued*

The principal activity of all the subsidiary undertakings is the supply of computer software and consultancy, with the exception of K3 Landsteinar Limited and Miracle Hindsight Limited which became dormant on 1 July 2006 when their trade and assets were transferred to its parent company, and K3 Business Technology Group Trustees Company Limited which is the trustee for the group's employee share ownership plan.

All subsidiary undertakings are wholly owned and all shares consist of ordinary shares only, with the exception of K3 Information Services Limited where there are also preference shares.

All subsidiary undertakings operate in the United Kingdom and are registered in England and Wales, with the exception of K3 Landsteinar (Ireland) Limited and Integrated Manufacturing Software Limited which operate in the Republic of Ireland and are registered in the Republic of Ireland.

All the above group companies are included in the consolidation.

	<b>Company £000</b>
<b>Cost</b>	
At 1 January 2006	20,109
Adjustments	(204)
Transfer to goodwill	(5,520)
Disposals	(4,357)
Dividends from subsidiary undertakings set against investment	(1,091)
At 31 December 2006	<u>8,937</u>
<b>Amounts written off</b>	
At 1 January 2006	5,910
Disposals	(4,357)
At 31 December 2006	<u>1,553</u>
<b>Net book value</b>	
At 31 December 2006	<u>7,384</u>
At 31 December 2005	<u>14,199</u>

The adjustments arose on the re-assessment of the fair value of the estimated deferred consideration due in respect of the investment in K3 Information Engineering Limited of £222,000 and further costs of acquisition of the investment of £18,000.

The amounts transferred to goodwill arose as a result of the transfer of the trade and net assets of K3 Landsteinar Limited and Miracle Hindsight Limited to the parent company. There is a consequent increase in the goodwill held in the parent company.

The disposals relate to non-trading subsidiary undertakings which were dissolved during the year.

### 13 Debtors

	Group		Company	
	2006 £000	2005 £000	2006 £000	2005 £000
Amounts falling due within one year:				
Trade debtors	7,129	5,210	5,550	1,613
Amounts owed by subsidiary undertakings	-	-	49	-
Other debtors	164	161	123	103
Prepayments and accrued income	1,329	1,013	832	246
Deferred tax asset (see note 17)	156	212	123	59
	<b>8,778</b>	<b>6,596</b>	<b>6,677</b>	<b>2,021</b>

### 14 Creditors: Amounts falling due within one year

	Group		Company	
	2006 £000	2005 £000	2006 £000	2005 £000
Bank loans and overdrafts	335	311	335	311
Obligations under finance leases and hire purchase contracts (see note 15)	129	249	106	4
Other loans due to related parties (see note 28)	397	229	397	229
Trade creditors	1,676	1,221	1,487	285
Amounts owed to subsidiary undertakings	-	-	1,485	2,491
Corporation tax	1,003	223	796	98
Taxation and social security	1,626	1,536	1,079	401
Other creditors	80	262	75	53
Deferred consideration	960	70	960	70
Accruals	2,907	2,308	2,428	825
Deferred income	4,541	4,174	3,279	1,704
	<b>13,654</b>	<b>10,583</b>	<b>12,427</b>	<b>6,471</b>

## Notes to Financial Statements continued

**15 Creditors: Amounts falling due after more than one year**

	Group		Company	
	2006 £000	2005 £000	2006 £000	2005 £000
Bank loans	356	689	356	689
Obligations under finance leases and hire purchase contracts	98	130	98	-
Other loans due to related parties	257	513	257	513
Deferred consideration	-	1,107	-	1,107
	711	2,439	711	2,309

The bank loan is secured by a fixed and floating charge over the assets of the group.

At the year end, other borrowings were repayable as follows:

	Group		Company	
	2006 £000	2005 £000	2006 £000	2005 £000
<b>Bank loans</b>				
Between one and two years	356	333	356	333
Between two and five years	-	356	-	356
	356	689	356	689
On demand or within one year	335	311	335	311
	691	1,000	691	1,000

**Finance leases**

Between one and two years	39	105	39	-
Between two and five years	59	25	59	-
	98	130	98	-
On demand or within one year	129	249	106	4
	227	379	204	4

**Other loans due to related parties**

Between one and two years	257	257	257	257
Between two and five years	-	256	-	256
	257	513	257	513
On demand or within one year	397	229	397	229
	654	742	654	742

## 16 Derivatives and other financial instruments

The group approach to risk management is summarised in the Accountability and Audit section of the Board Report on Corporate Governance on pages 18 to 20.

### *Interest rate profile*

The group has overdraft facilities with its bankers to cover any seasonal financing requirements or timing differences and hence the interest profile has followed that of base rates throughout the year. The undrawn committed overdraft facility at the year end was £950,000 (2005: £950,000) which is renewable on an annual basis.

In December 2005 the group negotiated a bank loan of £1,000,000 of which £691,000 is outstanding at 31 December 2006 (2005: £1,000,000) on which interest is charged at 2.25% over base rate.

The group has a loan from CA Fastigheter AB of £640,000 (2005: £710,000) with an interest rate of 8.5%. It also took out a loan during 2005 from Mr PJ Claesson of £1,000,000 at an interest rate of 8.5%. This was repaid during 2005. The group also has a standby facility from Mr Claesson for £250,000 until 30 June 2006 (2005: £250,000). Should the facility have been drawn upon, interest would have been charged at 8.5%.

The group has entered into finance leases with an average interest rate of 16.6% (2005: 19.1%).

### *Financial assets*

Approximately 19% of the group's assets are in currencies other than sterling. These balances are held in Euros and US Dollars and are partly hedged by amounts payable in Euro and US Dollars respectively. Cash balances held in Euros and US Dollars in excess of amounts required to meet payables in Euros and US Dollars are converted into sterling at the prevailing exchange rate.

At the year end the only financial assets held by the group were cash. All cash balances are at a floating rate of interest based upon bank base rates, held in sterling, Euros or US Dollars.

### *Financial instruments*

The group holds financial instruments to finance its potential investments and to manage interest rate risk arising from it. Consequently the main risk arising from the group's operation is interest rate movements. The group's objective is to manage the exposure to interest rate fluctuations.

### *Currency exposure*

The group's sales are largely invoiced in sterling with 6% invoiced in US Dollars and 6% in Euros. Where products are purchased in a foreign currency, the exchange exposure on the resulting creditor is reduced as the group holds financial assets in the same currency, i.e. Euros or US Dollars.

The following table shows the group's exposures at the year end.

	2006		2005	
	Euros £000	US\$ £000	Euros £000	US\$ £000
Net foreign currency monetary assets	820	1,003	764	17
Net foreign currency monetary liabilities	82	360	38	1

As permitted by FRS13, short term debtors and creditors have been excluded from the disclosures, other than currency disclosures. The directors consider the fair values of the financial assets and liabilities to be equal to their carrying amounts.

**17 Deferred taxation**

	<b>£000</b>
<b>Group</b>	
At 1 January 2006	212
Charged to profit and loss account (see note 7)	(56)
At 31 December 2006	156

The following deferred taxation asset has been recognised:

	<b>2006 £000</b>	<b>2005 £000</b>
<b>Group</b>		
Accelerated capital allowances	137	160
Other timing differences	19	14
Losses	-	38
Deferred tax asset	156	212

The group has not recognised tax losses of £618,000 (2005: £609,000) on the grounds that they may not be recovered in the foreseeable future.

	<b>2006 £000</b>	<b>2005 £000</b>
<b>Company</b>		
Accelerated capital allowances	104	57
Other timing differences	19	2
Deferred tax asset	123	59

The company has no unrecognised tax losses in either year.

The deferred tax assets have been recognised as they are expected to be recoverable against future taxable profits.

## 18 Called-up share capital

	2006 £000	2005 £000
<i>Authorised</i>		
26,500,000 ordinary shares of 25p each (2005: 20,000,000)	6,625	5,000
<i>Allotted, called-up and fully-paid</i>		
17,740,719 ordinary shares of 25p each (2005: 17,740,719)	4,435	4,435
1,550,000 ordinary shares of 25p each issued on pursuant to a private placing at 105p	388	-
196,552 ordinary shares of 25p each issued pursuant to a private placing at 116p	49	-
19,487,271 ordinary shares of 25p each (2005: 17,740,719)	4,872	4,435

In connection with the loan made by CA Fastigheter AB to the company to assist it with the acquisition of K3 Landsteinar, the company issued 200,000 warrants for ordinary shares of 25p each. These are exercisable at the lower of £1.00 or the price which any shares are issued by the company by way of a rights issue or placing during the period up to 31 January 2006. The company issued shares under a placing at £0.90 in September 2005 and hence the warrants will be exercisable at £0.90. The warrants are exercisable until 29 June 2008 or the date on which the loan is repaid whichever in the later.

In connection with a loan made by Johan and Marianne Claesson AB to the company to assist it with the acquisition of IEG, the company issued 400,000 warrants for the ordinary shares of 25p each. These are exercisable at the lower of £1.00 or the price at which any shares are issued by the company by way of a rights issue or placing during the period up to 23 June 2006. The company issued shares under a place at £0.90 in September 2005 and hence the warrants are currently exercisable at £0.90. The warrants are exercisable until 22 June 2008.

## 18 Called-up share capital continued

Options have been granted under the K3 Business Technology Group plc Executive Share Option Scheme 1994 and the K3 Business Technology Group plc Executive Share Option Scheme 2000 to subscribe for ordinary shares of the company as follows:

### *K3 Business Technology Group plc Executive Share Option Scheme 1994*

<b>Number of shares under option</b>	<b>Subscription price per share</b>	<b>Exercise period</b>
27,664	98.5p	Between 12 March 2000 and 27 July 2009 and if the market price reaches at least 100p
15,808	98.5p	Between 12 March 2000 and 27 July 2009 and if the market price reaches at least 125p
7,800	98.5p	Between 12 March 2000 and 27 July 2009 and if the market price reaches at least 150p
37,500	94p	Between 21 June 2008 and 20 June 2015 and if the growth in the earnings per share over the three year period ending 31 December 2007 is between 15% and 20%
37,500	94p	Between 21 June 2008 and 20 June 2015 and if the growth in the earnings per share over the three year period ending 31 December 2007 is between 20% and 25%
75,000	94p	Between 21 June 2008 and 20 June 2015 and if the growth in the earnings per share over the three year period ending 31 December 2007 is in excess of 25%

No options were exercised by members of the 1994 Scheme during the year and none lapsed unexercised during the year.

### *K3 Business Technology Group plc Executive Share Option Scheme 2000*

<b>Number of shares under option</b>	<b>Subscription price per share</b>	<b>Exercise period</b>
83,334	75p	Between 28 March 2004 and 27 March 2011 and if the market price reaches at least 100p
116,667	75p	Between 28 March 2004 and 27 March 2011 and if the market price reaches at least 125p
116,666	75p	Between 28 March 2004 and 27 March 2011 and if the market price reaches at least 150p
33,333	75p	Between 28 March 2004 and 27 March 2011 and if the market price reaches at least 175p
6,667	67.5p	Between 11 April 2005 and 10 April 2012 and if the market price reaches at least 125p
6,667	67.5p	Between 11 April 2005 and 10 April 2012 and if the market price reaches at least 150p
6,666	67.5p	Between 11 April 2005 and 10 April 2012 and if the market price reaches at least 175p

## 18 Called-up share capital continued

Number of shares under option	Subscription price per share	Exercise period
43,333	62.5p	Between 26 June 2006 and 25 June 2013 and if the market price reaches at least 100p
50,000	62.5p	Between 26 June 2006 and 25 June 2013 and if the market price reaches at least 125p
50,000	62.5p	Between 26 June 2006 and 25 June 2013 and if the market price reaches at least 150p
6,667	62.5p	Between 26 June 2006 and 25 June 2013 and if the market price reaches at least 175p
66,667	100p	Between 8 March 2007 and 7 March 2014 and if the market price reaches at least 125p
66,667	100p	Between 8 March 2007 and 7 March 2014 and if the market price reaches at least 150p
66,666	100p	Between 8 March 2007 and 7 March 2014 and if the market price reaches at least 175p
96,000	94p	Between 21 June 2008 and 20 June 2015 if the growth in the earnings per share over the three year period ending 31 December 2007 is between 15% and 20%
96,000	94p	Between 21 June 2008 and 20 June 2015 if the growth in the earnings per share over the three year period ending 31 December 2007 is between 20% and 25%
192,000	94p	Between 21 June 2008 and 20 June 2015 if the growth in the earnings per share over the three year period ending 31 December 2007 is in excess of 25%
49,638	101.5p	Between 3 April 2009 and 2 April 2016 if the growth in the earnings per share over the three year period ending 31 December 2008 is between 15% and 20%
49,638	101.5p	Between 3 April 2009 and 2 April 2016 if the growth in the earnings per share over the three year period ending 31 December 2008 is between 20% and 25%
99,276	101.5p	Between 3 April 2009 and 2 April 2016 if the growth in the earnings per share over the three year period ending 31 December 2008 is in excess of 25%
25,907	101.5p	Between 27 June 2009 and 26 June 2016 if the growth in the earnings per share over the three year period ending 31 December 2008 is between 15% and 20%
25,906	101.5p	Between 27 June 2009 and 26 June 2016 if the growth in the earnings per share over the three year period ending 31 December 2008 is between 20% and 25%
51,815	101.5p	Between 27 June 2009 and 21 June 2016 if the growth in the earnings per share over the three year period ending 31 December 2008 is in excess of 25%

## Notes to Financial Statements continued

**18 Called-up share capital continued**

Number of shares under option	Subscription price per share	Exercise period
4,717	106p	Between 2 October 2009 and 1 October 2016 if the growth in the earnings per share over the three year period ending 31 December 2008 is between 15% and 20%
4,716	106p	Between 2 October 2009 and 1 October 2016 if the growth in the earnings per share over the three year period ending 31 December 2008 is between 20% and 25%
9,434	106p	Between 2 October 2009 and 1 October 2016 if the growth in the earnings per share over the three year period ending 31 December 2008 is in excess of 25%

No options were exercised by members of the 2000 Scheme during the year. 302,178 share options at a subscription price of 101.5p were granted during the year together with 18,867 share options at a subscription price of 106p. 94,000 options lapsed unexercised during the year.

28,740 shares in K3 Business Technology Group plc are held by a subsidiary undertaking, K3 Business Technology Group Trustees Company Limited, as trustee of the group's employee share ownership plan.

**19 Reserves**

	Share premium account £000	Other reserve £000	Profit and loss account £000
<b>Group</b>			
At 1 January 2006 - as restated	7,813	6,070	(7,518)
Cancellation of share premium	(7,813)	-	7,813
Retained loss for the year	-	-	(309)
Currency translation differences on foreign currency net investments	-	-	(15)
Credit to equity for equity-settled share-based payments	-	-	85
Treasury shares acquired	-	-	(15)
Share capital issued	1,419	-	-
Expenses of equity share issue	(31)	-	-
At 31 December 2006	1,388	6,070	41

## 19 Reserves continued

	Share premium account £000	Other reserve £000	Profit and loss account £000
<b>Company</b>			
At 1 January 2006 - as restated	7,813	5,946	(7,883)
Cancellation of share premium	(7,813)	-	7,813
Retained loss for the year	-	-	(477)
Dividend from subsidiary undertaking	-	-	250
Credit to equity for equity-settled share-based payments	-	-	85
Treasury shares acquired	-	-	(15)
Share capital issued	1,419	-	-
Expenses of equity share issue	(31)	-	-
At 31 December 2006	1,388	5,946	(227)

Following the company's successful application to the High Court for the requisite confirmation of the cancellation of the share premium account in July 2006, the balance of the share premium account at that date was cancelled.

The group has adopted FRS 20, Share based payments. In accordance with the transitional provisions of FRS 20, the standard was applied retrospectively to all grants of equity instruments after 7 November 2002 that were unvested as of 1 January 2006, and to liabilities for share-based transactions existing at 1 January 2006. This has resulted in a charge for the current period of £85,000 with a corresponding credit to the profit and loss reserve and a restatement of the profit and loss account for the comparative period of an additional charge of £52,000 with a corresponding credit to the profit and loss reserve. The prior year adjustment effect for the company is £52,000. The cumulative effect on reserves and net assets up to 31 December 2004 is £nil, comprising charges of £31,000 with corresponding credits to the profit and loss reserve.

The other reserve comprises a merger relief reserve.

Of the above reserves, the directors only consider the profit and loss account to be distributable.

The treasury shares are held by a wholly-owned subsidiary, K3 Business Technology Group Trustees Company Limited, as trustee of the group's employee share ownership plan. The treasury shares represent 28,740 shares held under an employee share ownership plan which will be issued to the employees when they choose to withdraw them. The current market value of these shares as at 12 March 2007 is £34,631.

## Notes to Financial Statements continued

**20 Share-based payment**

K3 Business Technology Group plc operates two equity-settled share-based remuneration schemes for employees: an Executive Share Option Scheme for certain senior management including executive directors and an unapproved scheme for executive directors. Under both schemes there are two types of share options: those where the options vest based on the achievement of a share price target and those where the options vest on the achievement of target growth in adjusted earnings per share, i.e. adjusted for goodwill amortisation and exceptional items and with the tax charge being 30% of the operating profit so adjusted. All options are subject to the employee having completed three years service from the date of grant.

	2006		2005	
	Weighted average exercise price (pence)	Number	Weighted average exercise price (pence)	Number
Outstanding at the beginning of the year	90.40	978,000	83.93	350,000
Granted during the year	100.15	321,015	94.00	628,000
Forfeited during the year	-	-	-	-
Exercised during the year	-	-	-	-
Lapsed during the year	94.00	(94,000)	-	-
Outstanding at the end of the year	92.71	1,205,015	90.40	978,000

The exercise price of options outstanding at the end of the year ranged between 62.5p and 106p (2005: 62.5p and 100p) and their weighted average contractual life was 5.34 years (2005: 4.99 years).

Of the total number of options outstanding at the end of the year, 43,333 (2005: nil) had vested and were exercisable at the end of the year.

No options were exercised during the year.

The weighted average fair value of each option granted during the year was 30.18p (2005: 23.81p).

The following information is relevant in determination of the fair value of options granted during the year under the equity-settled share-based remuneration schemes operated by the company:

	2006	2005
Option pricing model used	Trinomial lattice	Trinomial lattice
Weighted average share price at grant date (pence)	100.15	94.00
Weighted average exercise price	92.71	90.40
Weighted average contractual life (years)	5.34	4.99
Weighted average expected volatility	39.74	38.29
Weighted average expected dividend growth	0%	0%
Weighted average risk-free interest rate	4.37%	3.88%

## 20 Share-based payment continued

The volatility of the company's shares was based on the average weekly share prices over the last three years.

Where the options vest on the achievement of a share price target, to allow for the effects of early exercise it was assumed that executive directors will exercise the options after the vesting date when the share price is 25% higher than the target share price and that other employees will exercise when the target share price is achieved.

	2006 £000	2005 £000
The share-based remuneration expense comprises:		
Equity-settled schemes	85	52

The group did not enter into any share-based payment transactions with parties other than employees during the current or previous year.

## 21 Reconciliation of movements in group shareholders' funds

	2006 £000	2005 £000
Loss for the financial year	(309)	(266)
Currency translation difference on foreign currency net investments	(15)	(1)
Issue of share capital	1,825	4,040
Credit to equity for equity-settled share-based payments	85	52
Purchase of treasury shares	(15)	(20)
Net addition to group shareholders' funds	1,571	3,805
Opening group shareholders' funds	10,800	6,995
Closing group shareholders' funds	12,371	10,800

## 22 Reconciliation of operating profit to operating cash flows

	2006 £000	2005 £000
Operating profit	763	604
Depreciation charges and fixed asset impairment	329	341
(Profit) loss on sale of tangible fixed assets	(27)	33
Amortisation of goodwill and intangibles	2,198	1,752
Equity-settled share-based payments	85	52
Write down of investments	-	17
(Increase) decrease in debtors	(2,276)	1,372
Increase in creditors	1,146	96
<b>Net cash inflow from operating activities</b>	<b>2,218</b>	<b>4,267</b>

## 23 Analysis of cash flows

	2006 £000	2005 £000
<i>Returns on investments and servicing of finance</i>		
Interest received	21	8
Interest paid	(190)	(209)
Interest element of finance lease rentals	(66)	(78)
<b>Net cash outflow</b>	<b>(235)</b>	<b>(279)</b>
<i>Taxation</i>		
Tax received (paid)	26	(80)
<b>Net cash inflow (outflow)</b>	<b>26</b>	<b>(80)</b>
<i>Capital expenditure and financial investment</i>		
Development costs capitalised	(229)	-
Purchase of tangible fixed assets	(146)	(180)
Sale of tangible fixed assets	40	74
<b>Net cash outflow</b>	<b>(335)</b>	<b>(106)</b>
<i>Acquisitions and disposals</i>		
Acquisition of subsidiary undertakings	-	(1,663)
Costs of acquisition of subsidiary undertakings	(18)	(696)
Net overdrafts acquired with subsidiary undertakings	-	(1,016)
Deferred consideration	(40)	(1,688)
Sale of business (net of costs)	-	(90)
Acquisition of investment	(1,398)	-
<b>Net cash outflow</b>	<b>(1,456)</b>	<b>(5,153)</b>
<i>Financing</i>		
Issue of ordinary share capital	1,825	1,350
Treasury shares purchased	(15)	(20)
New bank loan	-	1,000
New related party loan	-	1,000
Repayment of bank loans	(309)	-
Repayment of related party loans	(70)	(1,040)
Capital element of finance lease rental payments	(256)	(468)
<b>Net cash inflow</b>	<b>1,175</b>	<b>1,822</b>

## 24 Analysis and reconciliation of net debt

	1 January 2006	Cash flow	Other non-cash changes	31 December 2006
	£000	£000	£000	£000
Cash in hand, at bank	874	1,393	-	2,267
Debt due after one year	(1,202)	-	589	(613)
Debt due within one year	(540)	397	(589)	(732)
Finance leases	(379)	256	(104)	(227)
Cash resources (net debt)	(1,247)	2,046	(104)	695

	2006 £000	2005 £000
Increase in cash in the year	1,393	471
Cash outflow (inflow) from increase/decrease in debt and lease financing	653	(492)
Change in net debt resulting from cash flows	2,046	(21)
Finance leases acquired with subsidiaries	-	(92)
Loans converted into equity	-	521
New finance leases	(104)	(88)
Movement in net debt in year	1,942	320
Net debt at 1 January 2006	(1,247)	(1,567)
Cash resources (net debt) at 31 December 2006	695	(1,247)

## 25 Major non-cash transactions

During the year the group entered into finance lease arrangements in respect of assets with a total capital value of £104,000 (2005: £88,000). During 2005 £521,000 of debt within one year was converted into equity and £513,000 of debt due within one year was renegotiated and fell due after one year.

## 26 Financial commitments

There were no capital commitments in either the group or the company at the end of either financial year.

Annual commitments under non-cancellable operating leases are as follows:

	2006		2005	
	Land and buildings £000	Other £000	Land and Buildings £000	Other £000
<b>Group</b>				
Expiry date				
- within one year	83	34	75	19
- between two and five years	185	132	137	143
- after five years	31	-	125	-
	299	166	337	162
<b>Company</b>				
Expiry date				
- within one year	25	18	60	3
- between two and five years	185	100	41	79
- after five years	24	-	-	-
	234	118	101	82

Leases of land and buildings are typically subject to rent reviews at specified intervals and provide for the lessee to pay all insurance, maintenance and repair costs.

## 27 Pension arrangements

The group operates a defined contribution scheme and also makes contributions to personal pension schemes of certain senior employees and directors for which the total pension cost charge for the year amounted to £338,000 (2005: £197,000).

## 28 Related party transactions

At 1 January 2005 £533,000 remained outstanding to Mr PJ Claesson, a director of the company, in relation to deferred consideration and loan owed in connection with the acquisition of K3 BTG Limited and K3 Business Technology Software Limited. During 2005 further interest of £8,000 was accrued resulting in a total due of £541,000. This was satisfied by the issue of 605,820 ordinary shares of 25p each on 27 July 2005.

## 28 Related party transactions continued

On 23 June 2005 the company received a loan of £1m from Johan and Marianne Claesson AB, a company connected with Mr PJ Claesson, a director of the company. The loan was made in connection with the acquisition of Information Engineering Group Limited in June 2005. The loan was repayable in twelve equal quarterly instalments commencing on 31 March 2006 subject to earlier repayments from proceeds from a future placing or from new bank loans raised. £810,000 was repaid in October 2005 from the proceeds of the placing (see note 18) and the remaining £190,000 plus accrued interest at 8.5% per annum of £27,570 was repaid in December 2005 from the proceeds of the bank loan (see note 14). In connection with the loan, the company issued 400,000 warrants for ordinary shares of 25p. These are exercisable at the lower of £1.00 or at the price at which any shares are issued by the company by way of a rights issue or placing during the period up to 23 June 2006. The shares issued pursuant to the placing in September 2005 were at £0.90 and hence the current exercise price of the warrants is £0.90. The warrants are exercisable until 22 June 2008.

Included within other loans due to related parties is a loan of £640,000 (2005: £710,000) from CA Fastigheter AB, a company connected with Mr PJ Claesson, a director of the Company. The loan was made in connection with the acquisition of K3 Landsteinar in October 2004. The loan is repayable in twelve equal quarterly instalments commencing on 31 March 2006 subject to earlier repayments from proceeds from a future placing or from new bank loans raised. Repayments of £70,000 have been made during the year. The repayment of this loan from proceeds of a placing or bank loans is subordinate to the loan from Johan and Marianne Claesson AB. Interest is charged at 8.5% per annum and amounted to £14,000 (2005: £32,000) at the year end and is included with the loan within other loans due to related parties. In connection with the loan, the company issued 200,000 warrants for ordinary shares of 25p. These are exercisable at the lower of £1.00 or the price at which any shares are issued by the company by way of a rights issue or placing during the period up to 31 January 2006. The shares issued pursuant to the placing in September 2005 were at £0.90 and hence the current exercise price of the warrants is £0.90. The warrants are exercisable until the later of 29 June 2008 and the date upon which the loan is repaid.

In connection with the acquisition of K3 Landsteinar, Mr PJ Claesson has made available a standby-facility of £250,000 to assist the company with its working capital requirements. The facility was made available until 30 June 2006. The facility was never drawn upon, but should it have been interest would have been charged at 8.5% per annum.

On 25 September 2006, Mr DJ Bolton, a director of the company, provided a short-term loan to the company of £225,000. The loan was repaid on 26 October 2006 together with interest at 7% per annum of £1,247.

There were no other transactions with related parties during the year.

## 29 Post balance sheet events

On 9 February 2007, the group sold the Elucid Business to Sanderson Group plc, the software and IT services business, for £1,362,000 to be satisfied in cash. £1,112,000 was paid on completion and £250,000 is deferred until the end of April 2007.

On 9 March 2007, the group disposed of the majority of its stake in SiRVIS IT plc at the price at which it was acquired.

## Five Year Summary

## Profit and loss

	2006 £000	2005 As restated £000	2004 As restated £000	2003 As restated £000	2002 £000
Turnover					
- continuing operations	27,346	22,029	8,116	7,002	7,916
- discontinued operations	-	-	413	-	172
	27,346	22,029	8,529	7,002	8,088
Operating profit before amortisation of goodwill and intangibles, share option costs and exceptionals	3,046	2,408	603	1,074	975
Amortisation of goodwill and intangibles	(2,198)	(1,752)	(636)	(463)	(463)
Share option costs	(85)	(52)	(25)	(6)	-
Exceptional administrative expenses	-	-	-	(605)	-
Operating profit (loss)	763	604	(58)	-	512
(Loss) profit on disposal of operations	-	(90)	1,248	(100)	(173)
Finance charges	(262)	(287)	(55)	(105)	(73)
Profit (loss) on ordinary activities before taxation	501	227	1,135	(205)	266
Taxation	(810)	(493)	(59)	(130)	108
(Loss) profit for financial year	(309)	(266)	1,076	(335)	374

The profit and loss accounts have been restated for the costs of share options.

**Balance sheet**

	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>£000</b>	<b>As restated</b>	<b>As restated</b>	<b>As restated</b>	<b>£000</b>
		<b>£000</b>	<b>£000</b>	<b>£000</b>	
Fixed assets					
- intangible	13,877	15,844	9,919	3,354	3,817
- tangible	416	508	570	342	426
- investments	1,398	-	17	190	-
	<b>15,691</b>	<b>16,352</b>	<b>10,506</b>	<b>3,886</b>	<b>4,243</b>
Current assets	11,405	7,470	6,671	3,784	4,021
Creditors: amounts falling due within one year	(13,654)	(10,583)	(9,845)	(4,706)	(4,920)
Net current liabilities	(2,609)	(3,113)	(3,174)	(922)	(899)
Creditors: amounts falling due after more than one year	(711)	(2,439)	(377)	-	(51)
Net assets	<b>12,371</b>	<b>10,800</b>	<b>6,995</b>	<b>2,964</b>	<b>3,293</b>

**Cash flows**

	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>£000</b>	<b>As restated</b>	<b>As restated</b>	<b>As restated</b>	<b>£000</b>
		<b>£000</b>	<b>£000</b>	<b>£000</b>	
Net cash inflow from operating activities	2,218	4,267	1,244	1,365	471
Increase (decrease) in cash in the year	<b>1,393</b>	<b>471</b>	<b>(823)</b>	<b>1,103</b>	<b>186</b>

# Notice of Annual General Meeting

Notice is hereby given that the annual general meeting of the Company will be held at the offices of K3 Information Engineering, Churchgate House, 56 Oxford Street, Manchester M1 6EU on 23 May 2007 at 10.30 am at which the following business will be transacted.

## Ordinary Business

1. To receive and adopt the directors' and auditors' reports and the financial statements for the year ended 31 December 2006.
2. To appoint Mr TA Milne as a director in accordance with Article 94.
3. To re-appoint Mr NA Makeham as a director in accordance with Article 96.
4. To re-appoint BDO Stoy Hayward LLP as auditors of the Company to hold office from the conclusion of this meeting until the conclusion of the next annual general meeting at which financial statements are laid before the Company and to authorise the directors to fix their remuneration.

## Special Business

To consider and, if thought fit, pass the following resolutions, which will be proposed as ordinary resolutions:

5. That, in substitution for all existing and unexercised authorities, pursuant to section 80 of the Companies Act 1985 ("the Act"), the directors of the Company be generally and unconditionally authorised to exercise all or any powers of the Company to allot relevant securities (within the meaning of section 80(2) of the

Act) in the capital of the Company up to a maximum nominal amount of £414,000 (representing the entire authorised but unissued ordinary share capital of the Company) provided that this authority shall unless previously revoked or varied by the Company in general meeting expire five years from the date of this resolution save that the Company may before the expiry make an offer or agreement which would or might require the relevant securities to be allotted after such expiry and the directors of the company may allot relevant securities in pursuance of such an offer or agreement as if the authority conferred hereby had not expired.

6. To extend the period within which the shares granted to James McGrath, Robert Cooper and Peter Greenwood under the K3 Business Technology Group plc 2000 Executive Share Option Scheme may be exercised to 30 June 2008.

To consider and, if thought fit, pass the following resolution, which will be proposed as a special resolution:

7. That, pursuant to the resolution confirming authority under section 80 of the Companies Act 1985, the directors be and they are hereby empowered in accordance with section 95 of the Companies Act 1985 (the "Act"), to allot equity securities (as defined in section 94(2) of the Act) for cash pursuant to the authority conferred on them to allot relevant securities (as defined in section 80 of the Companies Act 1985) as if section 89(1) and subsections (1) – (6) of section 90 of the Act did not apply to any such allotment provided that this power shall be limited to:-

7.1 the allotment of equity securities in connection with or pursuant to an offer by way of rights, open offer or other pre-emptive offer to the holders of shares in the company and other persons entitled to participate therein in proportion (as nearly as practicable) to their respective holdings, subject to such exclusions or other arrangements as the directors may consider necessary or expedient to deal with fractional entitlements or legal or practical problems under the laws of any territory or the regulations or requirements of any regulatory authority or any stock exchange in any territory; and

7.2 the allotment (otherwise than pursuant to subparagraph 7.1 of this resolution) of equity securities up to an aggregate nominal amount of £540,000.

The power hereby conferred shall expire on the date of the next annual general meeting of the Company after the passing of this resolution save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the board may allot equity securities in pursuance of such an offer or agreement as if the power conferred hereby had not expired.

Registered Office	Dated 20 April 2007
Linden Business Centre	By Order of the Board
Linden Road	DJ Bolton
Colne	Secretary
Lancashire BB8 9BA	

## Notes

1. A member entitled to attend and vote at the above annual general meeting may appoint one or more proxies to attend and, on a poll, vote in his place. A proxy need not be a member of the Company.
2. Completing and returning a form of proxy shall not preclude a shareholder from attending and voting at the meeting should he wish.
3. To be valid, the form of proxy (together with the power of attorney or other authority (if any) under which it is signed or notarially certified copy of such authority) must arrive at the Proxy Processing Centre, Telford Road, Bicester OX26 4LD no later than 10.30 am on 21 May 2007. You may also deliver by hand to The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU. A form of proxy is enclosed with this notice.
4. The Company, pursuant to regulations 34 of the Uncertified Securities Regulations 1995, specifies that only those shareholders registered in the register of members of the Company as at 10.30 am on 21 May 2007 or, in the event that the annual general meeting is adjourned, in the register of members 48 hours before the time of any adjourned meeting, shall be entitled to attend and to vote at the annual general meeting in respect of the number of shares registered in their name at that time. Changes to entries on the relevant register of securities at 10.30 am on 21 May 2007, or in the event that the annual general meeting is adjourned less than 48 hours before the time of any adjourned meeting, shall be disregarded in determining the rights of any person to attend or vote at the annual general meeting.

## Notice of Annual General Meeting continued

5. On a show of hands every shareholder present in person has one vote, on a poll every shareholder has one vote for each share held by him. The necessary quorum at this meeting is two members present in person or by proxy and entitled to vote upon the business to be transacted.

6. Biographical details of Mr TA Milne and Mr NA Makeham are included on page 2 to these financial statements.

7. Resolution 5 would empower the directors to allot relevant securities for any reason up to an aggregate nominal amount of £414,000 representing the entire authorised but unissued ordinary share capital of the Company.

8. As part of the agreement for the disposal of the Elucid business on 9 February 2007, the directors agreed to extend the period within which some of the original owners of the Elucid business could exercise their existing share options to 30 June 2008. These options are held by James McGrath, Robert Cooper and Peter Greenwood.

The options are over a total of 87,000 Ordinary shares under the K3 Business Technology Group plc 2000 Executive Share Option Scheme ("the Scheme").

In accordance with the rules of the Scheme, options may only be exercised within one year of the date of cessation of employment with the Company at the directors' discretion.

Under the scheme, extending the period within which options may be exercised beyond one year following the date of cessation of employment is a material amendment to the benefit of Messrs McGrath, Cooper and Greenwood and requires approval by the ordinary

shareholders of the Company by ordinary resolution in general meeting.

Resolution 6 is proposed to give effect to the terms of the agreement made between the Company and Messrs McGrath, Cooper and Greenwood.

9. Resolution 7 would empower the directors to allot equity securities for cash other than to existing Ordinary Shareholders pro rata to their existing holdings. Such power would be limited to the situations referred to in sub-paragraphs 7.1 and 7.2 of that resolution. Sub-paragraph 7.1 refers to rights issues and similar issues, where difficulties arise in offering relevant securities to certain overseas shareholders or where fractional entitlements arise. Sub-paragraph 7.2 permits allotment for cash (other than rights issues or similar) of ordinary shares up to an aggregate nominal amount of £540,000 representing approximately 10% of the current issued ordinary share capital of the Company. The resolution is proposed so as to give the directors greater flexibility to take advantage of business opportunities as they arise. The directors have no present intention of exercising the authority.

10. The register of interests of the directors in the share capital of the Company and copies of the contracts of service of directors with the Company or with any of its subsidiary undertakings will be available for inspection at the registered office of the Company during normal business hours (Saturdays and public holidays excepted) from the date of this notice until the conclusion of the annual general meeting and at the place of the annual general meeting from at least 15 minutes prior to and until the conclusion of the annual general meeting.



