



K3 Business Technology Group plc
Linden Business Centre, Linden Road, Colne, Lancashire BB8 9BA
www.k3btg.com

Interim Report & Financial Statement 2005



K3 Business Technology Group plc

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OVERVIEW

Over the course of 2004, K3 was fundamentally transformed, with two acquisitions and the disposal of a non-core operation.

The acquisitions in 2004 extended the business into higher growth areas of retail and distribution within the supply chain software sector. Our third acquisition in June 2005, Information Engineering Group ("IEG"), complements our existing manufacturing software activities and we see significant synergies between the two businesses. As we stated in the Annual Report, all our software products are now Microsoft-based and we have in place a firm foundation for future growth.

The Group's results for the first half of the year are very encouraging and reflect full contributions from the two acquisitions made in 2004 and a partial contribution from IEG which was acquired in the second quarter of the current financial year.

Financial Results

Group turnover on continuing activities rose nearly four-fold to £9.08m from £2.38m. This reflected a full six months contribution from our acquisitions, K3 Landsteinar and K3 Elucid, as well as turnover generated by our existing manufacturing software business in Walton. Including a partial contribution of £0.26m from IEG, which we acquired in June 2005, the total turnover was £9.34m, against £2.79m last year.

Costs of £0.09m (2004: £0.24m) relating to the development of our SmartVisionCRM business application reflected the early completion of this project.

Overall, the adjusted operating profit¹ of the Group of £0.86m (2004: £0.13m) was significantly better than expectations reflecting the contribution of the acquisitions since 2004. Our new acquisition, IEG, contributed an adjusted operating profit² of £0.14m.

Profit on ordinary activities before taxation was £0.07m (2004: profit of £1.17m including profit on disposal of operations of £1.30m). Adjusted earnings per share³ were 3.9p (2004: 0.9p) and, after taking into account goodwill amortisation of £0.68m (2004: £0.26m) and exceptional items of nil (2004: £1.09m), loss per share was 1.1p (2004: earnings per share of 9.0p).

At 30 June 2005, the Group's net cash position was £1.19m overdrawn compared with cash balances of £3.05m at 30 June 2004 and £0.40 at 31 December 2004.

The Directors do not propose to pay a dividend (2004: nil).

1 Calculated before amortisation of goodwill of £0.68m (2004: £0.26m).

2 Calculated before amortisation of goodwill of £0.02m.

3 Calculated before amortisation of goodwill of £0.68m and exceptional items of £nil (2004: amortisation of goodwill of £0.26m and exceptional items of £1.09m).

OPERATIONAL REVIEW

Retail Division

The acquisition of K3 Landsteinar in October 2004 underpinned the Group's expansion into the retail sector and its operations now comprise our retail division. We are delighted with K3 Landsteinar's performance to date. Over the first half, it secured seven new contracts worth £6.7m, the most notable being agreements with Carpetright plc and Moss Pharmacy.

The Carpetright contract supported significant growth in consultancy services which grew to £2.95m in the period and contributed to total revenues of £6.30m and an adjusted operating profit⁴ of £0.61m. In the nine months of ownership K3 Landsteinar has delivered revenues of £9.23m and adjusted operating profits⁵ of £1.05m. These are well in excess of our expectations and whilst we are particularly encouraged by the strength of these results, they also reflect the earlier than expected receipt of revenues previously expected to fall in the second half of 2005.

Distribution Division

Order intake in the first half of 2005 was slower than expected. Nevertheless, the business demonstrated its ability to win larger opportunities with the award of the Scotts of Stow contract worth £0.30m at the beginning of 2005. Results during the first half were also depressed by the investment the division made in a significant upgrade to its core Warehouse Management module. Looking forward, there is an encouraging sales pipeline and therefore we believe order intake for the second half of the year should improve significantly.

First half revenues of £0.81m reflected a full six months contribution (2004: £0.46m for three months). The adjusted operating loss⁶ was £0.12m (2004: profit for three months of £0.08m).

Manufacturing Division

The acquisition of IEG in June 2005 transforms this division. Since the transaction was only completed just prior to the half year end, IEG made only a partial contribution to the division's results. During the period to 30 June 2005, IEG contributed an adjusted operating profit⁷ of £0.14m.

The Group's existing manufacturing software operation, based in Walton-on-Thames, turned in another good performance. Sales of Sigma, Omnis, JobBOSS and SmartVision together with SmartVisionCRM continued to prove attractive offerings to our customer base and first half revenues of £1.93m were marginally ahead of 2004 levels (£1.92m). Cost savings and lower central costs allocated against the business saw operating profits rise to £0.23m (2004: operating loss of £0.01m).

4 Calculated before amortisation of goodwill of £0.47m.

5 Calculated before amortisation of goodwill of £0.70m.

6 Calculated before amortisation of goodwill of £0.05m (2004: £0.02m).

7 Calculated before amortisation of goodwill of £0.02m.

Founded in 1986, IEG is one of two UK distributors of SYSPRO Enterprise Resource Planning software for the manufacturing sector. Targeting mid-range manufacturers, the software is entirely complementary to the division's existing products and offers a natural upgrade path for K3 customers. We see tremendous scope for both cost savings and cross-selling and, with the introduction of SYSPRO in June, we have already seen a boost to sales.

There is an encouraging sales pipeline for both businesses and we expect a good performance from the division in the second half.

PLACING

We also today announce that the Company is raising approximately £1.4 million gross by means of a placing of 1,555,555 new ordinary shares of 25p each ("New Ordinary Shares") with institutional investors at a price of 90p per share (the "Placing"). The Placing is being undertaken to repay shareholder loans and provide additional working capital for the Group.

The New Ordinary Shares, which represent 9.6% of the Group's issued share capital prior to the Placing, have been placed with institutional investors by Robert W. Baird Limited.

Application will be made for the New Ordinary Shares to be admitted to the Alternative Investment Market and to trading on the London Stock Exchange. The Placing is conditional on admission, which is expected to become effective on 28 September 2005. When issued, the New Ordinary Shares will rank pari passu in all respects with the existing Ordinary Shares. Following the Placing, K3 will have a total of 17,740,719 Ordinary Shares in issue.

OUTLOOK

While the retail division has seen the timing of some revenue fall into the first half rather than the second half of the year as originally anticipated, we believe growth prospects remain encouraging. Market conditions within the manufacturing sector are likely to remain challenging. However, the addition of IEG significantly strengthens our existing manufacturing software portfolio and we believe there are considerable synergies to be gained. Within our distribution software division, the sales pipeline is strong and we therefore expect the second half to show a stronger trading performance than the first half.

Overall, we continue to view the Group's prospects very positively.

George Matthews

Chairman

13 September 2005

	Notes	Unaudited six months to 30 June 2005 £000	Unaudited six months to 30 June 2004 £000	Audited year to 31 December 2004 £000
Turnover				
Continuing		9,081	2,377	8,116
Acquisitions		263	-	-
Discontinued		-	413	413
Total		9,344	2,790	8,529

Operating profit before goodwill amortisation		857	132	603
Goodwill amortisation		(679)	(255)	(636)

Continuing		59	(104)	(10)
Acquisitions		119	52	-
Discontinued		-	(71)	(23)
Operating profit (loss)	3	178	(123)	(33)

Profit on disposal of operations		-	1,303	1,248
Net interest payable and similar charges		(106)	(6)	(55)
Profit on ordinary activities before taxation		72	1,174	1,160
Tax on profit on ordinary activities		(225)	(256)	(59)
(Loss) profit for the financial period		(153)	918	1,101

(Loss) earnings per share

Basic	5	(1.1)p	9.0p	10.0p
Diluted	5	(1.1)p	9.0p	10.0p
Basic before amortisation of goodwill	5	3.9p	11.5p	15.8p
Basic before amortisation of goodwill and exceptional items	5	3.9p	0.9p	4.5p

The group has no recognised gains or losses in any of the above periods other than the (loss) profit for that period.

Consolidated Balance Sheet

AS AT 30 JUNE 2005

	Notes	Unaudited As at 30 June 2005 £000	Unaudited As at 30 June 2004 £000	Audited As at 31 December 2004 £000
Fixed assets				
Goodwill		16,394	2,919	9,919
Tangible assets		685	317	570
Investments		17	-	17
		<u>17,096</u>	<u>3,236</u>	<u>10,506</u>
Current assets				
Debtors		6,889	1,564	6,268
Cash at bank and in hand		56	3,045	403
		<u>6,945</u>	<u>4,609</u>	<u>6,671</u>
Creditors: amounts falling due within one year				
Convertible debt		(523)	-	(500)
Other creditors	6	(11,481)	(3,921)	(9,345)
		<u>(12,004)</u>	<u>(3,921)</u>	<u>(9,845)</u>
Net current (liabilities) assets		<u>(5,059)</u>	<u>688</u>	<u>(3,174)</u>
Total assets less current liabilities		12,037	3,924	7,332
Creditors: amounts falling due after more than one year				
Provisions for liabilities and charges	7	(3,045)	(12)	(337)
		<u>-</u>	<u>-</u>	<u>-</u>
Net assets		<u>8,992</u>	<u>3,912</u>	<u>6,995</u>
Capital and reserves				
Called-up share capital		3,895	2,548	3,329
Shares to be issued	8	-	30	-
Share premium account	8	6,463	6,441	6,463
Other reserve	8	6,070	2,359	4,486
Profit and loss account	8	(7,436)	(7,466)	(7,283)
Equity shareholders' funds		<u>8,992</u>	<u>3,912</u>	<u>6,995</u>

Consolidated Cash Flow Statement

FOR THE SIX MONTHS ENDED 30 JUNE 2005

	Notes	Unaudited six months to 30 June 2005 £000	Unaudited six months to 30 June 2004 £000	Audited year to 31 December 2004 £000
Net cash inflow from operating activities	9	1,980	703	1,633
Returns on investments and servicing of finance		(89)	(6)	24
Taxation		-	-	(76)
Capital expenditure and financial investment		(87)	(25)	(12)
Acquisitions and disposals		(3,217)	1,131	(2,331)
Cash (outflow) inflow before financing		<u>(1,413)</u>	<u>1,803</u>	<u>(762)</u>
Financing		(177)	16	(61)
(Decrease) increase in cash in the period		<u>(1,590)</u>	<u>1,819</u>	<u>(823)</u>

- The interim financial information has been prepared in accordance with the accounting policies adopted in the accounts for the year ended 31 December 2004.
- The financial information in this statement relating to the six months ended 30 June 2005 and the six months ended 30 June 2004 is unaudited and does not constitute full statutory accounts within the meaning of Section 240 of the Companies Act 1985. The figures for the year ended 31 December 2004 have been extracted from the statutory accounts which have been filed with the Registrar of Companies. The audit report was unqualified and did not contain any statement under section 237 (2) and (3) of the Companies Act 1985.

3. Operating profit (loss)

The operating loss for the six months ended 30 June 2005 is stated after charging £0.09m (2004: £0.24m) for development costs relating to the SmartVisionCRM project. The charge for the year ended 31 December 2004 was £0.47m.

4. Acquisition of subsidiary undertaking

On 23 June 2005 the company acquired the entire issued share capital of Information Engineering Group Limited ("IEG"). The total initial consideration was £4.46m of which £2.31m was in cash with £2.15m in shares. £1.66m of cash was paid on completion with a further £0.55m payable on 30 November 2005 and £0.10m payable on 30 November 2006. Further consideration of up to £1.6m is payable based on IEG's profits during the two years ending 31 May 2007. The fair value of the total consideration is estimated to be £5.61m.

4. Acquisition of subsidiary undertaking (continued)

The following table sets out the book values of the identifiable assets and liabilities acquired and their fair value to the group:

	Book value £000	Fair value adjustments £000	Fair value to the group £000
Fixed assets			
Tangible assets	201	-	201
Current assets			
Debtors	2,290	-	2,290
Cash	74	-	74
Total assets	2,565	-	2,565
Creditors			
Bank overdrafts	(1,064)	-	(1,064)
Trade	(371)	-	(371)
Other	(543)	-	(543)
Accruals and deferred income	(1,548)	-	(1,548)
Total liabilities	(3,526)	-	(3,526)
Net liabilities	(961)	-	(961)
Goodwill			7,138
Costs of acquisition			(564)
Consideration			5,613
Satisfied by			
Cash consideration			1,663
Shares issued			2,150
Deferred cash consideration			650
Further deferred cash consideration			1,150
			5,613

Net cash outflows in respect of the acquisition comprised:

	£000
Net bank overdrafts acquired	990

IEG earned a profit after taxation of £92,000 in the one month ended 30 June 2005.

5. (Loss) earnings per share

The calculations of (loss) earnings per share are based on the following (losses) earnings and numbers of shares:

	Unaudited six months to 30 June 2005		Unaudited six months to 30 June 2004		Audited year to 31 December 2004		
	Earnings (losses)	Per share amount	Earnings (losses)	Per share amount	Earnings (losses)	Per share amount	Per share amount
	£000	p	£000	p	£000	p	p
(Loss) earnings per share (eps)	(153)	(1.1)	918	9.0	1,101	10.0	10.0
Effect of goodwill amortisation	679	5.0	255	2.5	636	5.8	5.8
Eps before amortisation of goodwill	526	3.9	1,173	11.5	1,737	15.8	15.8
Exceptional items (net of tax)	-	-	¹ (1,085)	(10.6)	¹ (1,248)	(11.3)	(11.4)
Eps before amortisation of goodwill and exceptional items	526	3.9	88	0.9	489	4.5	4.4

	Unaudited six months to 30 June 2005	Unaudited six months to 30 June 2004	Audited year to 31 December 2004
	Number of shares	Number of shares	Number of shares
Weighted average number of shares:			
For basic earnings per share	13,416,215	10,192,428	10,980,489
Exercise of share options	27,196	-	40,264
For diluted earnings per share	13,443,411	10,192,428	11,020,753

- 1 Exceptional item in six months to 30 June 2004 and in year to 31 December 2004 relates to profit on disposal of the manufacturing software operation based in Crewe of £1.25m on which there was no tax charge due to the availability of capital losses (at 30 June 2004 the profit on disposal was estimated at £1.30m less tax of £0.22m).

6. Creditors: amounts falling due within one year

	Unaudited as at 30 June 2005 £000	Unaudited as at 30 June 2004 £000	Audited as at 31 December 2004 £000
Convertible debt			
6% convertible loan notes	523	-	500
Other creditors			
Bank loans and overdrafts	1,243	-	-
Obligations under finance leases and hire purchase contracts	312	55	330
Other loans	550	-	-
Other loans due to related parties	827	537	1,303
Trade creditors	1,849	257	1,071
Corporation tax	204	339	-
Taxation and social security	1,188	302	1,032
Other creditors	185	531	799
Accruals and deferred income	5,123	1,900	4,810
	11,481	3,921	9,345

7. Creditors: amounts falling due after more than one year

	Unaudited as at 30 June 2005 £000	Unaudited as at 30 June 2004 £000	Audited as at 31 December 2004 £000
Obligations under finance leases and hire purchase contracts	187	12	337
Other loans	100	-	-
Other loans due to related parties	1,458	-	-
Accruals and deferred income	1,300	-	-
	3,045	12	337

8. Reserves

	Share premium account £000	Other reserve £000	Profit and loss account £000
At 1 January 2005	6,463	4,486	(7,283)
Shares issued in relation to acquisition of Information Engineering Group Limited	-	1,584	-
Retained loss for the period	-	-	(153)
At 30 June 2005	6,463	6,070	(7,436)

9. Cash flow statement

Reconciliation of operating profit (loss) to operating cash flows

	Unaudited six months to 30 June 2005 £000	Unaudited six months to 30 June 2004 £000	Audited year to 31 December 2004 £000
Operating profit (loss)	178	(123)	(33)
Depreciation and fixed asset impairment	146	79	215
Loss on sale of tangible fixed assets	27	-	24
Amortisation of goodwill	679	255	636
Decrease (increase) in debtors	1,533	1,247	(445)
(Decrease) increase in creditors	(583)	(755)	1,236
	1,980	703	1,633

10. The above information is being sent to the shareholders and is available from the Company's registered office: Linden Business Centre, Linden Road, Colne, Lancashire, BB8 9BA.