

2 December 2008

K3 Business Technology Group

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/06	27.3	2.7	10.4	0.00	7.9	N/A
12/07	34.1	4.7	16.3	0.50	4.4	0.7
12/08e	39.0	6.5	19.2	0.75	3.7	1.0
12/09e	40.4	7.4	21.4	1.00	3.3	1.4

*PBT and EPS (fully diluted) are normalised, excluding goodwill amortisation, exceptional items and FRS20.

Investment summary: Macro matters

K3 is continuing to win new business and in the long term we believe the company has an attractive business model and considerable upside from the current low valuation. However, it is clear that the macro environment and particularly the retail backdrop has deteriorated further over the last quarter and consequently we have reduced our current year profit estimates by c 10%.

Unhelpful trends

Probably the stand-out factor, from the recent Software and IT Services reporting season, is that unless there is a business critical driver – eg legal, regulatory, compliance – the trading environment is becoming much tougher. For K3 we believe demand from the manufacturing sector has slowed (although the business has high recurring maintenance revenues), while the retail sector has been forced to pull-forward price discounts and is clearly not focused in the short-term on new IT expenditure. Therefore, we feel it is prudent to reduce our forecasts for both this year and next.

Forecasts and outlook

We have reduced our turnover estimates for both FY08 and FY09 by approximately 5%. Given the operational leverage impact of slowing high-margin software sales, this translates into a reduction of approximately 10% in our PBT forecasts for both this year and next. An encouraging order pipeline means we expect positive progress in FY09 but clearly visibility is likely to have reduced.

Valuation

Despite the inevitably tougher backdrop, K3 still possesses a unique sector and technology focus and an impressive management record for driving growth. On c 4x earnings the shares are fundamentally cheap given the track-record of EPS growth averaging almost 20%. K3 is still forecast to generate £3m+ of net cash flow in each of the next two years, which underpins a DCF base case of 130p+.

Price 71.5p
Market Cap £17m

Share price graph



Share details

Code KBT
Listing AIM
Sector Software & Computer Services
Shares in issue 23.7m

Price

52 week High 169.5p Low 71.5p

Balance Sheet as at 30 June 2008

Debt/Equity (%) 65.0
NAV per share (p) 104.5
Net borrowings (£m) 16.0

Business

K3 provides Microsoft-based supply chain management solutions to SMEs in the retail and manufacturing sectors.

Valuation

	2007	2008e	2009e
P/E relative	31%	48%	42%
P/CF	2.5	2.5	2.4
EV/Sales	0.8	0.7	0.6
ROE	11%	14%	14%

Geography based on revenues

UK	Europe	US	Other
74%	14%	11%	1%

Analysts

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Exhibit 1: Financials

Year end 31 December	£'000s	2006 IAS	2007 IAS	2008e IAS	2009e IAS
PROFIT & LOSS					
Revenue		27,350	34,150	38,960	40,433
Cost of Sales		(10,641)	(11,415)	(12,466)	(11,725)
Gross Profit		16,709	22,735	26,494	28,707
EBITDA		3,247	6,068	8,320	8,789
Operating Profit (before GW and except.)		2,918	5,760	7,820	8,270
Goodwill Amortisation		0	(896)	(2,000)	(2,000)
IFRS 2 charges		(85)	(152)	(152)	(152)
Other		0	0	0	0
Operating Profit		2,833	4,712	5,668	6,118
Net Interest		(262)	(1,036)	(1,350)	(900)
Profit Before Tax (norm)		2,656	4,724	6,470	7,370
Profit Before Tax (FRS 3)		2,571	3,676	4,318	5,218
Tax		(846)	(761)	(1,682)	(1,990)
Profit After Tax (norm)		1,810	3,963	4,787	5,380
Profit After Tax (FRS 3)		1,725	2,915	2,635	3,228
BALANCE SHEET					
Fixed Assets		17,962	45,547	43,431	41,312
Intangible Assets		273	12,282	10,282	8,282
Tangible Assets		416	1,305	1,155	1,036
Goodwill		15,684	31,494	31,494	31,494
Other		1,589	466	500	500
Current Assets		10,889	14,069	15,671	17,943
Stocks		0	0	0	0
Debtors		8,622	10,984	13,060	14,600
Cash		2,267	3,085	2,611	3,343
Current Liabilities		(5,246)	(10,732)	(11,302)	(11,946)
Creditors		(4,385)	(6,689)	(8,002)	(8,646)
Short term borrowings		(861)	(4,043)	(3,300)	(3,300)
Long Term Liabilities		(711)	(16,509)	(13,212)	(9,552)
Long term borrowings		(711)	(12,437)	(9,700)	(6,600)
Other long term liabilities		0	(4,072)	(3,512)	(2,952)
Net Assets		22,894	32,375	34,588	37,757
CASH FLOW					
Operating Cash Flow		2,208	6,228	6,845	7,180
Net Interest		(256)	(1,243)	(1,350)	(900)
Tax		21	(2,074)	(2,023)	(1,874)
Capex		(375)	(643)	(350)	(400)
Acquisitions/disposals		(1,395)	(16,493)	0	0
Financing		1,825	263	0	0
Dividends		0	0	(116)	(174)
Net Cash Flow		2,028	(13,962)	3,006	3,832
Opening net debt/(cash)		1,247	(695)	13,395	10,389
HP finance leases initiated		0	0	0	0
Other		(86)	(128)	0	0
Closing net debt/(cash)		(695)	13,395	10,389	6,557

Source: Company accounts/Edison Investment Research

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