

1 July 2009

K3 Business Technology Group

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/07	34.1	4.7	16.3	0.5	4.8	0.6
12/08	37.6	5.9	17.9	0.5	4.3	0.6
12/09e	37.2	6.0	18.0	0.5	4.3	0.6
12/10e	38.1	6.5	19.3	0.6	4.0	0.8

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

Investment summary: Wins outpace revenues

While some order slippage was perhaps inevitable – and we have adjusted numbers accordingly – K3 has continued to benefit from new order wins during H1. Combined with strong levels of recurring income, this highlights the resilience of the business model. Cash flow remains robust and forecast year end net debt in FY09 is expected to come in below £9m (£13m FY08).

H1: Some slippage, but new business still growing

Despite a slower start to the year than FY08, K3 has secured 18 new business wins (H108 17). However, the trading environment remains challenging and the retail software segment in particular continues to witness some order slippage. Meanwhile, manufacturing software continues to perform well with high levels of recurring income. Interim results due in September will point to the usual H2 seasonal bias mainly due to the receipt of SYSPRO licence revenues in October.

Forecasts: Service revenues lag new business wins

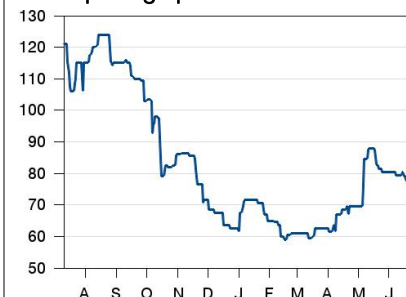
Q109 service income was low as the flurry of new orders received late in 2008 did not translate into implementation projects until Q2, although service billings are anticipated to remain strong for H2. However, due to the Q1 service income slippage, and our view of the overall economic environment for H2, we have trimmed our FY09 forecast such that we now expect operating profits of £7m compared with £7.6m previously as well as reducing our growth expectations for FY10.

Valuation: 100p+ a starting point

K3's share price has staged a significant recovery since the annual results but the valuation still remains attractive on a number of levels. The DCF value of 120p represents a significant premium to the current share price and a P/E below 5x significantly undervalues the business. In addition, the strong cash generation and growing recurring revenues add weight to the investment case.

Price 77.5p
Market Cap £18m

Share price graph



Share details

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

Price

52 week High 126.5p Low 59.0p

Balance Sheet as at 31 December 2008

Debt/Equity (%) N/A
NAV per share (p) 139.5
Net borrowings (£m) 13.4

Business

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

Valuation

	2008	2009e	2010e
P/E relative	31%	27%	29%
P/CF	2.2	1.8	2.2
EV/Sales	0.7	0.7	0.5
ROE	12%	11%	12%

Geography based on revenues

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

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Exhibit 1: Financials

Year end 31 December	£'000s	2006 IAS	2007 IAS	2008 IAS	2009e IAS	2010e IAS
PROFIT & LOSS						
Revenue		27,350	34,146	37,619	37,195	38,149
Cost of Sales		(10,641)	(11,415)	(11,278)	(10,786)	(11,063)
Gross Profit		16,709	22,731	26,341	26,408	27,086
EBITDA		3,247	6,068	7,663	7,328	7,555
Operating Profit (before GW and except.)		2,918	5,760	7,348	7,016	7,236
Goodwill Amortisation		0	(896)	(1,875)	(1,875)	(1,875)
IFRS 2 charges		(85)	(152)	(103)	(103)	(103)
Other		0	0	(12)	0	0
Operating Profit		2,833	4,712	5,358	5,038	5,258
Net Interest		(262)	(1,036)	(1,416)	(1,000)	(750)
Profit Before Tax (norm)		2,656	4,724	5,920	6,016	6,486
Profit Before Tax (FRS 3)		2,571	3,676	3,942	4,038	4,508
Tax		(846)	(761)	(1,137)	(1,685)	(1,816)
Profit After Tax (norm)		1,810	3,963	4,783	4,332	4,670
Profit After Tax (FRS 3)		1,725	2,915	2,805	2,354	2,692
Average Number of Shares Outstanding (m)		18.1	21.7	23.7	23.7	23.8
EPS - normalised (p)		10.5	16.8	18.2	18.3	19.6
EPS - normalised fully diluted (p)		10.4	16.3	17.9	18.0	19.3
EPS - FRS 3 (p)		9.5	13.4	11.8	9.9	11.3
Dividend per share (p)		0.0	0.5	0.5	0.5	0.6
Gross Margin (%)		61.1	66.6	70.0	71.0	71.0
EBITDA Margin (%)		11.9	17.8	20.4	19.7	19.8
Operating Margin (before GW and except.) (%)		10.7	16.9	19.5	18.9	19.0
BALANCE SHEET						
Fixed Assets		17,962	45,547	47,099	45,847	44,502
Intangible Assets		273	12,282	12,075	10,200	8,325
Tangible Assets		416	1,305	1,333	1,922	2,452
Goodwill		15,684	31,494	33,225	33,225	33,225
Other		1,589	466	466	500	500
Current Assets		10,889	14,069	13,518	11,509	11,069
Stocks		0	0	0	0	0
Debtors		8,622	10,984	10,690	9,569	9,815
Cash		2,267	3,085	2,828	1,939	1,254
Current Liabilities		(5,246)	(10,732)	(10,960)	(10,054)	(10,197)
Creditors		(4,385)	(6,689)	(5,466)	(5,554)	(5,697)
Short term borrowings		(861)	(4,043)	(5,494)	(4,500)	(4,500)
Long Term Liabilities		(711)	(16,509)	(13,714)	(9,089)	(4,964)
Long term borrowings		(711)	(12,437)	(10,346)	(6,246)	(2,646)
Other long term liabilities		0	(4,072)	(3,368)	(2,843)	(2,318)
Net Assets		22,894	32,375	35,943	38,212	40,410
CASH FLOW						
Operating Cash Flow		2,208	6,228	6,375	7,409	6,449
Net Interest		(256)	(1,243)	(1,323)	(1,000)	(750)
Tax		21	(2,074)	(1,614)	(1,685)	(1,816)
Capex		(375)	(643)	(1,334)	(900)	(850)
Acquisitions/disposals		(1,395)	(16,493)	(259)	0	0
Financing		1,825	263	24	0	0
Dividends		0	0	(119)	(119)	(119)
Operating Cash Flow		2,028	(13,962)	1,750	3,705	2,915
Opening net debt/(cash)		1,247	(695)	13,395	13,012	8,807
HP finance leases initiated		0	0	0	0	0
Other		(86)	(128)	(1,367)	500	0
Closing net debt/(cash)		(695)	13,395	13,012	8,807	5,892

Source: Company accounts/Edison Investment Research

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