

## Retail contracts deferred

The depressed retail environment in the UK and the Netherlands has made it tough for K3 to close the retail deals required to meet FY13 forecasts. The company notes that its other business lines are performing well. K3 continues to invest in its AX for Retail solution, which should generate returns in the longer term, but based on the short-term outlook, we have reduced our revenue and EPS forecasts for FY13 and FY14. On our revised numbers, the stock trades at a large discount to the sector.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
06/11	52.8	8.7	27.0	0.75	4.1	0.7
06/12	68.0	10.1	29.7	1.00	3.7	0.9
06/13e	69.1	7.1	19.2	1.05	5.7	1.0
06/14e	74.0	9.7	26.7	1.10	4.1	1.0

\*PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

### Weak retail environment affects trading

K3 recently noted (5 December AGM) that it needed to sign several key retail deals to meet expectations for FY13. Recent high-profile retail administrations highlight how tough the environment is, and since the AGM, these deals have been deferred. With Microsoft-based solutions, the best pricing is usually available at the end of December or June, making it likely that the earliest the deferred deals would be signed could be close to the end of FY13. While this may still enable some licence revenues to be recognised in H2, related services revenues would not be generated until FY14. Conversely, the other areas of K3's business are performing well, and the company continues to invest in building out its Microsoft Dynamics AX for Retail solution, for which there is a growing pipeline of interest.

### Retail revenues and profitability revised down

To reflect the deferred deals, we have revised down our revenue forecasts for the Microsoft UK and International divisions, cutting group revenue by £5.8m/7.7% in FY13 and £3.3m/4.2% in FY14. Assuming that operating expenses in both divisions are unchanged, this reduces normalised EBIT by £3.7m in FY13 and £2.8m in FY14, and normalised EPS falls from 30.4p to 19.2p in FY13 and 35.1p to 26.7p in FY14. Lower profitability results in a slower pay down of debt than previously forecast; we forecast net debt will reduce year-on-year by £2.6m in FY13 to £13.1m (previous forecast £10.9m). The majority of debt is term debt that is due in December 2013; we would expect the company to refinance before then.

### Valuation: Large discount to the sector

Since the beginning of the year, the share price has drifted down from 145p to 132p, and after Friday's announcement, fell a further 17%. On our revised forecasts, the company is trading on very depressed multiples of 5.7x FY13e EPS and 4.1x FY14e EPS. Key triggers for share price appreciation would be the signing of the delayed retail deals, evidence that debt is being repaid, conversions of the AX for retail pipeline and customer wins in Managed Services.

## Technology

21 January 2013

Price 110p

Market cap £31m

Shares in issue 28.6m

Free float 49.2%

Code KBT

Net debt at end FY12 £15.7m

Primary exchange AIM

Other exchanges N/A

### Share price performance



% 1m 3m 12m

Abs (23.0) (30.6) (32.6)

Rel (local) (26.9) (33.6) (38.7)

52-week high/low 207.5p 110.0p

### Business description

K3 provides Microsoft- and Sage-based ERP solutions and managed services to SMEs in the retail, distribution and manufacturing sectors.

### Next events

Preliminary results March 2013

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## Exhibit 1: Financial summary

	£'000s	2010*	2011	2012	2013e	2014e
Year end 30 June		IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>						
Revenue		59,783	52,800	67,961	69,090	73,994
Cost of Sales		(22,460)	(23,486)	(28,491)	(29,018)	(31,077)
Gross Profit		37,323	29,314	39,470	40,072	42,916
EBITDA		10,327	10,574	12,942	9,669	12,100
Operating Profit (before am of acq. Intang. and except.)		9,013	9,633	11,405	8,049	10,360
Amortisation of acquired intangibles		(2,892)	(2,826)	(3,586)	(3,800)	(3,800)
Share-based payments		39	(52)	(72)	(70)	(70)
Other		0	(942)	(395)	0	0
Operating Profit		6,160	5,813	7,352	4,179	6,490
Net Interest		(1,365)	(905)	(1,309)	(900)	(650)
Profit Before Tax (norm)		7,620	8,728	10,096	7,149	9,710
Profit Before Tax (FRS 3)		4,767	4,908	6,043	3,279	5,840
Tax		(1,018)	(428)	(319)	(858)	(1,262)
Profit After Tax (norm)		5,770	7,108	8,591	5,591	7,748
Profit After Tax (FRS 3)		3,749	4,480	5,724	2,421	4,578
Average Number of Shares Outstanding (m)		24.6	25.7	28.2	28.4	28.4
EPS - normalised (p)		23.5	27.7	30.4	19.7	27.3
EPS - normalised fully diluted (p)		23.4	27.0	29.7	19.2	26.7
EPS - FRS 3 (p)		15.2	17.5	20.3	8.5	16.1
Dividend per share (p)		0.75	0.75	1.00	1.05	1.10
Gross Margin (%)		62.4	55.5	58.1	58.0	58.0
EBITDA Margin (%)		17.3	20.0	19.0	14.0	16.4
Operating Margin (before GW and except.) (%)		15.1	18.2	16.8	11.7	14.0
<b>BALANCE SHEET</b>						
Fixed Assets		48,602	59,457	68,325	66,305	63,565
Intangible Assets		13,176	17,635	21,255	18,755	15,655
Tangible Assets		1,393	1,993	2,722	3,202	3,562
Goodwill		33,467	39,082	43,540	43,540	43,540
Other		566	747	808	808	808
Current Assets		14,808	23,456	32,418	30,945	33,784
Stocks		0	0	0	0	0
Debtors		14,439	22,642	30,322	30,286	33,247
Cash		369	814	2,096	659	537
Current Liabilities		(19,510)	(29,300)	(48,043)	(43,343)	(39,793)
Creditors		(5,491)	(7,874)	(8,797)	(9,447)	(9,447)
Other Creditors		(9,719)	(16,628)	(21,468)	(20,118)	(19,568)
Short term borrowings		(4,300)	(4,798)	(17,778)	(13,778)	(10,778)
Long Term Liabilities		(12,457)	(16,371)	(5,797)	(5,697)	(5,597)
Long term borrowings		(7,051)	(11,502)	0	0	0
Other long term liabilities		(5,406)	(4,869)	(5,797)	(5,697)	(5,597)
Net Assets		31,443	37,242	46,903	48,210	51,959
<b>CASH FLOW</b>						
Operating Cash Flow		7,331	5,640	7,284	10,355	9,140
Net Interest		(1,303)	(947)	(839)	(900)	(650)
Tax		(1,637)	(1,368)	(1,312)	(1,858)	(1,962)
Capex		(1,638)	(2,055)	(3,160)	(3,400)	(2,800)
Acquisitions/disposals		(2,856)	(5,407)	(7,132)	(1,350)	(650)
Financing		1,434	174	5,026	0	0
Dividends		(247)	(64)	(214)	(285)	(299)
Net Cash Flow		1,084	(4,027)	(347)	2,563	2,878
Opening net debt/(cash)		13,012	10,982	15,486	15,682	13,119
HP finance leases initiated		0	0	0	0	0
Other		946	(477)	151	0	0
Closing net debt/(cash)		10,982	15,486	15,682	13,119	10,241

Source: K3 Business Technology Group, Edison Investment Research. Note: \*18-month period ended 30 June 2010.

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