

23 December 2010

K3 Business Technology Group

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/08	37.6	5.9	17.9	0.50	10.5	0.3
06/10**	59.8	7.6	23.4	0.75	8.0	0.4
06/11e	55.0	8.2	23.7	0.60	7.9	0.3
06/12e	61.0	9.4	27.2	0.60	6.9	0.3

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, share based payments and exceptional items. ** 18 months ended 30 June 2010.

Investment summary: Sage 200 acquisition

K3's purchase of FD Systems' Sage 200 business builds on the Sage business acquired in the recent Panacea deal. As well as enhancing K3's Sage expertise, the deal offers potential for cross-selling of hosting and managed services to the acquired customer base. We estimate that the deal will be earnings enhancing (+2% FY11, +4% FY12) and will drive growth in recurring revenues.

K3 adds Sage customer base

K3 has acquired the Sage 200 business of FD Systems. The business is based in Camberley, close to the recent Hook-based Panacea acquisition, and adds c 330 Sage 200 customers to K3's existing base of over 1,700 customers. The business generates annual revenues of c £2.35m (c 40% is recurring) and underlying operating profit of c £0.5m. As well as adding Sage 200 expertise, we see potential for K3 to sell its application hosting services to the acquired customer base.

Terms of the deal: All cash

K3 is paying £1.25m in cash (£0.95m upfront and £0.3m on 28 February 2011) and will draw down funds from the £7.5m revolving credit facility. K3 is paying 0.5x trailing sales and 2.5x trailing operating profit, which compares favourably to K3's trailing EV/sales multiple of 1.4x and trailing EV/operating profit multiple of 8.2x.

Changes to estimates: Earnings enhancing

Revising our forecasts to include the Sage 200 business, revenues increase by 2.2% for FY11 and 3.7% for FY12. We estimate that the deal will be earnings enhancing, driving increases of 2.3% and 4.2% respectively to FY11 and FY12 normalised EPS. We estimate the deal will increase K3's net debt position from £11.5m to £12.8m at the end of FY11 and £8.0m to £9.0m at the end of FY12.

Valuation: Undervalued on revised forecasts

On revised estimates, K3 is trading on 7.9x FY11 and 6.9x FY12 normalised EPS, towards the low end of its peer group. We believe that K3 can continue to re-rate if it can successfully integrate recent acquisitions and cross-sell hosting services to the newly acquired customer bases.

Price 188p
Market Cap £48m

Share price graph



Share details

Code KBT
Listing AIM
Sector Software & Computer Services
Shares in issue 25.6m

Price

52 week High 196.5p Low 82.0p

Balance Sheet as at 30 June 2010

Debt/Equity (%) 35
NAV per share (p) 122.9
Net debt (£m) 11.0

Business

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

Valuation

	2010	2011e	2012e
P/E relative	76%	67%	68%
P/CF	6.3	6.6	5.3
EV/Sales	1.0	1.1	0.9
ROE	18%	16%	17%

Geography based on revenues (2010)

UK	Europe	US	Other
76%	18%	4%	2%

Analysts

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Exhibit 1: Financials

Note: *FY10 covers the 18 month period ended 30 June 2010.

	£'000s	2006	2007	2008	2010*	2011e	2012e
		IAS	IAS	IAS	IAS	IAS	IAS
Year end 31 December/ 30 June							
PROFIT & LOSS							
Revenue		27,350	34,146	37,626	59,783	55,003	61,048
Cost of Sales		(10,641)	(11,415)	(11,285)	(22,460)	(15,951)	(17,704)
Gross Profit		16,709	22,731	26,341	37,323	39,052	43,344
EBITDA		3,365	6,250	7,937	10,327	9,732	10,797
Operating Profit (before am of acq. Intang. and except.)		2,918	5,760	7,354	9,013	9,103	10,167
Amortisation of acquired intangibles		0	(896)	(1,875)	(2,892)	(2,360)	(2,450)
Share-based payments		(85)	(152)	(103)	39	(100)	(100)
Other		0	0	(12)	(28)	0	0
Operating Profit		2,833	4,712	5,364	6,132	6,643	7,617
Net Interest		(262)	(1,036)	(1,416)	(1,365)	(888)	(800)
Profit Before Tax (norm)		2,656	4,724	5,926	7,620	8,214	9,367
Profit Before Tax (FRS 3)		2,571	3,676	3,948	4,767	5,754	6,817
Tax		(846)	(761)	(1,137)	(1,018)	(1,561)	(1,827)
Profit After Tax (norm)		1,890	3,650	4,310	5,770	6,094	6,980
Profit After Tax (FRS 3)		1,725	2,915	2,811	3,749	4,194	4,990
Average Number of Shares Outstanding (m)		18.1	21.7	23.7	24.6	25.6	25.6
EPS - normalised (p)		10.5	16.8	18.2	23.5	23.8	27.2
EPS - normalised fully diluted (p)		10.4	16.3	17.9	23.4	23.7	27.2
EPS - FRS 3 (p)		9.5	13.4	11.9	15.2	16.4	19.5
Dividend per share (p)		0.0	0.5	0.5	0.8	0.6	0.6
Gross Margin (%)		61.1	66.6	70.0	62.4	71.0	71.0
EBITDA Margin (%)		12.3	18.3	21.1	17.3	17.7	17.7
Operating Margin (before GW and except.) (%)		10.7	16.9	19.5	15.1	16.5	16.7
BALANCE SHEET							
Fixed Assets		17,962	45,547	47,099	48,478	53,464	51,884
Intangible Assets		273	12,282	12,075	12,565	11,006	9,356
Tangible Assets		416	1,305	1,333	1,393	1,763	1,833
Goodwill		15,684	31,494	33,225	33,954	40,129	40,129
Other		1,589	466	466	566	566	566
Current Assets		10,889	14,069	13,518	14,808	18,530	21,326
Stocks		0	0	0	0	0	0
Debtors		8,622	10,984	10,690	14,439	17,782	19,569
Cash		2,267	3,085	2,828	369	748	1,757
Current Liabilities		(13,712)	(19,386)	(19,035)	(20,072)	(20,972)	(21,022)
Creditors		(4,385)	(6,689)	(5,466)	(5,690)	(6,590)	(7,140)
Other Creditors		(8,466)	(8,654)	(8,075)	(10,082)	(10,082)	(9,582)
Short term borrowings		(861)	(4,043)	(5,494)	(4,300)	(4,300)	(4,300)
Long Term Liabilities		(711)	(16,509)	(13,714)	(11,724)	(13,429)	(10,351)
Long term borrowings		(711)	(12,437)	(10,346)	(7,051)	(9,256)	(6,486)
Other long term liabilities		0	(4,072)	(3,368)	(4,673)	(4,173)	(3,865)
Net Assets		14,428	23,721	27,868	31,490	37,593	41,837
CASH FLOW							
Operating Cash Flow		2,208	6,228	6,375	7,331	7,289	9,060
Net Interest		(256)	(1,243)	(1,323)	(1,303)	(888)	(800)
Tax		21	(2,074)	(1,614)	(1,637)	(2,061)	(2,327)
Capex		(375)	(643)	(1,334)	(1,638)	(1,500)	(1,500)
Acquisitions/disposals		(1,395)	(16,493)	(259)	(2,856)	(4,525)	(500)
Financing		1,825	263	24	1,434	0	0
Dividends		0	0	(119)	(247)	(141)	(154)
Net Cash Flow		2,028	(13,962)	1,750	1,084	(1,826)	3,779
Opening net debt/(cash)		1,247	(695)	13,395	13,012	10,982	12,808
HP finance leases initiated		0	0	0	0	0	0
Other		(86)	(128)	(1,367)	970	0	0
Closing net debt/(cash)		(695)	13,395	13,012	10,958	12,808	9,029

Source: Edison Investment Research, K3 Business Technology accounts

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