

28 March 2011

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	8.1	0.4
06/11e	53.0	8.3	23.7	0.60	8.0	0.3
06/12e	61.8	9.8	27.4	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: UK Retail acquisition

K3 has acquired a Microsoft Dynamics NAV provider specialising in Retail and Distribution for cash consideration of £0.8m. We estimate the deal will boost UK Retail revenues by 12% in FY12 and should be earnings accretive. The deal also gives access to 70 customers to whom K3 could sell its Managed Services.

K3 bolsters UK Retail business

K3 has acquired Clarita, a UK-based provider of Microsoft Dynamics NAV solutions to the Retail and Distribution markets. Clarita has c 70 customers with around one-third recurring revenues. Clarita is also a distributor of K3's Pebblestone fashion distribution software.

Terms of the deal

K3 is paying £0.82m in cash and assuming £0.23m in financial obligations. In CY10, Clarita generated revenues of £3.1m and underlying profit of £0.25m (8.1% margin), implying an EV/Sales multiple of 0.36x trailing revenues and EV/EBITA multiple of 4.2x trailing EBITA, reasonable compared with K3's multiples of 1.3x and 7.3x respectively.

Changes to forecasts

We raise our revenue forecasts by 1.1% in FY11 and 4.2% in FY12 and EPS forecasts by 1.2% in FY11 and 2.7% in FY12. K3 will use the remaining revolving credit facility to fund the deal, resulting in a forecast net debt position of £14.2m at end FY11 (up from £13.4m) falling to £9.6m by end FY12 (up from £8.9m).

Valuation: Undemanding, despite recent rise

At 8.0x FY11 and 6.9x FY12 EPS, K3 trades at a discount to both the UK software and IT services sectors. We believe that as K3 integrates recent acquisitions and starts to generate cost and revenue synergies (in particular selling Managed Services to the existing customer base), the stock could trade up to nearer 10x EPS. Our discounted cashflow analysis values the stock at 236p (25% upside).

Price 188.5p
Market Cap £49m

Share price graph

Share details

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

Price

52 week High Low
196.5p 111.5p

Balance Sheet as at 31 December 2010

Debt/Equity (%) 33
NAV per share (p) 138
Net borrowings (£m) 11.4

Business

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

Valuation

	2010	2011e	2012e
P/E relative			
P/CF			
EV/Sales			
ROE			

Geography based on revenues (2010)

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

Analysts

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Exhibit 1: Financials

Note: 2010 is the 18 month period ended 30 June 2010

	£'000s	2006	2007	2008	2010*	2011e	2012e
		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
Year end 31 December/ 30 June							
PROFIT & LOSS							
Revenue		27,350	34,146	37,626	59,783	53,017	61,782
Cost of Sales		(10,641)	(11,415)	(11,285)	(22,460)	(15,375)	(17,917)
Gross Profit		16,709	22,731	26,341	37,323	37,642	43,865
EBITDA		3,365	6,250	7,937	10,327	10,485	11,768
Operating Profit (before am of acq. Intang. and except.)		2,918	5,760	7,354	9,013	9,249	10,648
Amortisation of acquired intangibles		0	(896)	(1,875)	(2,892)	(2,434)	(2,550)
Share-based payments		(85)	(152)	(103)	39	(40)	(40)
Other		0	0	(12)	(28)	0	0
Operating Profit		2,833	4,712	5,364	6,132	6,775	8,058
Net Interest		(262)	(1,036)	(1,416)	(1,365)	(907)	(864)
Profit Before Tax (norm)		2,656	4,724	5,926	7,620	8,342	9,784
Profit Before Tax (FRS 3)		2,571	3,676	3,948	4,767	5,868	7,194
Tax		(846)	(761)	(1,137)	(1,018)	(1,418)	(1,859)
Profit After Tax (norm)		1,890	3,650	4,310	5,770	6,124	7,075
Profit After Tax (FRS 3)		1,725	2,915	2,811	3,749	4,450	5,335
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	23.9	27.6
EPS - normalised fully diluted (p)		10.4	16.3	17.9	23.4	23.7	27.4
EPS - FRS 3 (p)		9.5	13.4	11.9	15.2	17.4	20.8
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	19.8	19.0
Operating Margin (before GW and except.) (%)		10.7	16.9	19.5	15.1	17.4	17.2
BALANCE SHEET							
Fixed Assets		17,962	45,547	47,099	48,478	53,421	51,251
Intangible Assets		273	12,282	12,075	12,565	12,517	10,317
Tangible Assets		416	1,305	1,333	1,393	1,929	1,959
Goodwill		15,684	31,494	33,225	33,954	38,292	38,292
Other		1,589	466	466	566	683	683
Current Assets		10,889	14,069	13,518	14,808	18,836	23,433
Stocks		0	0	0	0	0	0
Debtors		8,622	10,984	10,690	14,439	18,883	21,666
Cash		2,267	3,085	2,828	369	(47)	1,767
Current Liabilities		(13,712)	(19,386)	(19,035)	(20,072)	(20,355)	(20,506)
Creditors		(4,385)	(6,689)	(5,466)	(5,690)	(6,390)	(7,274)
Other Creditors		(8,466)	(8,654)	(8,075)	(10,082)	(9,965)	(9,232)
Short term borrowings		(861)	(4,043)	(5,494)	(4,300)	(4,000)	(4,000)
Long Term Liabilities		(711)	(16,509)	(13,714)	(11,724)	(15,766)	(12,896)
Long term borrowings		(711)	(12,437)	(10,346)	(7,051)	(10,181)	(7,411)
Other long term liabilities		0	(4,072)	(3,368)	(4,673)	(5,585)	(5,485)
Net Assets		14,428	23,721	27,868	31,490	36,136	41,282
CASH FLOW							
Operating Cash Flow		2,208	6,228	6,375	7,331	6,741	9,869
Net Interest		(256)	(1,243)	(1,323)	(1,303)	(907)	(864)
Tax		21	(2,074)	(1,614)	(1,637)	(1,418)	(1,859)
Capex		(375)	(643)	(1,334)	(1,638)	(1,500)	(1,500)
Acquisitions/disposals		(1,395)	(16,493)	(259)	(2,856)	(6,170)	(908)
Financing		1,825	263	24	1,434	103	0
Dividends		0	0	(119)	(247)	(141)	(154)
Net Cash Flow		2,028	(13,962)	1,750	1,084	(3,292)	4,583
Opening net debt/(cash)		1,247	(695)	13,395	13,012	10,982	14,228
HP finance leases initiated		0	0	0	0	0	0
Other		(86)	(128)	(1,367)	946	46	0
Closing net debt/(cash)		(695)	13,395	13,012	10,982	14,228	9,644

Source: Edison Investment Research, company accounts

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