Outlook

Edison investment research

9 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	10.6	0.3
06/10**	59.8	7.6	23.4	0.75	8.1	0.4
06/11e	52.4	8.3	23.4	0.60	8.1	0.3
06/12e	59.3	9.6	26.7	0.60	7.1	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: Profitability maintained

Despite a tough sales environment and hence weaker new business, K3 maintained profitability during H1. The acquisition of Sense adds scale to the Manufacturing division's AX business. Our underlying profitability forecasts are substantially unchanged before the inclusion of Sense. Our EPS forecasts are marginally reduced but we believe the stock is still undervalued and could trade up to c 10x FY11 EPS.

H111 results: Better profits despite weaker new sales

K3 saw a tough trading environment in H1, with new business sales difficult to close. Sales to the existing customer base partially compensated, and the higher proportion of services enabled K3 to beat our normalised operating profit forecast for H1. Managed Services ended H1 on an annualised run rate of £3.28m (+41% h-o-h).

Expanding the AX business

K3 has acquired Sense Enterprise Solutions, a Dynamics AX business, for £1.2m initial consideration funded by the revolving credit facility. The deal makes K3 the largest AX reseller in the UK and adds skills and a customer base that should bring stability to the business and enable it to scale more efficiently.

Changes to forecasts

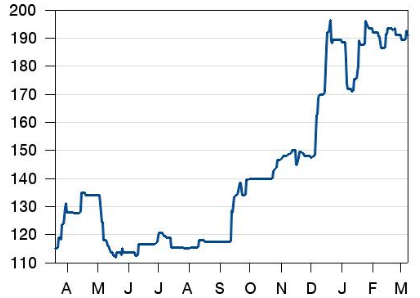
We have reduced our revenue forecasts to reflect the lengthened sales cycles and factored in a small contribution from the Sense acquisition. Our operating profit forecasts are substantially unchanged apart from the addition of the Sense acquisition (+ 0.6% in FY11, +2.2% in FY12). Normalised EPS falls by 1.3% in FY11 and 1.9% in FY12 as higher interest and stock option dilution are factored in.

Valuation: Further upside potential

At 8.1x FY11 and 7.1x 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	189.5p
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	76%	77%	77%
P/CF	6.4	7.3	5.0
EV/Sales	1.0	1.2	1.0
ROE	18%	16%	16%

Revenues by geography (2010)

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

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K3 Business Technology is a research client of Edison Investment Research Limited

Investment summary: Profitability maintained

Company description: ERP specialist for supply chain

K3 is a value-added Microsoft channel partner and owning the 'channel to market' is key to the business model. K3 designs and implements supply chain software solutions – generally based on Microsoft technologies – in two industry sectors: retail and manufacturing. The group has a well-balanced business model of predictable, recurring licence income in the manufacturing software sector combined with higher growth opportunities in retail software. A series of acquisitions has scaled up the group since 2004. Recent acquisitions have built out the Managed Services business and added Sage solutions to the product suite.

Valuation: Undervalued versus the sector

K3 outperformed the market in 2010, rising 124% versus a 43% increase in the FTSE AIM All-Share and 17% increase in the FTSE techMARK. As K3 has started building up its services business, we compare its valuation to both the software and IT services sectors – K3 is trading at a discount to both sectors. K3's closer peers (Sanderson, Clarity Commerce) tend to trade on lower multiples (c 5x current year EPS), although they also generate lower margins than K3. We believe that K3 could trade up to nearer 10x current year EPS as it integrates recent acquisitions and starts to benefit from cost and revenue synergies. Using a group WACC of 13% and a long-term growth rate of 3%, we calculate a discounted cashflow valuation of 236p per share (25% upside). A 1% increase/decrease in WACC moves the valuation by +36p/-30p.

Sensitivities: Macro risks; acquisition strategy

The main sensitivities or risks to our forecasts are: the macro environment – a significant increase in interest rates could affect consumer spending and the IT budgets of retailers; organic growth, which in all divisions depends on the ability to hire and retain skilled staff; and acquisitions – deals have transformed the scale of the group and the record so far has been a good one. Potentially, however, the inherent risks are greater in any strategy which has recourse to M&A.

Financials: Profitability maintained

Despite lower than-expected revenues in H1, a higher proportion of service revenues enabled K3 to beat our operating profit forecasts. Our profitability forecasts for FY11 and FY12 are substantially unchanged apart from the addition of the Sense acquisition. Slightly higher interest and diluted share count results in a small decrease in EPS forecasts.

Exhibit 1: Changes to forecasts

Note: Figures in £m except per share data.

	EPS			PBT			EBITDA		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
FY11e	23.7	23.4	-1.3	8.2	8.3	0.5	9.7	10.4	6.8
FY12e	27.2	26.7	-1.9	9.4	9.6	2.0	10.8	11.5	6.6

Source: Edison Investment Research

Company description: Supply chain ERP specialist

K3: Value-added reseller for retail and manufacturing sectors

K3 is a value-added Microsoft channel partner and owning the 'channel to market' is key to the business model. K3 designs and implements supply chain software solutions – generally based on Microsoft technologies – in two industry sectors: retail and manufacturing. The group has a well-balanced business model of predictable, recurring licence income in the manufacturing software sector combined with higher growth opportunities in retail software. Recent acquisitions have added Sage solutions to the product suite. K3 has also in recent years built a Managed Services business through a combination of in-house development and acquisitions.

Background

K3 started life in 2000 as the result of a buyout of the UK manufacturing Enterprise Resource Planning (ERP) business of Kewill Systems, comprising two business units and c 1,500 customers with a high proportion of recurring revenues. In 2001, K3 joined AIM through a reverse acquisition by RAP Group, a DIY products supplier, and the initial strategy was to hone the group down into a focused IT services company. Since then the company has broadened its ERP offering with a number of acquisitions, and moved into the Managed Services market.

Exhibit 2: Acquisition history

Date	Company	Sector	Details
Oct-04	Alpha Landsteinar	Retail	One of Microsoft's largest UK Dynamics resellers. Develops a version of Dynamics for retailers
Jun-05	IEG	Manufacturing	Resells SYSPRO, a Microsoft-based ERP solution for SME manufacturers. Adds high recurring revenue business & upgrade path
Mar-07	MBL	Manufacturing	SYSPRO reseller
Sep-07	Landsteinar Nederland	Retail	Dutch sister company of Alpha Landsteinar. Over 50% of revenues from franchised outlets of IKEA.
Dec-07	Index	Manufacturing	Microsoft Dynamics AX reseller
Mar-10	DigiMIS	Hosting	Specialises in hosting ERP applications, particularly SYSPRO.
Mar-10	Pebblestone	Retail	Dutch trade & assets. Specialises in fashion retail software.
Jun-10	Pebblestone	Retail	Remainder of the business ie IP and international sales channels
Nov-10	Panacea	Managed Services/ Sage	Managed services & IT solutions provider: Sage ERP & CRM, Microsoft Dynamics NAV-based distribution solutions, Dynamics CRM, SAP BusinessObjects and Microsoft Business Intelligence
Dec-10	FD Systems	Sage	Sage 200 business
Mar-11	Sense Enterprise Solutions	Manufacturing	Microsoft Dynamics AX reseller

Source: K3 Business Technology Group

Software solutions business model: Grow internal IP

The group serves as a channel to market for ERP products based on Microsoft and Sage solutions, and business intelligence solutions from Microsoft and SAP.

Exhibit 3: Product range

Microsoft-based	Sage-based	Other
SYSPRO (based on .NET)	Sage 1000	SAP BusinessObjects (business intelligence)
Dynamics NAV	Sage Line 500	
Dynamics AX	Sage 200	
Dynamics CRM	Sage CRM	
Business Intelligence	Sage SalesLogix	

Source: Edison Investment Research

Group strategy has been to focus on adding internal IP to the product range. As a straight reseller of Microsoft products, K3 would achieve a gross margin of c 50% on software sold. By adding its own proprietary software to customise products for more specific requirements, K3 is able to retain a higher percentage of the software licence fee. K3 also continues to look for complementary acquisitions that will expand product/service lines and feeder businesses that can be migrated to Dynamics or SYSPRO.

Managed services: Cross-sell and support SYSPRO globally

K3 has developed its Managed Services business through a combination of in-house development and acquisition (DigiMIS, Panacea). In addition to offering outsourced IT support to its customer base, K3 offers application hosting to its 1,800-strong customer base. Only a small proportion of customers have taken the service since its launch in March 2010, and we expect K3 to focus heavily on selling managed services across its customer base. The recent agreement with SYSPRO to provide hosting services to the wider 14,000-strong global SYSPRO customer base is an additional source of hosting customers.

Manufacturing division: UK-focused, dominant position

The Manufacturing division has c 900 customers and is the largest supplier of supply chain management software to the sector in the UK. This division reports revenues from three business lines:

1) SCS: sells SYSPRO solutions to manufacturing customers and is made up of the combination of IEG and MBL. K3 is the exclusive distributor of SYSPRO in the UK.

2) K3 AX: sells Microsoft Dynamics AX solutions mainly to food and process manufacturers and incorporates the Index acquisition. From March 2011, this will also include the Sense Enterprise Solutions AX business.

3) Small systems: maintains legacy software that is not Microsoft-based and also develops Microsoft Dynamics CRM software. Customers served by this division often upgrade to one of the solutions offered by K3 AX or SCS.

K3 has designed a variety of add-on modules for functions such as advanced planning and scheduling, warehouse management, delivery route planning, recipe management, personnel, and time and attendance systems.

Revenue model

K3 operates in the low to mid-range with contract values between £50k and £250k. Initial contract values will comprise c 50% licence fee and c 50% services to design and integrate the system. Maintenance is charged at 20-25% of the licence fee on an annual basis. For SYSPRO, K3 charges an annual licence fee renewal in October, creating a heavy weighting of Manufacturing revenues to the second half of the calendar year. Sales of additional software modules or customised software after the initial licensing are reported as Account Management revenues.

H111 operational performance

The Manufacturing business declined 6% in H111, driven by weaker new sales in K3 AX and continued attrition in the Small Systems business. The division signed 13 major new contracts with an average order value of £72k (H110[1]: 13 contracts at an average of £177k). The SCS business was flat y-o-y, with the lack of new sales (as sales cycles lengthened) offset by sales to the existing customer base. Margins improved slightly on flat revenues. The K3 AX business was impacted by a lack of large deals although the company is confident that larger deals in the pipeline will sign in H211. As the company has previously guided, the Small Systems business continues to decline with no major upgrades to solutions in other divisions during H1. Margins, however, were maintained at the same absolute level as a year ago.

Exhibit 4: Financial performance of Manufacturing division, H111 versus H110

Revenues (£m)	H110a	H111a	H111e	y-o-y
Manufacturing	*9.91*	*9.35*	*9.86*	*-6%*
SCS	6.95	6.92	6.95	0%
K3 AX	1.43	1.27	1.50	-11%
Small systems	1.53	1.15	1.41	-25%
Adj. Operating Profit (£m)				
Manufacturing	*3.64*	*3.29*	*3.48*	
SCS	2.95	3.04	2.95	
K3 AX	0.20	-0.22	0.15	
Small systems	0.49	0.48	0.38	
Adj. Operating Margin	36.7%	35.1%	35.3%	
SCS	42.4%	43.8%	42.4%	
K3 AX	14.0%	-17.5%	10.0%	
Small systems	32.0%	41.2%	27.0%	

Source: K3 Business Technology Group

Microsoft Dynamics AX acquisition

On 7 March, K3 announced that it had acquired Sense Enterprise Solutions (Sense), a Microsoft Dynamics AX specialist. Sense has provided AX solutions to 40 customers in the Manufacturing and Distribution markets. Sense is the only UK member of AxPact, an international network of AX resellers that, to date, have installed c 10% of AX projects worldwide. K3 estimates that this acquisition will make it the largest AX reseller in the UK. Like K3, Sense has a partnership with Omnica to resell its Dynamics AX-based multi-channel retail software.

K3 believes that the deal will add scale and stability to the AX division, which has struggled to remain profitable over the last few years.

K3 paid £1.2m cash upfront plus £0.35m for surplus cash, with a further potential £0.9m dependent on achieving performance-based criteria over three years. In CY10, Sense generated revenues of £1.8m (c 33% recurring) and underlying profit of £0.3m (16.7% margin), valuing the acquisition on a CY10 EV/Sales of 0.7x and EV/EBIT of 4x (versus 1.3x and 7.7x for K3). This compares to K3 AX CY10 revenues of £2.4m and EBITA of -£0.3m. The initial consideration will be funded by K3's £7.5m revolving credit facility, of which £5.0m had been used before this deal.

[1] H110 refers to the six month period ended 31 December 2009

Retail division: Growth from international expansion

The Retail division has around 350 customers and operates out of two divisions.

1) **UK:** sells Microsoft Dynamics NAV-based software to retailers. The Alpha Landsteinar acquisition was integrated into this division. K3 is also developing Dynamics AX for Retail solutions.
2) **Netherlands:** sells the same NAV-based solution to overseas retailers, particularly European customers. This division was created by the Landsteinar Nederland acquisition and strengthened by last year's Pebblestone acquisition. A significant percentage of the Landsteinar business's revenues are generated from a large global furniture retailer (the company mandates that its 14 franchises use K3 for their supply chain software). Franchises are based in Eastern Europe, the Middle East, the Far East and Australia. While it is unlikely that more franchises will be granted, existing franchisees are encouraged to open up new stores in existing and new countries.

The company develops own IP products such as modules for multi-channel, EPOS, fashion and CRM. K3 also continues to look to acquire filler volume business and strategic product.

Revenue model

This division sells systems split roughly one-third licence fee/two-thirds services. Annual maintenance fees are c 25% of the licence fee. Contract sizes are larger in this division, in the region of £250k-£3m.

H111 operational performance

Exhibit 5: Financial performance of Retail division, H111 versus H110

Revenues (£m)	H110a	H111a	H111e	y-o-y
Retail	*13.26*	*12.60*	*15.12*	*-4.9%*
UK	11.33	9.32	11.07	-17.7%
Netherlands	1.93	3.28	4.05	70.1%
Adj. Operating Profit (£m)				
Retail	*1.99*	*2.58*	*2.36*	
UK	1.68	1.83	1.63	
Netherlands	0.31	0.75	0.73	
Adj. Operating Margin				
Retail	*15.0%*	*20.4%*	*15.6%*	
UK	14.8%	19.6%	14.7%	
Netherlands	16.1%	22.9%	18.0%	

Source: K3 Business Technology Group

The UK business signed eight major new contracts with an average order value of £425k (H110: eight contracts at an average of £663k, although this was skewed by one contract worth £2.5m). K3 has not seen a repeat of the very large deal signed a year ago, hence the 18% drop in revenues y-o-y. This division has a strong pipeline of new business, particularly for the AX product. Staff operated at capacity in H1 but the company has invested in sales and delivery staff, which should expand capacity in H2. Despite the large drop in new business, margins were higher on an absolute basis than a year ago as services made up a higher proportion of sales and K3 sold more own-IP product.

The Netherlands business signed six new major contracts at an average of £107k (H110: four contracts at an average of £125k). The Pebblestone business has been fully integrated and the company has invested in improving product and services for the Pebblestone customer base. Business with the division's largest customer has started to recover after a period of weakness, in particular seeing an uptick from October. Our H111 forecasts included the Pebblestone IP business, which has been disclosed separately. Bearing in mind that the IP business separately reported revenues of £471k and profit of £364k, the Netherlands business improved profitability significantly in H1.

Managed services: Growth engine

K3 introduced its Managed Services offering in November 2007 to provide specialist IT support to customers. This was originally only available to customers in the Manufacturing division but from the beginning of FY11, the company extended the offering to the Retail division. The move into hosting via the March 2010 DigiMIS acquisition expanded the service into the infrastructure space, and enables the company to offer a full outsourced IT service to customers. The recent acquisitions of Panacea and FD's Sage 200 business added a further 400 customers who could potentially use K3's hosting service.

The hosting capability within the Managed Services business enables K3 to offer its software to customers in whichever way suits them best. Of the hosting deals signed to date (which have been with larger customers), the company generates £2-3 of additional recurring revenues for every £1 of maintenance revenues. Maintenance revenues totalled £20m in CY10, highlighting that growth from hosting revenues could be significant.

Hosting: Cross-selling opportunity enhanced by SYSPRO deal

K3's hosting business uses datacentres in London, Edinburgh and New York. Contracts tend to be multi-year, resulting in a high level of recurring revenues. At the time of the acquisition, DigiMIS had 14 customers at 65 sites and hosted SYSPRO, Microsoft Dynamics, Microsoft Outlook, Blackberry, email services and any other applications the customer required. A key attraction of the deal was that half of the customers were using SYSPRO (five of them K3 customers), making DigiMIS the only SYSPRO hoster in the UK. In February 2011, K3 announced that it had signed an exclusive agreement with SYSPRO to provide its hosting service on a worldwide basis. K3 is SYSPRO's exclusive distributor in the UK, with 500 of K3's 1,800 customers using SYSPRO. Since the DigiMIS buy, K3 had offered hosting of SYSPRO to its customer base on an ad-hoc basis. This agreement gives K3 the ability to offer its hosting services to the 14,000-strong global customer base across the SYSPRO global partner network.

SYSPRO's new hosted solution, SYSPRO BusinessLive, can be deployed on an on-demand (subscription) basis or upfront licence fee basis. In addition to providing the hosting service for BusinessLive, K3 will be able to market this solution to new customers in the UK. The subscription service is likely to appeal to smaller customers for whom upfront licensing is prohibitive on a cost-basis and therefore should enable K3 to expand its SYSPRO offering outside of its usual mid-tier customer base.

H111 operational performance

Revenues in H110 consisted of the K3 in-house managed services business, as DigiMIS had not yet been acquired. H111 revenues added a full six months of the DigiMIS business and six weeks of Panacea's managed services business. The business was operating at an annualised run rate of £3.28m at the end of H111, up from £2.33m at the end of FY10. Revenues and margins came in lower than our expectations as the company invested heavily, hiring an extra five heads in H1 and focusing on developing NAV, AX and Sage hosting solutions. The NAV solution is being piloted by three customers and K3 aims to have a customer piloting the Sage solution by mid-year.

Exhibit 6: Financial performance of Managed Services division, H111 versus H110

	H110a	H111a	H111e	y-o-y
Revenues (£m)	0.36	1.679	1.93	366%
Adj. operating profit (£m)	0.09	0.151	0.33	68%
Adj. operating margin	25.0%	9.0%	17.1%	

Source: K3 Business Technology Group

Sage: New division resulting from recent acquisitions

In H111, K3 acquired two businesses that offer Sage solutions and is now a reseller of Sage 1000, Sage Line 500, Sage 200, Sage CRM and Sage SalesLogix. Sage products are targeted at smaller SMEs than the Dynamics products, providing a complementary set of solutions so that the whole SME market can be targeted. H111 results included six weeks of the Panacea business and a negligible amount from the FD acquisition (which completed on 23 December 2010), driving revenues of £565k at break-even. The combined business has annualised revenues of £4.7m, of which 51% are recurring, higher than the group average of 44% reported in CY10. With many of the integration costs born in H1, we would expect profitability to improve in H2.

IP division: Product development drives margins

The IP division was set up to manage both the portfolio of IP acquired from Pebblestone and the related reseller channel. Both were acquired in June 2010. On revenues of £471k in H1, the division reported margins of £364k (77.3%) showing the value to K3 of IP ownership. We believe that other in-house developed products may be managed by this division in the future.

Sensitivities

The main sensitivities or risks to our forecasts are:

- Macro environment. A significant increase in interest rates could affect consumer spending and the IT budgets of retailers and manufacturers.
- Organic growth. In all divisions, organic growth depends on the ability to hire and retain skilled staff.
- Acquisitions. Deals have transformed the scale of the group and the record so far has been a good one. Potentially, however, the inherent risks are greater in any strategy which has recourse to M&A.

Valuation

Multiples-based valuation: Undervalued versus the sector

K3 outperformed the market in 2010, rising 124% versus a 43% increase in the FTSE AIM All-Share and 17% increase in the FTSE techMARK. As K3 has started building up its services business, we compare its valuation to both the software and IT services sectors – K3 is trading at a discount to both sectors. K3's closer peers (Sanderson, Clarity Commerce) tend to trade on lower multiples (c 5x current-year EPS), although they also generate lower margins than K3. We believe that K3 could trade up to nearer 10x current year EPS as it integrates recent acquisitions and starts to benefit from cost and revenue synergies.

Exhibit 7: Valuation metrics

	EV/Sales (x)		P/E (x)	
	This FY	Next FY	This FY	Next FY
K3	1.2	1.0	8.1	7.1
UK software	3.7	2.6	20.9	14.0
UK IT services	1.5	1.3	18.6	11.9

Source: Edison Investment Research

DCF-based valuation: Undervalued

Using a group WACC of 13% and a long-term growth rate of 3%, we calculate a discounted cashflow valuation of 236p per share (25% upside). A 1% increase/decrease in WACC moves the valuation by +36p/ -30p.

Financials

Review of H111 results

Exhibit 8: Summary of financial performance

£'000	H111	H110	Change
Revenues	24,671	23,532	4.8%
Normalised operating profit	6,253	5,464	14.4%
Normalised profit before tax	5,829	5,059	15.2%
Normalised net income	4,325	3,689	17.2%
Reported EPS (p)	12.7	11.6	9.5%
Normalised EPS (p)	16.9	15.0	12.7%

Source: K3 Business Technology Group

K3 reported revenue growth of 5% y-o-y, although excluding the £1.22m contribution from recent acquisitions, revenues were flat y-o-y. While both the Manufacturing and Retail divisions saw slower new sales, margins were maintained in absolute terms as services made up a higher percentage of revenues. Normalised operating profit was stronger than we forecast, driven by better profitability in the Retail division and a strong performance from the IP division.

Cashflow and balance sheet: Impact of acquisitions

Cash conversion fell to 78% from 154% a year ago. This is mainly explained by the profile of new deals in CY09, with customer deposits received in December 2009 not repeated in CY10 as new business was tougher to sign, and the costs on those contracts being incurred during the course of CY10. K3 expects cash conversion in CY11 to revert to more normal levels.

K3 renegotiated its revolving credit facilities in September 2010 and now has a £5m working capital facility and a £7.5m facility for acquisitions, both in place until the end of CY12. Before the Sense deal, K3 had drawn down £5.0m of the acquisitions facility. Factoring in the Sense acquisition, we forecast that K3 will have a net debt position of £13.4m by the end of FY11 reducing to £8.9m by the end of FY12.

Changes to forecasts

We have revised down our revenue forecasts for FY11 and FY12 to reflect the slower new business in H1. However, margins are maintained, leaving our normalised operating profit forecasts substantially unchanged before the Sense acquisition is factored in. Slightly higher interest payments (as the Sense deal used the revolving credit facility) and a higher diluted share count results in a slight reduction to our EPS forecasts (-1.3% FY11, -1.9% FY12).

- Manufacturing: We forecast flat SCS revenues in FY11 and FY12 with slightly stronger margins than in FY10. The K3 AX division includes the Sense business from March. We forecast continued revenue declines for the Small Systems division but expect that strong margins will be maintained.
- Retail: We expect a better H2 for the UK business, resulting in a 9% decline in FY11 revenues, following by modest growth of 2% in FY12. We expect that the Netherlands business will show growth in H2 and will grow a further 3% in FY12.
- Sage: We factor in a full six months for both acquired businesses in H2 and assume that steps taken to integrate the businesses in late 2010/early 2011 result in profitability from H211.
- IP: We assume that this business grows 1% in FY12 and maintains margins at the current level.
- Managed Services: H211 will benefit from a full six months from the Panacea acquisition. We assume that K3 will continue to win hosting customers, driving strong growth for this division. We assume that margins will improve as the investment in new staff drives new customer wins.

Exhibit 9: Divisional forecasts

Note: * 18 month period ended 30 June 2010 **Compares 12 month periods ended 30 June 2010 and 30 June 2009.

	12 mths	12 mths					y-o-y Revenue growth		
Revenues (£m)	Jun-09	Jun-10	FY10*	FY11e	FY12e		FY10**	FY11e	FY12e
Manufacturing	*14.29*	*15.59*	*21.32*	*16.20*	*17.14*		*9%*	*4%*	*6%*
SCS	10.11	10.40	14.08	10.58	10.63		3%	2%	0%
K3 AX	1.66	2.54	3.34	3.31	4.43		53%	30%	34%
Small systems	2.52	2.65	3.91	2.31	2.08		5%	-13%	-10%
Retail	*21.55*	*26.97*	*36.79*	*26.55*	*27.18*		*25%*	*-2%*	*2%*
UK	17.49	21.63	29.43	19.72	20.15		24%	-9%	2%
Netherlands	4.06	5.34	7.36	6.83	7.03		32%	28%	3%
Managed Services	*0.60*	*1.23*	*1.60*	*4.41*	*6.50*		*105%*	*258%*	*47%*
Sage	*0*	*0*	*0*	*4.32*	*7.51*		*N/A*	*N/A*	*74%*
IP	*0*	*0*	*0*	*0.93*	*0.94*		*N/A*	*N/A*	*1%*
Total	36.44	43.79	59.78	52.42	59.28		20.2%	19.7%	13.1%
							Operating margin		
Adj. Operating Profit (£m)						Jun-09	Jun-10	FY11e	FY12e
Manufacturing	*2.94*	*4.06*	*4.47*	*3.63*	*4.09*	20.6%	26.0%	22.4%	23.9%
SCS	2.41	3.10	3.37	3.18	3.19	23.8%	29.8%	30.1%	30.0%
K3 AX	-0.41	0.13	-0.18	-0.25	0.32	-24.7%	5.1%	-7.7%	7.3%
Small systems	0.94	0.83	1.28	0.71	0.58	37.3%	31.3%	30.6%	28.0%
Retail	*3.51*	*3.75*	*4.90*	*4.46*	*4.47*	*16.3%*	*13.9%*	*16.8%*	*16.4%*
UK	2.70	2.85	3.70	3.07	3.10	15.4%	13.2%	15.6%	15.4%
Netherlands	0.81	0.90	1.20	1.39	1.37	20.0%	16.9%	20.3%	19.5%
Managed services	*0.22*	*0.30*	*0.41*	*0.40*	*0.90*	*36.7%*	*24.4%*	*9.0%*	*13.8%*
Sage	*0*	*0*	*0*	*0.35*	*0.77*	*N/A*	*N/A*	*8.0%*	*10.2%*
IP	*0*	*0*	*0*	*0.73*	*0.73*	*N/A*	*N/A*	*78.2%*	*77.5%*
Head office	-0.10	-0.64	-0.78	-0.41	-0.56				
Total	6.57	7.47	9.00	9.15	10.39	18.0%	17.1%	17.5%	17.5%

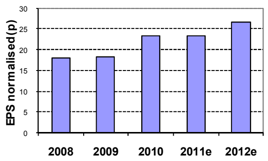
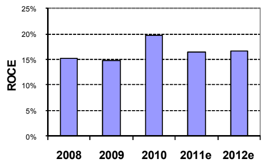
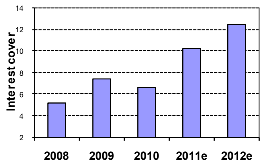
Source: K3 Business Technology, Edison Investment Research

Exhibit 10: Financials

Note: * 18-month period ended 30 June 2010

£'000s	2006	2007	2008	2010*	2011e	2012e
Year end 31 December/ 30 June	IFRS	IAS	IAS	IAS	IAS	IAS
PROFIT & LOSS						
Revenue	27,350	34,146	37,626	59,783	52,417	59,282
Cost of Sales	(10,641)	(11,415)	(11,285)	(22,460)	(15,201)	(17,192)
Gross Profit	16,709	22,731	26,341	37,323	37,216	42,090
EBITDA	3,365	6,250	7,937	10,327	10,391	11,513
Operating Profit (before am of acq. Intang. and except.)	2,918	5,760	7,354	9,013	9,155	10,393
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)	(146)	0
Operating Profit	2,833	4,712	5,364	6,132	6,535	7,803
Net Interest	(262)	(1,036)	(1,416)	(1,365)	(900)	(836)
Profit Before Tax (norm)	2,656	4,724	5,926	7,620	8,109	9,557
Profit Before Tax (FRS 3)	2,571	3,676	3,948	4,767	5,635	6,967
Tax	(846)	(761)	(1,137)	(1,018)	(1,403)	(1,816)
Profit After Tax (norm)	1,890	3,650	4,310	5,770	6,052	6,891
Profit After Tax (FRS 3)	1,725	2,915	2,811	3,749	4,232	5,151
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	23.6	26.9
EPS - normalised fully diluted (p)	10.4	16.3	17.9	23.4	23.4	26.7
EPS - FRS 3 (p)	9.5	13.4	11.9	15.2	16.5	20.1
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	19.4
Operating Margin (before GW and except.) (%)	10.7	16.9	19.5	15.1	17.5	17.5
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	13,337	11,137
Tangible Assets	416	1,305	1,333	1,393	1,929	1,959
Goodwill	15,684	31,494	33,225	33,954	37,472	37,472
Other	1,589	466	466	566	683	683
Current Assets	10,889	14,069	13,518	14,808	18,034	22,163
Stocks	0	0	0	0	0	0
Debtors	8,622	10,984	10,690	14,439	18,669	21,114
Cash	2,267	3,085	2,828	369	(635)	1,049
Current Liabilities	(13,712)	(19,386)	(19,035)	(20,072)	(19,655)	(19,522)
Creditors	(4,385)	(6,689)	(5,466)	(5,690)	(6,190)	(6,790)
Other Creditors	(8,466)	(8,654)	(8,075)	(10,082)	(9,965)	(9,232)
Short term borrowings	(861)	(4,043)	(5,494)	(4,300)	(3,500)	(3,500)
Long Term Liabilities	(711)	(16,509)	(13,714)	(11,724)	(14,841)	(11,971)
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)	(5,585)	(5,485)
Net Assets	14,428	23,721	27,868	31,490	36,959	41,921
CASH FLOW						
Operating Cash Flow	2,208	6,228	6,375	7,331	6,661	9,668
Net Interest	(256)	(1,243)	(1,323)	(1,303)	(900)	(836)
Tax	21	(2,074)	(1,614)	(1,637)	(1,403)	(1,816)
Capex	(375)	(643)	(1,334)	(1,638)	(1,500)	(1,500)
Acquisitions/disposals	(1,395)	(16,493)	(259)	(2,856)	(5,275)	(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	(2,455)	4,454
Opening net debt/(cash)	1,247	(695)	13,395	13,012	10,982	13,391
HP finance leases initiated	0	0	0	0	0	0
Other	(86)	(128)	(1,367)	970	46	0
Closing net debt/(cash)	(695)	13,395	13,012	10,958	13,391	8,937

Source: K3 Business Technology and Edison Investment Research

Growth	Profitability	Balance sheet strength
		

Sensitivities evaluation	
Litigation/regulatory	○
Pensions	○
Currency	◖
Stock overhang	○
Interest rates	●
Oil/commodity prices	○

Growth metrics	%	Profitability metrics	%	Balance sheet metrics	
EPS CAGR 08-12e	10.4	ROCE 11e	16.4	Gearing 11e	36.2
EPS CAGR 10-12e	6.8	Avg ROCE 08-12e	17.0	Interest cover 11e	10.2
EBITDA CAGR 08-12e	9.7	ROE 11e	16.4	CA/CL 11e	0.9
EBITDA CAGR 10-12e	5.6	Gross margin 11e	71.0	Stock turn 11e	N/A
Sales CAGR 08-12e	12.0	Operating margin 11e	17.5	Debtor days 11e	130
Sales CAGR 10-12e	-0.4	Gr mgn / Op mgn 11e	4.1	Creditor days 11e	151

Company details	
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Principal shareholders	%
P J Claesson	21.5
BlackRock Investment Management (UK) Ltd	7.4
Laxnes BV	6.2
Herald Investment Management Ltd	4.7
Hargreave Hale Ltd	3.8
David Bolton	3.4
M.D.Barnard & Co. Ltd	3.4

Forthcoming announcements/catalysts	Date *
Trading update	June 2011
Preliminary results	September 2011
AGM	November 2011
*Note: * = estimated*	

Management team

CEO: Andy Makeham

Andy has over 20 years of experience running or working in IT companies. Previously, he was divisional sales and marketing director at Kewill Systems.

CFO: David Bolton

David qualified as a chartered accountant with Ernst & Young in the mid–1970s. He has held finance positions with both quoted and unquoted companies, most notably BTR, where he spent 12 years.

Chairman: Tom Milne

Tom was appointed as chairman of the board in May 2006. He has a wealth of experience in developing successful retail software companies.

Companies named in this report

Sanderson, Clarity Commerce