

25 January 2011

## K3 Business Technology

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: Growth strategy on track

K3's trading update confirmed that H111 has met expectations and that the company has a healthy pipeline going into H211. The company's Managed Services strategy is well underway – acquisitions have brought application hosting and additional managed services skills and expertise into the business, positioning the company well to grow its recurring revenue base.

### H1 profit up y-o-y; pipeline bodes well for H2

Although we are expecting the underlying business before acquisitions to deliver flat revenues in H111 versus the same period a year ago (when K3 reported an adjusted operating profit of £5.5m on revenues of £20.3m), the company expects to show an improvement in profitability over the same period. Including acquisitions the company expects to report materially higher adjusted operating profits (our forecast £5.9m on revenues of £27.4m). In H2, the company expects to close several major contracts that are currently being negotiated. In addition, K3 will have a full contribution from the businesses acquired during 2010 (DigiMIS, Pebblestone, Panacea and certain assets of FD Systems).

### Managed services strategy well underway

Aside from bolstering its European Retail activities, K3's acquisition strategy over the last year has focused on developing its Managed Services business. The DigiMIS acquisition added hosting expertise, and the more recent Panacea and FD Systems' assets acquisitions have added further Managed Services expertise, additional Microsoft Dynamics customers and an installed base of Sage users. K3 now has the opportunity to grow recurring revenues across a wider range of applications and has a larger customer base to which it can potentially cross-sell Managed Services.

### Valuation: Undemanding, despite recent rise

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 187.5p  
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 Low  
196.5p 89.5p

#### Balance Sheet as at 30 June 2010

Debt/Equity (%) 35  
NAV per share (p) 122.9  
Net cash (£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			
P/CF			
EV/Sales			
ROE			

#### Geography based on revenues (2010)

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

#### Analysts

Katherine Thompson 020 3077 5730  
Dan Ridsdale 020 3077 5729  
tech@edisoninvestmentresearch.co.uk

## Exhibit 1: Financials

Year end 31 December/ 30 June	£'000s	2006	2007	2008	2010*	2011e	2012e
		IAS	IAS	IAS	IAS	IAS	IAS
<b>PROFIT &amp; LOSS</b>							
<b>Revenue</b>		<b>27,350</b>	<b>34,146</b>	<b>37,626</b>	<b>59,783</b>	<b>55,003</b>	<b>61,048</b>
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
<b>EBITDA</b>		<b>3,365</b>	<b>6,250</b>	<b>7,937</b>	<b>10,327</b>	<b>9,732</b>	<b>10,797</b>
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
<b>Operating Profit</b>		<b>2,833</b>	<b>4,712</b>	<b>5,364</b>	<b>6,132</b>	<b>6,643</b>	<b>7,617</b>
Net Interest		(262)	(1,036)	(1,416)	(1,365)	(888)	(800)
<b>Profit Before Tax (norm)</b>		<b>2,656</b>	<b>4,724</b>	<b>5,926</b>	<b>7,620</b>	<b>8,214</b>	<b>9,367</b>
<b>Profit Before Tax (FRS 3)</b>		<b>2,571</b>	<b>3,676</b>	<b>3,948</b>	<b>4,767</b>	<b>5,754</b>	<b>6,817</b>
Tax		(846)	(761)	(1,137)	(1,018)	(1,551)	(1,827)
<b>Profit After Tax (norm)</b>		<b>1,890</b>	<b>3,650</b>	<b>4,310</b>	<b>5,770</b>	<b>6,094</b>	<b>6,980</b>
<b>Profit After Tax (FRS 3)</b>		<b>1,725</b>	<b>2,915</b>	<b>2,811</b>	<b>3,749</b>	<b>4,194</b>	<b>4,990</b>
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
<b>BALANCE SHEET</b>							
<b>Fixed Assets</b>		<b>17,962</b>	<b>45,547</b>	<b>47,099</b>	<b>48,478</b>	<b>53,464</b>	<b>51,884</b>
Intangible Assets		273	12,232	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
<b>Current Assets</b>		<b>10,889</b>	<b>14,069</b>	<b>13,518</b>	<b>14,808</b>	<b>18,530</b>	<b>21,326</b>
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
<b>Current Liabilities</b>		<b>(13,712)</b>	<b>(19,386)</b>	<b>(19,035)</b>	<b>(20,072)</b>	<b>(20,972)</b>	<b>(21,022)</b>
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)
<b>Long Term Liabilities</b>		<b>(711)</b>	<b>(16,509)</b>	<b>(13,714)</b>	<b>(11,724)</b>	<b>(13,429)</b>	<b>(10,351)</b>
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)
<b>Net Assets</b>		<b>14,428</b>	<b>23,721</b>	<b>27,868</b>	<b>31,490</b>	<b>37,593</b>	<b>41,837</b>
<b>CASH FLOW</b>							
<b>Operating Cash Flow</b>		<b>2,208</b>	<b>6,228</b>	<b>6,375</b>	<b>7,331</b>	<b>7,289</b>	<b>9,060</b>
Net Interest		(256)	(1,243)	(1,323)	(1,303)	(888)	(800)
Tax		21	(2,074)	(1,614)	(1,637)	(2,051)	(2,327)
Capex		(375)	(643)	(1,334)	(1,638)	(1,500)	(1,500)
Acquisitions/disposals		(1,395)	(16,493)	(239)	(2,855)	(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
<b>Opening net debt/(cash)</b>		<b>1,247</b>	<b>(695)</b>	<b>13,395</b>	<b>13,012</b>	<b>10,982</b>	<b>12,808</b>
HP finance leases initiated		0	0	0	0	0	0
Other		(86)	(123)	(1,367)	970	0	0
<b>Closing net debt/(cash)</b>		<b>(695)</b>	<b>13,395</b>	<b>13,012</b>	<b>10,958</b>	<b>12,808</b>	<b>9,029</b>

Source: Edison Investment Research, company accounts

## EDISON INVESTMENT RESEARCH LIMITED

Edison is Europe's leading investment research company. It has won industry recognition, with awards in both the UK and internationally. The team of more than 65 includes over 35 analysts supported by a department of supervisory analysts, editors and assistants. Edison writes on more than 280 companies across every sector and works directly with corporates, investment banks, brokers and fund managers. Edison's research is read by major institutional investors in the UK and abroad, as well as by the private client broker and international investor communities. Edison was founded in 2003 and is authorised and regulated by the Financial Services Authority ([www.fsa.gov.uk/register/firmBasicDetails.do?sid=181584](http://www.fsa.gov.uk/register/firmBasicDetails.do?sid=181584)).

## DISCLAIMER

Copyright 2011 Edison Investment Research Limited. All rights reserved. This report has been commissioned by K3 Business Technology and prepared and issued by Edison Investment Research Limited for publication in the United Kingdom. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Edison Investment Research Limited at the time of publication. The research in this document is intended for professional advisers in the United Kingdom for use in their roles as advisers. It is not intended for retail investors. This is not a solicitation or inducement to buy, sell, subscribe, or underwrite securities or units. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment. A marketing communication under FSA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. Edison Investment Research Limited has a restrictive policy relating to personal dealing. Edison Investment Research Limited is authorised and regulated by the Financial Services Authority for the conduct of investment business. The company does not hold any positions in the securities mentioned in this report. However, its directors, officers, employees and contractors may have a position in any or related securities mentioned in this report. Edison Investment Research Limited or its affiliates may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and are subject to large and sudden swings. In addition it may be difficult or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance. This communication is intended for professional clients as defined in the FSA's Conduct of Business rules (COBS 3.5).

## Edison Investment Research

Lincoln House, 296-302 High Holborn, London, WC1V 7JH ■ tel: +44 (0)20 3077 5700 ■ fax: +44 (0)20 3077 5750 ■ [www.edisoninvestmentresearch.co.uk](http://www.edisoninvestmentresearch.co.uk)  
Registered in England, number 4794244. Edison Investment Research is authorised and regulated by the Financial Services Authority.