

K3 Business Technology

Trading update

Retail investment starting to pay off

Software & comp services

The improving order intake from the retail sector for both existing and recently developed solutions highlighted in September has continued through the remainder of H114. This, combined with improving performance in the Managed Services division, supports FY14 expectations. We make no change to forecasts and with K3 trading at a discount to peers, we highlight the potential for upside as evidence of sustained revenue and margin recovery emerges, closing the discount to peers.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
06/12	68.0	10.1	29.7	1.00	4.8	0.7
06/13	63.5	4.4	14.1	1.00	10.1	0.7
06/14e	73.1	6.5	15.7	1.05	9.1	0.7
06/15e	75.4	8.5	21.2	1.10	6.7	0.8

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

Project Gemstone starting to drive new business

At FY13 results in September, the company announced that it had released the first commercial version of Dynamics AX for Retail (called *ax | is fashion*) and had started to receive orders for this product, as well as seeing improved order intake from retail customers for Dynamics NAV solutions. Since then, the company has seen a promising level of demand for the new solution and has secured order wins in recent months. As previously planned, an enhanced version of the solution is on track for delivery in mid-2014.

FY14 trading in line with expectations

Trading for H114 has been in line with management's expectations. Management sees continuing momentum in the Microsoft UK division (including growing demand for the new *ax | is fashion* solution) and improving performance in the Managed Services division as underpinning FY14 forecasts. Consequently, we make no changes to our estimates.

Valuation: Evidence of sustained recovery is key

K3's share price has remained relatively stable since FY13 results were released in September. The stock trades on an FY14e P/E of 9.1x and an EV/sales multiple of 0.8x FY14e. This is still at a material discount to its peers (sub-£200m market cap UK Software P/E 15.3x, EV/sales 2.0x). With operating margins moving towards 10% in FY14 we believe that K3 could trade up to at least 10x FY14e EPS (157p), and with evidence of sustained improvement in the Microsoft UK division and further improvement in margins, could move towards 200p (equivalent to EV/sales of 1x FY14e).

20 January 2014

Price 143.0p
Market cap £45m

Net debt (£m) at end FY13	13.8
Shares in issue	31.6m
Free float	57%
Code	KBT
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.8	(2.1)	8.3
Rel (local)	(3.4)	(6.1)	(4.7)
52-week high/low	148.00p	93.00p	

Business description

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

Next event

FY14 interims	March 2014
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Exhibit 1: Financial summary

	£000s	2010*	2011	2012	2013	2014e	2015e
Year end 30 June		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		59,783	52,800	67,961	63,513	73,052	75,385
Cost of Sales		(22,460)	(23,486)	(28,491)	(30,375)	(32,143)	(32,415)
Gross Profit		37,323	29,314	39,470	33,138	40,909	42,969
EBITDA		10,327	10,574	12,942	7,261	9,514	12,139
Operating Profit (before am of acq. Intang. and except.)		9,013	9,633	11,405	5,164	7,074	9,099
Amortisation of acquired intangibles		(2,892)	(2,826)	(3,586)	(3,182)	(3,200)	(3,200)
Share-based payments		39	(52)	(72)	(70)	(70)	(70)
Other		0	(942)	(395)	(727)	(200)	0
Operating Profit		6,160	5,813	7,352	1,185	3,604	5,829
Net Interest		(1,365)	(905)	(1,309)	(723)	(600)	(550)
Profit Before Tax (norm)		7,620	8,728	10,096	4,441	6,474	8,549
Profit Before Tax (FRS 3)		4,767	4,908	6,043	462	3,004	5,279
Tax		(1,018)	(428)	(319)	780	(777)	(1,111)
Profit After Tax (norm)		5,770	7,108	8,591	4,165	4,997	6,737
Profit After Tax (FRS 3)		3,749	4,480	5,724	1,242	2,227	4,167
Average Number of Shares Outstanding (m)		24.6	25.7	28.2	29.2	31.4	31.4
EPS - normalised (p)		23.5	27.7	30.4	14.3	15.9	21.4
EPS - normalised fully diluted (p)		23.4	27.0	29.7	14.1	15.7	21.2
EPS - FRS 3 (p)		15.2	17.5	20.3	4.3	7.1	13.3
Dividend per share (p)		0.75	0.75	1.00	1.00	1.05	1.10
Gross Margin (%)		62.4	55.5	58.1	52.2	56.0	57.0
EBITDA Margin (%)		17.3	20.0	19.0	11.4	13.0	16.1
Operating Margin (before GW and except.) (%)		15.1	18.2	16.8	8.1	9.7	12.1
BALANCE SHEET							
Fixed Assets		48,602	59,457	68,325	69,398	67,708	64,218
Intangible Assets		13,176	17,635	21,255	21,040	19,240	15,640
Tangible Assets		1,393	1,993	2,722	2,927	3,037	3,147
Goodwill		33,467	39,082	43,540	44,610	44,610	44,610
Other		566	747	808	821	821	821
Current Assets		14,808	23,456	32,418	25,523	32,420	32,827
Stocks		0	0	0	0	0	0
Debtors		14,439	22,642	30,322	25,251	28,620	30,980
Cash		369	814	2,096	272	3,800	1,847
Current Liabilities		(19,510)	(29,300)	(48,043)	(39,272)	(42,728)	(36,438)
Creditors		(5,491)	(7,874)	(8,797)	(5,842)	(6,698)	(6,908)
Other Creditors		(9,719)	(16,628)	(21,468)	(19,379)	(19,979)	(18,479)
Short term borrowings		(4,300)	(4,798)	(17,778)	(14,051)	(16,051)	(11,051)
Long Term Liabilities		(12,457)	(16,371)	(5,797)	(4,524)	(4,492)	(4,492)
Long term borrowings		(7,051)	(11,502)	0	(32)	0	0
Other long term liabilities		(5,406)	(4,869)	(5,797)	(4,492)	(4,492)	(4,492)
Net Assets		31,443	37,242	46,903	51,125	52,908	56,115
CASH FLOW							
Operating Cash Flow		7,331	5,640	7,284	8,022	7,801	8,488
Net Interest		(1,303)	(947)	(839)	(820)	(600)	(550)
Tax		(1,637)	(1,368)	(1,312)	(1,217)	(977)	(1,811)
Capex		(1,638)	(2,055)	(3,160)	(4,613)	(3,950)	(2,750)
Acquisitions/disposals		(2,856)	(5,407)	(7,132)	(1,917)	(400)	0
Financing		1,434	174	5,026	2,677	0	0
Dividends		(247)	(64)	(214)	(286)	(314)	(330)
Net Cash Flow		1,084	(4,027)	(347)	1,846	1,560	3,047
Opening net debt/(cash)		13,012	10,982	15,486	15,682	13,811	12,251
HP finance leases initiated		0	0	0	0	0	0
Other		946	(477)	151	25	0	0
Closing net debt/(cash)		10,982	15,486	15,682	13,811	12,251	9,204

Source: K3 Business Technology, Edison Investment Research. Note: *18-month period.

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