

K3 Business Technology

Trading update

FY16 trading in line

K3 expects to report FY16 results broadly in line with market expectations. Trading was encouraging during H216, with a good level of contract wins in the final months of the year. Net debt has reduced over the year, although is higher than we forecast, partly due to a major retail customer going into administration close to year-end. We make no changes to estimates, pending FY16 results on 13 September.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
06/14	72.0	6.6	18.5	1.25	17.1	0.4
06/15	83.4	7.2	19.1	1.50	16.5	0.5
06/16e	87.5	9.4	23.3	1.65	13.6	0.5
06/17e	95.6	11.9	26.2	1.82	12.1	0.6

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

FY16 broadly in line with market expectations

K3 has reported that FY16 trading was encouraging, particularly in its core sectors. Results for the year should therefore be broadly in line with market expectations. This is despite providing in full for a retail customer that went into administration in June. The crucial final months of the year saw a good level of contract wins across both the Retail and Manufacturing divisions, and this combined with renewals supported significant new business for K3 hosting. Recurring revenues should show growth y-o-y, reflecting the increasing proportion of cloud-based business. Integration of DdD continues on track, and should be earnings enhancing in FY17.

Net debt reducing, although higher than expected

Net debt at year-end is expected to be £8.9m, down from the £12.1m at the end of FY15. This is higher than our £5.8m forecast – several factors have caused this, including the customer that has gone into administration and euro-denominated debt being translated at a lower exchange rate (from roughly €1.3/£1 through H216 to €1.2/£1 on 30 June). We expect to get a clearer picture on working capital when the company reports FY16 results on 13 September, at which point we will also incorporate the recent Merac acquisition.

Valuation: Own-IP strategy to drive upside

The stock is trading on a P/E multiple of 13.6x FY16e EPS and 12.1x FY17e EPS compared to small-cap UK software and IT services stocks trading on an average 17x current year and 15x next year EPS. K3 continues to invest in developing and supporting its own-IP solutions and building out its partner channel. Combined with a focus on selling hosting services to a larger proportion of customers, the company has the potential to grow the business on a multi-year basis. We believe that the stock could trade up to 15x FY17e EPS (393p per share).

Software & comp services

14 July 2016

Price **316.00p**
Market cap **£114m**

€1.19:£1

Net debt (£m) at end FY16 8.9

Shares in issue 36.0m

Free float 78%

Code KBT

Primary exchange AIM

Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	(11.6)	(7.5)	27.7
Rel (local)	(18.5)	(10.6)	30.0

52-week high/low 373.50p 250.50p

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 events

FY16 results 13 September 2016

Analysts

Katherine Thompson +44 (0)20 3077 5730

Dan Ridsdale +44 (0)20 3077 5729

tech@edisongroup.com
[Edison profile page](#)

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

Exhibit 1: Financial summary

	£'000s	2012	2013	2014	2015	2016e	2017e
Year end 30 June		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		67,961	63,513	71,950	83,427	87,506	95,609
Cost of Sales		(28,491)	(30,375)	(32,990)	(40,446)	(40,131)	(43,878)
Gross Profit		39,470	33,138	38,960	42,981	47,375	51,731
EBITDA		12,942	7,261	9,861	10,975	13,540	15,676
Operating Profit (before am of acq. Intang. and except.)		11,405	5,164	7,328	8,169	10,215	12,151
Amortisation of acquired intangibles		(3,586)	(3,182)	(2,989)	(2,800)	(2,900)	(2,900)
Share-based payments		(72)	(70)	(27)	(18)	(30)	(30)
Other		(395)	(727)	(1,722)	(546)	(900)	0
Operating Profit		7,352	1,185	2,590	4,805	6,385	9,221
Net Interest		(1,309)	(723)	(705)	(926)	(780)	(300)
Profit Before Tax (norm)		10,096	4,441	6,623	7,243	9,435	11,851
Profit Before Tax (FRS 3)		6,043	462	1,885	3,879	5,605	8,921
Tax		(319)	780	675	(436)	(1,057)	(1,659)
Profit After Tax (norm)		8,591	4,165	5,874	6,162	7,738	9,592
Profit After Tax (FRS 3)		5,724	1,242	2,560	3,443	4,548	7,262
Average Number of Shares Outstanding (m)		28.2	29.2	31.4	31.6	32.6	36.0
EPS - normalised (p)		30.4	14.3	18.7	19.5	23.7	26.6
EPS - normalised fully diluted (p)		29.7	14.1	18.5	19.1	23.3	26.2
EPS - FRS 3 (p)		20.3	4.3	8.1	10.9	14.0	20.2
Dividend per share (p)		1.00	1.00	1.25	1.50	1.65	1.82
Gross Margin (%)		58.1	52.2	54.1	51.5	54.1	54.1
EBITDA Margin (%)		19.0	11.4	13.7	13.2	15.5	16.4
Operating Margin (before GW and except.) (%)		16.8	8.1	10.2	9.8	11.7	12.7
BALANCE SHEET							
Fixed Assets		68,325	69,398	67,067	67,497	73,872	72,047
Intangible Assets		21,255	21,040	20,040	20,806	27,256	25,606
Tangible Assets		2,722	2,927	2,439	2,316	2,241	2,066
Goodwill		43,540	44,610	43,952	43,541	43,541	43,541
Other		808	821	636	834	834	834
Current Assets		32,418	25,523	29,535	33,734	39,564	44,147
Stocks		0	0	0	0	0	0
Debtors		30,322	25,251	28,888	31,839	34,283	36,934
Cash		2,096	272	647	1,895	5,281	7,213
Current Liabilities		(48,043)	(39,272)	(40,278)	(32,886)	(31,758)	(36,018)
Creditors		(8,797)	(5,842)	(7,218)	(7,640)	(8,012)	(8,750)
Other Creditors		(21,468)	(19,379)	(18,799)	(21,803)	(20,303)	(19,153)
Short term borrowings		(17,778)	(14,051)	(14,261)	(3,443)	(3,443)	(8,115)
Long Term Liabilities		(5,797)	(4,524)	(3,719)	(14,850)	(11,282)	(3,082)
Long term borrowings		0	(32)	(14)	(10,531)	(7,603)	(3)
Other long term liabilities		(5,797)	(4,492)	(3,705)	(4,319)	(3,679)	(3,079)
Net Assets		46,903	51,125	52,605	53,495	70,397	77,094
CASH FLOW							
Operating Cash Flow		7,284	8,022	5,352	9,600	9,068	12,614
Net Interest		(839)	(820)	(848)	(950)	(780)	(300)
Tax		(1,312)	(1,217)	290	(264)	(1,697)	(2,259)
Capex		(3,160)	(4,613)	(4,487)	(4,564)	(4,700)	(4,600)
Acquisitions/disposals		(7,132)	(1,917)	(129)	(1,998)	(7,900)	0
Financing		5,026	2,677	277	69	12,800	0
Dividends		(214)	(286)	(316)	(397)	(477)	(594)
Net Cash Flow		(347)	1,846	139	1,496	6,314	4,860
Opening net debt/(cash)		15,486	15,682	13,811	13,628	12,079	5,765
HP finance leases initiated		0	0	0	0	0	0
Other		151	25	44	53	0	0
Closing net debt/(cash)		15,682	13,811	13,628	12,079	5,765	905

Source: K3 Business Technology Group, Edison Investment Research

Edison, the investment intelligence firm, is the future of investor interaction with corporates. Our team of over 100 analysts and investment professionals work with leading companies, fund managers and investment banks worldwide to support their capital markets activity. We provide services to more than 400 retained corporate and investor clients from our offices in London, New York, Frankfurt, Sydney and Wellington. Edison is authorised and regulated by the [Financial Conduct Authority](#). Edison Investment Research (NZ) Limited (Edison NZ) is the New Zealand subsidiary of Edison. Edison NZ is registered on the New Zealand Financial Service Providers Register (FSP number 247505) and is registered to provide wholesale and/or generic financial adviser services only. Edison Investment Research Inc (Edison US) is the US subsidiary of Edison and is regulated by the Securities and Exchange Commission. Edison Investment Research Limited (Edison Aus) [46085869] is the Australian subsidiary of Edison and is not regulated by the Australian Securities and Investment Commission. Edison Germany is a branch entity of Edison Investment Research Limited [4794244]. www.edisongroup.com

DISCLAIMER

Copyright 2016 Edison Investment Research Limited. All rights reserved. This report has been commissioned by K3 Business Technology Group and prepared and issued by Edison for publication globally. 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 at the time of publication. The securities described in the Investment Research may not be eligible for sale in all jurisdictions or to certain categories of investors. This research is issued in Australia by Edison Aus and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. The Investment Research is distributed in the United States by Edison US to major US institutional investors only. Edison US is registered as an investment adviser with the Securities and Exchange Commission. Edison US relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. As such, Edison does not offer or provide personalised advice. We publish information about companies in which we believe our readers may be interested and this information reflects our sincere opinions. The information that we provide or that is derived from our website is not intended to be, and should not be construed in any manner whatsoever as, personalised advice. Also, our website and the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA 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 has a restrictive policy relating to personal dealing. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report. Edison 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. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (ie without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision. To the maximum extent permitted by law, Edison, its affiliates and contractors, and their respective directors, officers and employees will not be liable for any loss or damage arising as a result of reliance being placed on any of the information contained in this report and do not guarantee the returns on investments in the products discussed in this publication. FTSE International Limited ("FTSE") © FTSE 2016. "FTSE" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent.