

K3 Business Technology

Acquisition

Broadening the managed services offering

The bolt-on acquisition of Willow Starcom strengthens K3's hosting and managed services business, providing additional hosting capacity and expertise. The company expects the deal to be earnings accretive in its first full year of ownership. We have revised our forecasts to reflect the deal, with FY16 revenue and EPS increased by 3.0% and 2.5% respectively.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
06/13	63.5	4.4	14.1	1.00	16.0	0.4
06/14	72.0	6.6	18.5	1.25	12.2	0.6
06/15e	80.2	7.6	19.3	1.31	11.7	0.6
06/16e	88.9	9.8	25.0	1.38	9.0	0.6

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

Acquisition of Willow Starcom

K3 has acquired Willow Starcom, a wholly owned subsidiary of Access Intelligence. Willow Starcom provides remotely managed, on-premise and cloud-hosted IT support services as well as related hardware, software support and consultancy. It operates in two data centres in Manchester and is a Microsoft Hosting Partner. For the year ended 30 November 2014, the business generated revenue of £2.66m, EBITDA of £0.37m (14% margin) and PBT of £0.1m. K3 has paid £1.75m for the business on a debt-free/cash-free basis, funded from existing banking resources, equating to a trailing EV/Sales multiple of 0.7x (versus K3 at 1.2x) and a trailing EV/EBITDA multiple of 7.2x (versus K3 at 8.5x).

Changes to forecasts

We have made no change to our FY15 forecasts other than to reflect the £1.75m cost of the acquisition. We have factored in revenue of £2.6m in FY16 (in the Manufacturing & Distribution division) with an EBITA of £0.33m. We have increased our net interest expense forecast to reflect the higher level of debt. This results in an increase in revenue of 3.0%, EBITA of 3.1% and normalised EPS of 2.5%. We have not factored in any cost synergies; these could add upside to our forecasts.

Valuation: Trading at a discount to peers

The stock is trading on a P/E multiple of 11.7x FY15e EPS and 9.0x FY16e EPS. Sub-£200m market cap UK software stocks are trading on 17.5x current year and 14.7x next year EPS and UK IT service companies are trading on 16.8x current year and 14.1x next year EPS. K3 continues to invest in developing and supporting its own-IP solutions, including its "ax|is" solution. Combined with a focus on growing the SYSPRO and Sage businesses and selling hosting services to a larger proportion of customers, K3 has the potential to grow the business on a multi-year basis. We would expect triggers for a stock re-rating to include evidence that K3 continues to win more "ax|is" contracts, expansion of the international channel, and the managed services business winning customers. We believe that the stock could trade up to at least 15x FY15e EPS (289p per share).

Software & comp services

22 April 2015

Price **226.0p**
Market cap **£72m**

Net debt (£m) at end H115	12.1
Shares in issue	31.8m
Free float	77%
Code	KBT
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	0.0	3.9	6.9
Rel (local)	(0.7)	(1.6)	(0.4)
52-week high/low	232.50p	207.50p	

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

FY15 preliminary results September 2015

Analysts

Katherine Thompson +44 (0)20 3077 5730
Ian Robertson +44 (0)20 3681 2523

tech@edisongroup.com

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Exhibit 1: Financial summary

	£'000s	2012	2013	2014	2015e	2016e
Year end 30 June		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		67,961	63,513	71,950	80,170	88,850
Cost of Sales		(28,491)	(30,375)	(32,990)	(38,660)	(42,415)
Gross Profit		39,470	33,138	38,960	41,510	46,435
EBITDA		12,942	7,261	9,861	11,460	13,964
Operating Profit (before am of acq. Intang. and except.)		11,405	5,164	7,328	8,560	10,739
Amortisation of acquired intangibles		(3,586)	(3,182)	(2,989)	(3,000)	(3,000)
Share-based payments		(72)	(70)	(27)	(20)	(30)
Other		(395)	(727)	(1,722)	(158)	0
Operating Profit		7,352	1,185	2,590	5,382	7,709
Net Interest		(1,309)	(723)	(705)	(1,000)	(900)
Profit Before Tax (norm)		10,096	4,441	6,623	7,560	9,839
Profit Before Tax (FRS 3)		6,043	462	1,885	4,382	6,809
Tax		(319)	780	675	(968)	(1,279)
Profit After Tax (norm)		8,591	4,165	5,874	6,192	8,060
Profit After Tax (FRS 3)		5,724	1,242	2,560	3,414	5,530
Average Number of Shares Outstanding (m)		28.2	29.2	31.4	31.7	31.8
EPS - normalised (p)		30.4	14.3	18.7	19.6	25.4
EPS - normalised fully diluted (p)		29.7	14.1	18.5	19.3	25.0
EPS - FRS 3 (p)		20.3	4.3	8.1	10.8	17.4
Dividend per share (p)		1.00	1.00	1.25	1.31	1.38
Gross Margin (%)		58.1	52.2	54.1	51.8	52.3
EBITDA Margin (%)		19.0	11.4	13.7	14.3	15.7
Operating Margin (before GW and except.) (%)		16.8	8.1	10.2	10.7	12.1
BALANCE SHEET						
Fixed Assets		68,325	69,398	67,067	66,831	64,156
Intangible Assets		21,255	21,040	20,040	18,540	16,240
Tangible Assets		2,722	2,927	2,439	2,089	1,714
Goodwill		43,540	44,610	43,952	45,702	45,702
Other		808	821	636	500	500
Current Assets		32,418	25,523	29,535	33,819	36,957
Stocks		0	0	0	0	0
Debtors		30,322	25,251	28,888	32,507	36,027
Cash		2,096	272	647	1,312	930
Current Liabilities		(48,043)	(39,272)	(40,278)	(31,851)	(30,720)
Creditors		(8,797)	(5,842)	(7,218)	(8,041)	(8,910)
Other Creditors		(21,468)	(19,379)	(18,799)	(18,799)	(18,799)
Short term borrowings		(17,778)	(14,051)	(14,261)	(5,011)	(3,011)
Long Term Liabilities		(5,797)	(4,524)	(3,719)	(14,105)	(12,105)
Long term borrowings		0	(32)	(14)	(10,400)	(8,400)
Other long term liabilities		(5,797)	(4,492)	(3,705)	(3,705)	(3,705)
Net Assets		46,903	51,125	52,605	54,694	58,288
CASH FLOW						
Operating Cash Flow		7,284	8,022	5,352	8,506	10,263
Net Interest		(839)	(820)	(848)	(1,000)	(900)
Tax		(1,312)	(1,217)	290	(1,368)	(1,779)
Capex		(3,160)	(4,613)	(4,487)	(4,050)	(3,550)
Acquisitions/disposals		(7,132)	(1,917)	(129)	(2,208)	0
Financing		5,026	2,677	277	44	0
Dividends		(214)	(286)	(316)	(395)	(417)
Net Cash Flow		(347)	1,846	139	(471)	3,618
Opening net debt/(cash)		15,486	15,682	13,811	13,628	14,099
HP finance leases initiated		0	0	0	0	0
Other		151	25	44	0	0
Closing net debt/(cash)		15,682	13,811	13,628	14,099	10,481

Source: K3 Business Technology, Edison Investment Research

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