

# K3 Business Technology

Trading update

FY15 in line, with strong cash management

**K3 expects to report FY15 results broadly in line with market expectations, while net debt has fallen faster than we forecast. The company is making good progress with its strategy to grow its own-IP business, which should support revenue and margin growth in the medium term. K3 is planning to report full year results in mid-September.**

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
06/13	63.5	4.4	14.1	1.00	16.9	0.4
06/14	72.0	6.6	18.5	1.25	12.9	0.5
06/15e	80.2	7.6	19.3	1.31	12.4	0.6
06/16e	88.9	9.8	25.0	1.38	9.5	0.6

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

## FY15 trading in line

K3 expects to report FY15 results broadly in line with market expectations. The company noted that it saw weaker than expected demand from the Dutch market, and has also seen a small negative impact from the weakening of the euro over the period (the euro weakened 3% in Q215 vs Q115). The IP business has seen strong levels of interest and is making progress in its efforts to grow the number of global channel partners. Recurring income is expected to show year-on-year growth, helped by strong demand for hosting.

## Debt reduction better than expected

K3 expects to report a net debt position of £12.1m at the end of FY15, significantly lower than our £14.1m forecast. With profitability expected to be close to our forecasts, we assume that the benefit has come from better working capital management. The reduction of £1.5m over the year is after paying £1.75m for Willow Starcom in April. We make no changes to our forecasts, pending full year results in mid-September.

## Valuation: Re-rating has further to go

The stock is trading on a P/E multiple of 12.4x FY15e EPS and 9.5x FY16e EPS. Sub-£200m market cap UK software and IT services stocks are trading on 17.4x current year and 15.1x 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 &amp; comp services

10 July 2015

**Price** **238.50p**
**Market cap** **£76m**

Net debt (£m) at end FY15	12.1m
Shares in issue	31.8m
Free float	77%
Code	KBT
Primary exchange	AIM
Secondary exchange	N/A

## Share price performance



%	1m	3m	12m
Abs	(9.1)	5.3	13.8
Rel (local)	(6.7)	11.3	13.7
52-week high/low	265.50p	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 event

FY15 results	Mid-September 2015
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## Analysts

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**Exhibit 1: Financial summary**

	£'000s	2012	2013	2014	2015e	2016e
Year end 30 June		IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>						
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
<b>BALANCE SHEET</b>						
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
<b>CASH FLOW</b>						
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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