

K3 Business Technology

Trading update

Growth on track

Trading in H115 was in line with management expectations, with continued interest in K3's new Microsoft Dynamics AX solution and improving demand for SYSPRO and Microsoft Dynamics NAV solutions. K3 continues to build its international reseller channel and in H115 saw the first sales of its new AX solution through this. We make no changes to estimates but highlight that if trading continues to be as strong in H2, there is scope for upgrades.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
06/13	63.5	4.4	14.1	1.00	14.9	0.5
06/14	72.0	6.6	18.5	1.25	11.4	0.6
06/15e	79.7	8.0	20.4	1.31	10.3	0.6
06/16e	84.2	9.9	25.3	1.38	8.3	0.7

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

Strong first half

H115 trading was in line with management expectations. Revenues grew c 20% y-o-y, implying H115 revenues of c £41m, more than half our full-year revenue forecast of £79.7m. The company continues to make progress with direct sales of its new Microsoft Dynamics AX solution, and has made the first sales of this solution via its international reseller channel in Europe, Australasia and North America. K3 is also seeing improving sales of SYSPRO and Microsoft Dynamics NAV products, although demand from the Dutch retail market remains weak. The company did not quantify net debt at the end of H115, noting that, as expected, it benefited from SYSPRO licence renewals. Higher working capital to support strong period end sales should reverse in H2, depending on the timing of H2 sales.

Developing product and reseller channel

The company continues to focus on investing in AX product development, developing its SYSPRO business and expanding its international reseller channel (K3 was recently accredited as one of only 25 Microsoft global independent software vendors). The company expects to report H115 results in mid-March when it will change its divisional reporting to reflect the industry sectors in which it operates (retail, manufacturing and distribution) and global IP. We make no changes to estimates now but note that there is upgrade potential if trading continues to be as strong in H215.

Valuation: Trading at a discount

The stock is trading on a P/E of 10.3x FY15e, 8.3x FY16e and an EV/sales multiple of 1.0x FY15e. This is still at a material discount to its peers (sub-£500m market cap UK software current year P/E 21.3x, EV/sales 2.5x). With evidence of sustained demand for the new ax |is solution and continued debt reduction, we see scope for the share price to reduce the discount to peers. The wider global opportunity for ax |is could provide further upside potential in the longer term.

Software & comp services

20 January 2015

Price **210.0p**
Market cap **£67m**

Net debt (£m) at end FY14	13.6
Shares in issue	31.8m
Free float	77%
Code	KBT
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(5.8)	(3.5)	46.9
Rel (local)	(6.5)	(8.1)	51.6
52-week high/low	232.50p	145.50p	

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 interims	March 2015
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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	79,705	84,196
Cost of Sales		(28,491)	(30,375)	(32,990)	(34,273)	(36,204)
Gross Profit		39,470	33,138	38,960	45,432	47,992
EBITDA		12,942	7,261	9,861	11,356	13,502
Operating Profit (before am of acq. Intang. and except.)		11,405	5,164	7,328	8,556	10,402
Amortisation of acquired intangibles		(3,586)	(3,182)	(2,989)	(3,100)	(3,100)
Share-based payments		(72)	(70)	(27)	(70)	(70)
Other		(395)	(727)	(1,722)	0	0
Operating Profit		7,352	1,185	2,590	5,386	7,232
Net Interest		(1,309)	(723)	(705)	(600)	(500)
Profit Before Tax (norm)		10,096	4,441	6,623	7,956	9,902
Profit Before Tax (FRS 3)		6,043	462	1,885	4,786	6,732
Tax		(319)	780	675	(1,034)	(1,287)
Profit After Tax (norm)		8,591	4,165	5,874	6,522	8,114
Profit After Tax (FRS 3)		5,724	1,242	2,560	3,752	5,444
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	20.6	25.6
EPS - normalised fully diluted (p)		29.7	14.1	18.5	20.4	25.3
EPS - FRS 3 (p)		20.3	4.3	8.1	11.8	17.1
Dividend per share (p)		1.00	1.00	1.25	1.31	1.38
Gross Margin (%)		58.1	52.2	54.1	57.0	57.0
EBITDA Margin (%)		19.0	11.4	13.7	14.2	16.0
Operating Margin (before GW and except.) (%)		16.8	8.1	10.2	10.7	12.4
BALANCE SHEET						
Fixed Assets		68,325	69,398	67,067	64,469	61,571
Intangible Assets		21,255	21,040	20,040	17,840	15,340
Tangible Assets		2,722	2,927	2,439	2,041	1,643
Goodwill		43,540	44,610	43,952	43,952	43,952
Other		808	821	636	636	636
Current Assets		32,418	25,523	29,535	33,423	36,318
Stocks		0	0	0	0	0
Debtors		30,322	25,251	28,888	32,319	34,832
Cash		2,096	272	647	1,104	1,486
Current Liabilities		(48,043)	(39,272)	(40,278)	(38,554)	(33,954)
Creditors		(8,797)	(5,842)	(7,218)	(7,994)	(8,444)
Other Creditors		(21,468)	(19,379)	(18,799)	(18,799)	(17,749)
Short term borrowings		(17,778)	(14,051)	(14,261)	(11,761)	(7,761)
Long Term Liabilities		(5,797)	(4,524)	(3,719)	(3,705)	(3,705)
Long term borrowings		0	(32)	(14)	0	0
Other long term liabilities		(5,797)	(4,492)	(3,705)	(3,705)	(3,705)
Net Assets		46,903	51,125	52,605	55,632	60,230
CASH FLOW						
Operating Cash Flow		7,284	8,022	5,352	8,702	10,388
Net Interest		(839)	(820)	(848)	(600)	(500)
Tax		(1,312)	(1,217)	290	(1,434)	(1,787)
Capex		(3,160)	(4,613)	(4,487)	(3,302)	(3,302)
Acquisitions/disposals		(7,132)	(1,917)	(129)	0	0
Financing		5,026	2,677	277	0	0
Dividends		(214)	(286)	(316)	(395)	(417)
Net Cash Flow		(347)	1,846	139	2,971	4,382
Opening net debt/(cash)		15,486	15,682	13,811	13,628	10,657
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	10,657	6,275

Source: K3 Business Technology, Edison Investment Research

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