

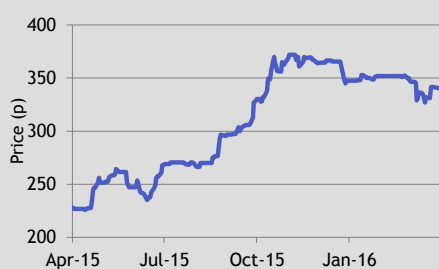
K3 BUSINESS TECHNOLOGY GROUP SOFTWARE AND COMPUTER SERVICES

KBT.L

340p

Market Cap: £109.9m

SHARE PRICE (p)



12m high/low

372p/226p

Source: LSE Data

KEY INFORMATION

Enterprise value	£123.6m
Index/market	FTSE AIM
Next news	H1 FY16, Mar 16
Gearing	12%
Interest cover	11.4x

**K3 BUSINESS TECHNOLOGY GROUP IS A
RESEARCH CLIENT OF PROGRESSIVE**

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Placing and complementary acquisition

Integrated solution with a fashion retail focus

K3 has announced a placing of £13.5 million before costs to fund the acquisition of Retail Support International (also known as DdD Retail) for up to €10 million. DdD operates in Denmark, Germany, Sweden and Norway and provides a proprietary combined point of sale software (cloud based)/hardware solution, focusing on the fashion retail industry. Complementary to its existing retail software offering, the deal is in line with K3's strategy of seeking acquisitions which accelerate growth and also increase sales of K3-owned intellectual property. We estimate that it will be 4%-5% enhancing in the first full year of ownership and upgrade Adjusted EPS in FY16E by 1% and in FY17E by 4%. The accompanying trading update reiterates that the Group has a 'very healthy' pipeline of new deals and notes that management will consider further acquisitions and disposal of non-core businesses.

- DdD's core offering is a fully integrated combined hardware/software proposition that provides and integrates Point of Sale, back-office and head office systems. It is a plug-and-play solution which is delivered via the cloud and licensed on a monthly, 'consumption' basis.
- In its financial year to the end of December 2015, DdD reported revenue of €6.2 million (of which 56% was recurring), EBIT of €0.87 million and free cash flow of €1.04 million.
- K3 will pay up to €10 million (approx. £7.9 million) comprising €8.9 million (approx. £7.0 million) initial cash consideration and up to €1.1 million (approx. £0.9 million) deferred cash consideration based upon certain performance targets.
- The placing of 4.09 million shares (approx. 11.4% of the enlarged share capital) at 330p will raise £13.5 million before costs of around £0.7 million. As well as funding the DdD acquisition, the balance of around £4.9m will be used for 'additional product enhancement opportunities and working capital'.
- We upgrade Revenue estimates for FY16E and FY17E by 1.1% and 6.5% respectively. Adjusted EPS estimates increase by 1.4% for FY16E (two months of ownership) and by 4.3% for FY17E reflecting the effects of the acquisition and placing.

NB: estimates in this document include the impact of the acquisition and placing while, ahead of the admission of the new shares, the Market Cap and Enterprise Value noted on the left-hand side of this page do not.

FYE JUNE (£M)	FY13	FY14	FY15	FY16E	FY17E
Revenue	63.5	72.0	83.4	89.6	95.6
Adjusted EBITDA	7.2	9.8	10.9	13.0	15.8
Adjusted PBT	4.4	6.6	7.2	9.4	11.6
Adjusted EPS (p)	13.9	18.4	19.1	23.6	26.9
EV/Sales	1.9x	1.7x	1.5x	1.4x	1.3x
EV/ Adj. EBITDA	16.9x	12.4x	11.2x	9.4x	7.7x
P/E	25.4x	19.1x	18.4x	15.0x	13.5x

Source: Company Information and Progressive Equity Research estimates

The acquisition of DdD

K3's management had previously said that it would consider acquisitions that would accelerate growth, complement the Group's existing activities and add intellectual property (IP) in line with its focus on increasing sales of its own IP. We believe that the acquisition of DdD fits those criteria well and it is worth remembering that, in its interim results, K3's Retail business had reported a significant increase in its gross margin on recurring revenues to 70.8% with an increase in the proportion of K3's IP in the revenue mix. We expect the deal to be earnings enhancing in K3's FY17E.

DdD was established in 1989, is headquartered in Denmark, employs 43 people and operates in Denmark, Germany, Sweden and Norway. It has approximately 2,700 installations across 1,800 stores covering over 750 customers. Customers include Esprit, the sportswear chain and Saint Tropez, the women's fashion brand. It provides proprietary point of sale software, focusing on the fashion retail industry. Its "Retail in a Box" core offering is a fully integrated combined hardware/software proposition which is delivered via the cloud and licensed on a monthly 'consumption' basis. The announcement notes that its attractions to retailers include 'its rich customer interface as well as its ease of use and rapid installation'.

DdD summary financial information (€000s)

Year Ended 31 December	2013	2014	2015
Revenue	6,370	6,121	6,233
Of which recurring (%)	46%	52%	56%
Gross margin %	59%	58%	64%
EBITDA	930	739	1,079
EBIT	713	509	868
Net cash from operating activities	808	615	1,159
Capital expenditure/development costs	32	105	117
Free cash flow	776	510	1,042
Net assets	1,356	1,667	2,248

Source: Company information

Trading update reiterates good pipeline of new deals

The outlook statement in March's interim results announcement pointed to 'healthy' pipelines in both its Retail and Manufacturing and Distribution activities and flagged continued investment in product development. The trading update that accompanies the acquisition announcement reiterates that point and notes that the Board is 'confident about the potential to exploit K3's IP and expects to see continuing progress in its growth strategy'. It also repeats that it expects cloud-based consumption licensing to be an increasing feature of the Group's revenue mix, together with rising channel partner sales and hosting.

We have previously noted that the increasing adoption of subscription models as the industry moves towards consumption-based licensing will affect the timing of revenues. Revenues will reflect a shift as subscription contracts will provide income which is recognised over longer time periods (and less up-front) but with a potentially greater lifetime value of such contracts.

In looking at the structure and focus of the Group, the Board says that it will consider further acquisitions as well as disposals of non-core businesses.

Estimates

We estimate that the acquisition will be 4%-5% enhancing in the first full year of ownership. Taking account of the placing and acquisition, we upgrade Adjusted EPS estimates by 1.4% for FY16E (two months of ownership) and by 4.3% for FY17E. The adjustments to our estimates are shown in the table below.

Estimate changes

£m unless stated	FY16E			FY17E		
	Old	New	Change (%)	Old	New	Change (%)
Revenue	88.6	89.6	1.1%	89.8	95.6	6.5%
Adj EBITDA	12.8	13.0	1.7%	14.5	15.8	9.2%
Reported PBT	5.1	5.5	6.2%	6.7	8.5	25.8%
Fully adj PBT	9.1	9.4	3.5%	9.9	11.6	17.6%
Reported EPS (p)	12.9	13.4	3.9%	16.8	18.7	11.5%
Fully adj EPS (p)	23.3	23.6	1.4%	25.8	26.9	4.3%

Source: Progressive Equity Research estimates

SUMMARY FINANCIALS

Profit & Loss	FY-12A	FY-13A	FY-14A	FY-15A	FY-16E	FY-17E
Revenue	68.0	63.5	72.0	83.4	89.6	95.6
Adj EBITDA	12.9	7.2	9.8	10.9	13.0	15.8
Adj EBITA	11.3	5.1	7.3	8.2	10.2	12.1
Reported PBT	6.0	0.5	1.9	3.7	5.5	8.5
PBT before exceptionals and AAG	10.0	4.4	6.6	7.2	9.4	11.6
Fully adj PBT	10.0	4.4	6.6	7.2	9.4	11.6
NOPAT	9.3	4.4	6.2	7.0	8.4	10.2
Reported EPS (p)	19.8	4.2	8.1	10.1	13.4	18.7
EPS before exceptionals and AAG (p)	29.5	13.9	18.4	19.1	24.0	26.9
Fully adj EPS (p)	29.5	13.9	18.4	19.1	23.6	26.9
Dividend per share (p)	1.0	1.0	1.3	1.5	1.8	1.9
Cash flow & Balance sheet	FY-12A	FY-13A	FY-14A	FY-15A	FY-16E	FY-17E
Operating cash flow	7.3	8.0	5.4	9.6	8.5	12.8
Free Cash flow £m	1.8	1.1	(0.0)	8.4	1.0	4.6
FCF per share p	6.1	3.7	(0.0)	26.1	2.9	12.6
Acquisitions	(7.1)	(1.9)	(0.1)	(6.6)	(8.6)	0.0
Disposals	0.0	0.0	0.0	0.0	0.0	0.0
Shares issued	5.0	2.7	0.3	0.0	13.5	0.0
Net cash flow	(0.5)	2.0	0.1	5.5	5.9	4.6
Overdrafts / borrowings	(17.8)	(14.1)	(14.3)	(13.9)	(13.9)	(13.9)
Cash & equivalents	2.1	0.3	0.6	1.9	7.8	12.3
Net (Debt)/Cash	(15.7)	(13.8)	(13.6)	(12.0)	(6.1)	(1.6)
NAV and returns	FY-12A	FY-13A	FY-14A	FY-15A	FY-16E	FY-17E
Net asset value	46.9	51.1	52.6	53.5	70.9	77.1
NAV/share (p)	164.7	162.6	165.8	169.2	198.4	215.8
Net Tangible Asset Value	(17.9)	(14.5)	(11.4)	(8.9)	3.5	11.1
NTAV/share (p)	(62.8)	(46.2)	(35.9)	(28.1)	9.9	31.1
Average equity	42.1	49.0	51.9	53.1	62.2	74.0
Post-tax ROE (%)	13.6%	2.5%	4.9%	6.1%	7.1%	9.2%
Metrics	FY-12A	FY-13A	FY-14A	FY-15A	FY-16E	FY-17E
Revenue growth		-6.5%	13.3%	16.0%	7.4%	6.6%
Adj EBITDA growth		-44.1%	36.8%	10.3%	19.7%	21.9%
Adj EBIT growth		-55.1%	43.3%	11.6%	25.0%	18.9%
Adj PBT growth		-56.4%	50.9%	9.5%	30.3%	23.6%
Adj EPS growth		-52.9%	32.8%	4.0%	23.3%	13.8%
Dividend growth		0.0%	25.0%	20.0%	16.7%	5.7%
Adj EBIT margins	16.7%	8.0%	10.1%	9.8%	11.4%	12.7%
Valuation	FY-12A	FY-13A	FY-14A	FY-15A	FY-16E	FY-17E
EV/Sales	1.8	1.9	1.7	1.5	1.4	1.3
EV/EBITDA	9.5	16.9	12.4	11.2	9.4	7.7
EV/NOPAT	13.1	27.8	19.8	17.5	14.5	12.0
PER	11.9	25.4	19.1	18.4	14.9	13.1
Dividend yield	0.3%	0.3%	0.4%	0.4%	0.5%	0.5%
FCF yield	1.7%	1.0%	0.0%	7.4%	0.8%	3.6%

Source: Company information, Progressive Equity Research estimates

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