PROGRESSIVE EQUITY RESEARCH

19 January 2014

K3 BUSINESS TECHNOLOGY GROUP

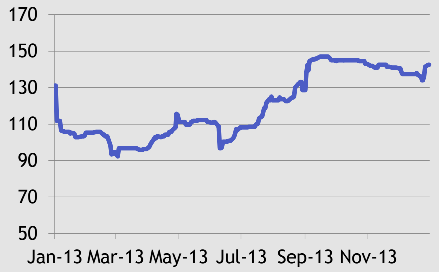
SOFTWARE & COMPUTER SERVICES

KBT.L

142.5p

Market Cap: £45.0m

SHARE PRICE PERFORMANCE



12m high/low	147p/92p

Source: LSE Data

KEY INFORMATION

Enterprise value	£58.8m
Index/market	FTSE AIM
Next news	H1 results, March 2014
Gearing	31%
Interest cover	12.2x

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In-line H1 trading update

Improving performance underpins estimates

- **K3's trading update for the first half (six months to the end of December 2013) of its current financial year notes that trading is in line with management's expectations. It highlights the improvement in performance of the Microsoft UK Division and the successful launch of its new "*ax | is fashion*" solution with an enhanced version on track for release in mid-2014. The new solution is already seeing encouraging demand and the update notes order wins in the last few months. The announcement says that the Microsoft UK Division's progress, in conjunction with an improving performance in the Managed Services Division, will 'help to underpin forecast results for the full financial year'. We make no changes to estimates at this stage.**
- K3 finished its last financial year (twelve months to the end of June 2013) with a useful tailwind which was expected to provide a firm footing for FY14. That has clearly borne fruit in the form of an improved performance in the Microsoft UK Division in particular.
- Late in the FY13 financial year, K3 secured its first major order for Microsoft's AX for Retail solution in a contract with a book retailer with Microsoft as the prime delivery contractor and K3 providing the specialist retail modules required.
- In November 2013, WeirdFish (fashion) was the launch customer for *ax | is fashion* which is an enhancement of AX for Retail and includes a number of K3 fashion modules built into the core Dynamics for Retail platform.
- K3 provides a complete multi-channel solution for retailers and wholesalers to create a joined-up shopping experience for their customers regardless of how they make their purchases. It is continuing to aim for the delivery of its solutions on a more global basis.
- Investment in the development of the hosting platforms in the Managed Services Division was largely completed in FY13 and a reduced divisional cost base should contribute to an improving performance.

FYE JUNE	2011	2012	2013	2014E	2015E
Revenue	52.8	68.0	63.5	71.5	77.5
Adjusted EBITDA	10.6	12.9	7.3	9.8	10.5
Adjusted PBT	8.7	10.0	4.4	6.9	7.6
Adjusted EPS	22.8	24.4	13.9	17.7	19.6
EV/Sales	1.1x	0.9x	0.9x	0.8x	0.8x
EV/ Adj. EBITDA	5.6x	4.5x	8.1x	6.0x	5.6x
P/E	6.3x	5.8x	10.3x	8.0x	7.3x
Dividend yield (%)	0.5%	0.7%	0.7%	0.8%	0.8%

Source: Company Information and Progressive Equity Research estimates

FINANCIAL FORECASTS

Year ended Jun	**FY-11**	**FY-12**	**FY-13**	**FY-14**	**FY-15**
	£m	**£m**	**£m**	**£m**	**£m**
Profit & Loss	**Act**	**Act**	**Act**	**Est**	**Est**
Revenue £m	52.8	68.0	63.5	71.5	77.5
Adj EBITDA £m	10.6	12.9	7.3	9.8	10.5
Adj EBIT £m	9.6	11.4	5.2	7.8	8.5
Reported PBT	4.9	6.0	0.5	3.4	4.1
PBT before exceptionals and AAG	8.7	10.0	4.4	6.9	7.6
Fully adj PBT	8.7	10.1	4.4	7.0	7.7
NOPAT £m	6.7	8.0	3.6	5.4	6.0
Reported EPS	16.7	19.8	4.2	8.6	10.5
EPS before exceptionals and AAG	22.7	24.3	10.4	17.6	19.4
Fully adj EPS	22.8	24.4	13.9	17.7	19.6
Dividend per share p	0.8	1.0	1.0	1.1	1.2
Cash flow & Balance sheet					
Operating cash flow	5.6	7.3	8.0	8.8	9.5
Free Cash flow £m	2.4	3.6	3.9	4.2	4.9
FCF per share p	8.9	12.4	13.2	13.3	15.6
Capex	-2.1	-3.2	-4.6	-3.5	-3.0
Acquisitions	-5.4	-7.1	-1.9	-0.4	-0.4
Net cash flow	-4.2	-5.4	-0.8	1.9	3.1
Shares issued	0.2	5.0	2.7	0.0	0.0
Net cash	-15.5	-15.7	-13.8	-11.9	-8.8

Metrics	**FY-11**	**FY-12**	**FY-13**	**FY-14**	**FY-15**
Revenue growth	*20.4%*	*28.7%*	*-6.5%*	*12.6%*	*8.4%*
Adj EBITDA growth	*27.4%*	*22.4%*	*-43.9%*	*34.5%*	*7.5%*
Adj EBIT growth	*28.8%*	*18.4%*	*-54.7%*	*50.4%*	*9.5%*
Adj PBT growth	*31.5%*	*15.7%*	*-56.0%*	*56.9%*	*10.5%*
Adj EPS growth	*22.7%*	*7.2%*	*-43.2%*	*27.9%*	*10.5%*
Dividend growth	*50.0%*	*33.3%*	*0.0%*	*10.0%*	*9.1%*
Adj EBIT margins	*18.2%*	*16.8%*	*8.1%*	*10.9%*	*11.0%*
Operating cash conversion	53%	56%	110%	90%	90%
Capex/Depreciation	218%	206%	219%	175%	150%

Valuation	**FY-11**	**FY-12**	**FY-13**	**FY-14**	**FY-15**
EV/sales	1.1	0.9	0.9	0.8	0.8
EV/EBITDA	5.6	4.5	8.1	6.0	5.6
EV/NOPAT	8.7	7.4	16.3	10.8	9.9
PER	6.3	5.8	10.3	8.0	7.3
Dividend yield	0.5%	0.7%	0.7%	0.8%	0.8%
FCF yield	6.2%	8.7%	9.2%	9.3%	10.9%

Source: Progressive Equity Research Ltd estimates

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