K3 Business Technology Group plc

Unaudited Half Yearly Report for the six months to 31 December 2012

World Class Software. World Class Service.

K3 Business Technology Group plc

K3 is the UK's leading supplier of integrated business systems encompassing Enterprise Resource Planning (ERP) software, Customer Relationship Management (CRM) software, Business Intelligence and e-commerce, hosting and managed services to the supply chain industry. Focussed on the Retail, Manufacturing and Distribution markets, we support more than 3,000 customers in over 20 countries.

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Chairman's Statement

"It is worth noting the robustness of our recurring income (from software license renewals and support contracts) which increased by 3% year-on-year to £17.60m"

Overview

The six months to 31 December 2012 have been an extremely difficult period for K3 combining challenging trading conditions, especially in the retail sector, and a period of significant investment as we increased resources to create a new global retail solution built around Microsoft's latest AX technology ("Project Gemstone") and continued to develop our Managed Services offering. The Group's retail software activities in particular suffered from customers deferring spending decisions and some expected large deals did not close. This resulted in the deferral of software licence revenue and loss of services revenue for which the cost of the sales and delivery resource had already been committed by K3 and so reduced both like-for-like sales and margins, and increased operating costs. The Group's results reflect these challenges, with revenue decreased to £31.55m against £33.36m in the same six months in 2011 and adjusted profit from operations*1 reduced to £2.94m against £6.91m in 2011. Our investment in our Microsoft AX offering in the first half totalled £2.15m after capitalising £0.57m of development costs and profitability was also adversely affected by exceptional reorganisation costs amounting to £0.48m (2011: £0.14m).

Alongside the headline figures, it is worth noting the robustness of our recurring income (from software licence renewals and support contracts), which increased by 3% year-on-year to £17.60m and the Group's very strong operating cash generation at £6.92m. Net debt has also reduced by 8% to £12.32m against the same point in 2011. The acquisitions we made in the prior year performed in line with our expectations at the time of purchase and contributed £6.08m of income and £0.76m of adjusted profit from operations*2.

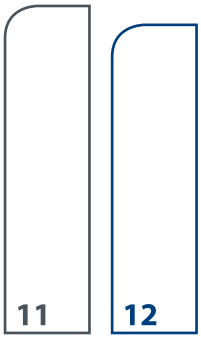
Project Gemstone is progressing well and we expect our AX solution to be a very significant driver for growth. Microsoft is investing heavily in AX as its strategic global enterprise business solution and we believe this will create a significant opportunity for K3. We aim to leverage our dominant position as Microsoft's largest retail partner in the UK and extend this internationally through our established independent software vendor distributor channel. As we previously reported, we are encouraged by the growing pipelines for AX. The net cost of the AX resource investment charged to profit from operations in the current period was £2.15m after capitalising £0.57m of development costs.

We continue to invest in Managed Services. Here we have improved our product offering and reduced the price points of various services. Both customer numbers and revenues are growing. However, the increase in costs together with the phased recognition of income (which is recognised over the life of the hosting contract) means that we operated at a small loss in the first half. Nonetheless, the growth opportunity is still exciting with a number of large international prospects now at an advanced stage.

There has been some disruption to the business over the past 12 months resulting from the strategic review and sales process which followed the approach by Mr P J Claesson regarding a possible offer for the Company. As we previously announced, this process ended on 18 September 2012 without a final offer being received that the Board felt able to recommend to shareholders and the Board is now firmly focused on its business investment strategy.

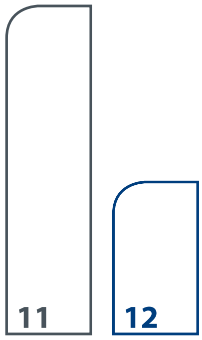
As we have stated previously, developing K3's own intellectual property ("IP"), our global channels to market and our Managed Services offering will help drive medium and long term growth and yield significant returns. The steps we have taken in the first half help support this strategy and, subject to market conditions, we expect to see K3 return to growth within the next 12 months.

*See note 8 on page 19 for further details



Revenue

£31.55m



Adjusted Profit From Operations[*1]

£2.94m

Financial Results

For the six months to 31 December 2012, the Group generated revenues of £31.55m (2011: £33.36m). Recurring revenues from software licence renewals and support contracts in the half year increased to £17.6m (2011: £17.1m), representing 56% of Group income in the first half, and continue to underpin the results of the Group. Software sales decreased to £3.72m (2011: £5.04m) and services revenue was £8.54m (2011: £10.79m) reflecting the shortfall in new software wins.

Adjusted profit from operations[*1] for the six month period reduced to £2.94m against the same period last year (2011: £6.91m). The upper tier of our Microsoft UK retail sales has moved rapidly to a focus on the AX software suite which is being developed and we have incurred net costs of £2.15m in building up the resource to manage the deals. Additionally, we have capitalised £0.57m in respect of new Retail AX intellectual property that will benefit future periods. We incurred £0.48m of exceptional reorganisation costs, which related primarily to acquisitions we made in the prior year, with the financial and operational benefits to come through in the second half and beyond. These acquisitions contributed £6.08m to revenues (2011: £3.83m) and £0.76m (2011: £0.51m) to adjusted profit from operations[*2]. Profit from operations at £0.62m (2011: £4.66m) reflected the factors above plus a small increase in the amortisation of intangibles.

Adjusted profit before tax[*3] reduced to £2.51m (2011: £6.23m). Profit before tax was £0.19m (2011: £3.98m). This reflects the shortfall in profit from operations, a £0.06m increase in intangibles amortisation and a £0.25m reduction in finance costs as facility utilisation reduces. Adjusted earnings per share[*4] reduced to 6.5p (2011: 18.1p). Basic earnings per share were 0.8p (2011: 12.3p). This is stated after amortisation of acquired intangibles (net of tax) of £1.22m (2011: £1.19m) and acquisition and reorganisation costs (net of tax) of £0.39m (2011: £0.46m). There was a net tax credit for the period of £0.03m (2011: charge of £0.52m), which includes the benefit of a £0.60m credit to deferred tax on acquired intangibles (2011: £0.57m), including the impact of UK tax rates reducing in future years.

*See note 8 on page 19 for further details

"Operating cash flow in the first half was £6.92m, representing 235% of adjusted profit from operations*1"

Cash flow and banking

Net debt at the period end reduced by 8% year-on-year to £12.32m and is £3.36m lower than at the start of the financial year (2011: £13.35m and 30 June 2012: £15.68m). Operating cash flow in the first half was £6.92m, representing 235% of adjusted profit from operations*1 (2011: £5.81m, representing 84%). This highlights the ability of the Group to generate cash from its recurring income base, with cash generation strongest in the first half of the year, reflecting SYSPRO licence and support contract renewals. Deferred and contingent consideration outstanding relating to acquisitions amounted to £1.04m (2011: £4.48m) and we have drawn down an additional £0.84m on our facilities to fund settlement of this consideration. Finance costs reduced to £0.44m (2011: £0.69m) reflecting lower borrowings and foreign currency gains.

Dividend

In line with the Group's dividend policy, no interim dividend is proposed but the Directors intend to propose a final dividend with results for the full financial year.

- **Net debt** at the period end **reduced by 8%** year-on-year to £12.32m and is **£3.36m lower** than at the start of the financial year
- **Finance costs reduced** to £0.44m (2011: £0.69m) reflecting **lower borrowings** and foreign currency gains

*See note 8 on page 19 for further details

Operational Review

The financial results by operating division are summarised in the table below:

	Revenue Six months to 31 December 2012 £m	Revenue Six months to 31 December 2011 £m	Adjusted profit Six months to 31 December 2012 £m	Adjusted profit Six months to 31 December 2011 £m
Microsoft UK	8.47	12.10	(1.26)	1.52
International	5.39	4.84	0.47	1.40
SYSPRO and Sage	14.60	13.81	4.11	4.07
Managed Services	3.09	2.61	(0.16)	0.09
Head office costs	–	–	(0.22)	(0.17)
	31.55	33.36	2.94	6.91

Encouragingly, our total Microsoft Dynamics pipeline **currently stands at close to £36.0m**

Microsoft UK Division

Project Gemstone

Microsoft is investing heavily in AX as its strategic global enterprise business solution. Project Gemstone is our software development project, supported by Microsoft, that will create a world class MS Dynamics AX solution for the retail and wholesale markets.

We are taking our existing market-leading retail and wholesale solutions and incorporating the functionality into a single product, Gemstone. The final product will be CFMD "Certified for Microsoft Dynamics" which means that Microsoft will support its international distribution. The first commercial release will be mid year 2013, with more releases following over the next 12 months.

We expect K3 to become one of Microsoft's leading global software authors for the retail and wholesale sectors as a result of this process. We already have an established reseller channel which we will extend to exploit fully this opportunity. Microsoft is seeking to appoint a single 'Go To Market' partner for AX retail and wholesale and we hope that Project Gemstone will help us to secure this status.

Results

The results of the Microsoft UK Division have been heavily impacted by Project Gemstone, our Microsoft AX for Retail product and the sales, delivery and development resources required for this together with very weak retail markets. It has been difficult to close deals at a time when retailers are struggling in the recession and some expected major deals have not been signed. This in turn has meant that consulting services have been depressed. However, we have attempted to offset this by focusing delivery resource on key software development areas and this is likely to result in an additional £1.0m of accelerated product development in the year (of which 50% has been recognised in the period). Encouragingly, our total Microsoft Dynamics pipeline currently stands at close to £36.0m (2011: £28.6m), with a fundamental switch from NAV to AX deals and this should help to support the Group's return to growth.

Revenues for the International Division **increased by 11% year-on-year to £5.39m**

Revenues at the Microsoft UK Division reduced by 30% to £8.47m (2011: £12.1m), with recurring income delivering £3.59m (2011: £4.37m) due to the absence of major new deals and loss of a significant account. New order wins for the division totalled £0.6m (2011: £8.6m), with the reduction effectively mirroring the pipeline increase year on year. The reduction in revenues and increased retail AX cost base resulted in an adjusted loss from operations[*5] of £1.26m (2011: profit of £1.52m), with retail AX contributing a net £2.15m of losses. Whilst the revenue in the retail AX unit had a combined value of only £0.25m, these contracts are important to the evolution of our AX product as they contain our own new IP that we will be utilising in larger contracts. Project Gemstone also incorporates work with our International Division on a development roadmap for fashion, wholesale and multi-channel retail product based on the successful products we already have running with Microsoft Dynamics NAV.

The smaller units in the Division, which sell a mixture of non-retail NAV, non-retail AX and legacy products, enjoyed an improved operating performance assisted by the rationalisation in the cost base following acquisitions in previous years, and a strong performance from Retail Systems Group Ltd ("RSG") which we acquired in December 2011 (revenue: £0.93m, adjusted profit from operations[*6]: £0.14m). RSG provides a product offering more suitable for smaller retailers, and its results are benefitting from the marketing of the rest of the Retail Division.

International Division

The International Division, based in The Netherlands and Singapore, saw a mixed performance. Inter IKEA Systems B.V. (the owner and franchisor of the IKEA concept and the largest customer in the Group) continued to perform extremely well with revenue up 16% at £2.0m (2011: £1.72m). The domestic Dutch fashion market, by contrast, slowed considerably with customers reluctant to commit to deals whilst the full impact of Government austerity measures are being absorbed. Our cost base in Holland is geared to a higher level of activity and the severity of the impact on the Dutch market means that margins have reduced. There are however a number of operational changes that will improve this situation as we move into the second half of the year. Revenues increased by 11% year-on-year to £5.39m (2011: £4.84m), mainly reflecting the addition of Unisoft, and recurring income increased to £1.93m (2011: £1.90m). Adjusted profit from operations[*7] significantly reduced to £0.47m (2011: £1.40m), reflecting not only market weaknesses and the cost factors referenced above but also the slowdown in licence sales, particularly from our high margin international Pebblestone distribution channel. The Unisoft business that we acquired in December 2011, which provides retail Point of Sale (POS) solutions in Holland and Scandinavia, performed ahead of expectations, contributing sales of £1.43m and a small profit. Its January maintenance billing will contribute £0.6m to second half profit from operations.

We signed 21 significant new contracts in the period, worth a total of £0.53m (2011: nine contracts, £0.50m).

The International and Microsoft UK Divisions are actively working together on Project Gemstone and we expect significant opportunities to flow through the reseller channel as a result.

The prospects pipeline, excluding potential business anticipated in a long term plan with Inter IKEA Systems B.V., currently amounts to £7.1m of orders (2011: £3.3m). The increase in the pipeline reflects deferral of deals and some large pipeline AX deals.

The International and Microsoft UK Divisions are actively working together on **Project Gemstone** and we expect **significant opportunities** to flow through the reseller channel

*See note 8 on page 19 for further details

"The K3 SYSPRO unit performed very strongly"

SYSPRO and Sage Division

In the first half, the SYSPRO and Sage Division (which comprises four business units) saw revenues increase by 6% to £14.60m (2011: £13.81m), with recurring income up 13% to £9.97m (2011: £8.79m). Adjusted profit from operations*8 was marginally higher than prior year at £4.11m (2011: £4.07m). Acquisitions made in the prior year contributed £3.30m of revenue (2011: £3.10m) and £0.62m of adjusted profit from operations*9 (2011: £0.31m). In total, the Division signed £2.10m of new orders against £1.9m in the same period in 2011, with SYSPRO sales being exceptionally strong. The pipeline of prospects is increasing steadily with a value of £14.0m (2011: £9.20m). This includes £10.2m of potential Sage business.

The K3 SYSPRO unit, which supplies SYSPRO ERP solutions, performed very strongly, signing software deals with both new and existing customers and contributing adjusted profit from operations*10 of £2.96m (2011; £2.93m). In total, seven new deals were won with a combined value of £1.2m (2011: six deals; £0.60m) and a number of these deals were signed with extended period maintenance agreements. We have a very strong offering for the current market, which is well-priced, rich in functionality and delivered by a highly experienced team. In addition to the new sales, annual SYSPRO software licence fee renewals of approximately £6.0m (2011: £5.90m) were collected between October and December. The October renewal percentage was 98% (2011: 98%) and 85% of the recurring income falls in the first half year.

Our Sage business, representing the merged businesses of Panacea and Fifth Dimension Systems, started the year slowly. This reflected deal slippage at the end of the previous year as well as the fact that sales of Sage 500 and Sage 1000 have slowed as the X3 product was launched as a new product of choice. In total 22 new deals worth £0.84m were signed in the first half (2011: 39 deals worth £1.3m). The X3 product started to get traction from midway through Q2 and we closed three new X3 sales before the period end, with a pipeline of 30 significant potential deals worth £4.0m at the period end. We also closed a number of deals in the complementary business intelligence and CRM product sets, and completed the integration of the two Sage businesses merging the sales, marketing and delivery resources. The cost of the integration is included in exceptional operating costs and is expected to result in an annualised benefit of £0.8m, which will help deliver strong results in the second half year.

The other two business units in this Division supply customers running smaller ERP systems who can be offered upgrade opportunities to our SYSPRO or AX solutions and hosting. These businesses performed well in the period contributing £1.68m (2011: £1.02m) of revenue, substantially all of which is recurring.

*See note 8 on page 19 for further details

"We remain confident of prospects and expect K3 to return to growth within the next 12 months"

Managed Services Division

Revenue rose by 18% to £3.09m (2011: £2.61m), with recurring income delivering £2.09m (2011: £2.04m). As previously reported the profitability of the Division is being adversely affected by the cost of our investment in the second half of the prior year in both resource and operating capability of our hosting operation. We now have a number of large new contracts in the pipeline, the delivery of which has been made possible by this investment. In the current environment, customers usually need the impetus of a "compelling event" in order to make a complete switch to fully hosted ERP solutions from an on-site solution. Nonetheless, we continue to grow the customer base, with 398 customers (2011: 346 customers) now using part of our managed services solution. We have now added platforms for all Sage software including the new X3 product and have created a platform for hosting Dynamics AX as well as low cost platforms for NAV and Pebblestone which can provide cloud functionality to our smaller retail customers.

Divisional overheads have increased to £1.74m (2011: £1.36m), capitalised development was £0.15m (2011: £0.22m) and capital expenditure was £0.28m (2011: £0.25m). Adjusted loss from operations*11, after taking account of the investment being made, was £0.16m (2011: profit of £0.09m).

At 31 December 2012 the run rate of recurring income had increased to c.£4.4m (2011: £4.2m) with the slow rate of increase being attributable to delay in closing deals in Microsoft UK. Currently, the prospects pipeline stands at £4.2m of which £3.3m would be recurring income.

Head Office

Head office costs*12 for the first half were £0.22m (2011: £0.17m).

Outlook

Difficult market conditions and the transitioning of our UK retail offering to Microsoft AX have contributed to fewer major new contract wins than expected, resulting in a year-on-year decrease in sales and profit in the first six months of the financial year.

We believe that the investments we have made and will be making in the second half of the financial year will address many of the issues we are currently facing and expect our new IP enriched AX product, when it is commercially launched mid year 2013, to be a major growth driver for the Group.

In the meantime, the positive combination of high levels of recurring income and strong performance in other product areas will provide core profitability and good cash flows for the Group. We remain confident of prospects and expect K3 to return to growth within the next 12 months.

Tom Milne
Chairman

*See note 8 on page 19 for further details

Consolidated Income Statement

for the six months ended 31 December 2012

	Notes	Unaudited Six months to 31 December 2012 £'000	Unaudited Six months to 31 December 2011 £'000	Audited Year to 30 June 2012 £'000
Revenue		**31,547**	33,355	67,961
Profit from operations before amortisation of acquired intangibles, acquisition costs and exceptional items		**2,940**	6,912	11,333
Amortisation of acquired intangibles		**(1,817)**	(1,754)	(3,586)
Acquisition costs		**(27)**	(357)	(593)
Exceptional reorganisation costs		**(476)**	(141)	(557)
Exceptional income		**–**	–	755
Profit from operations		**620**	4,660	7,352
Finance income		**2**	3	7
Finance expense		**(437)**	(688)	(1,316)
Profit before taxation		**185**	3,975	6,043
Tax credit (expense)	2	**31**	(518)	(319)
Profit for the period		**216**	3,457	5,724

All of the profit for the period is attributable to equity holders of the parent.

Earnings Per Share	3			
Basic		**0.8p**	12.3p	20.3p
Diluted		**0.7p**	12.0p	19.8p

Consolidated Statement of Comprehensive Income

for the six months ended 31 December 2012

	Unaudited Six months to 31 December 2012 £'000	Unaudited Six months to 31 December 2011 £'000	Audited Year to 30 June 2012 £'000
Profit for the period	**216**	3,457	5,724
Other comprehensive income (expense)			
Items that may be reclassified into profit or loss			
Exchange differences on translation of foreign operations	**218**	(900)	(1,392)
Net investment hedge	**(40)**	278	415
Cash flow hedges:			
Losses recognised on hedging instruments	**–**	(4)	36
Transferred to income statement	**–**	35	49
Other comprehensive income (expense), net of tax	**178**	(591)	(892)
Total comprehensive income for the period	**394**	2,866	4,832

All of the total comprehensive income for the period is attributable to equity holders of the parent.

Consolidated Statement of Financial Position

as at 31 December 2012

	Notes	Unaudited As at 31 December 2012 £'000	Unaudited As at 31 December 2011 £'000	Audited As at 30 June 2012 £'000
ASSETS				
Non-current assets				
Property, plant and equipment		**2,886**	2,310	2,722
Goodwill		**44,300**	44,293	43,540
Other intangible assets		**20,354**	22,846	21,255
Deferred tax assets		**702**	524	710
Available-for-sale investments		**98**	98	98
Total non-current assets		**68,340**	70,071	68,325
Current assets				
Trade and other receivables		**24,885**	26,791	30,322
Cash and cash equivalents		**2,236**	1,405	2,096
Total current assets		**27,121**	28,196	32,418
Total assets		**95,461**	98,267	100,743
LIABILITIES				
Non-current liabilities				
Long-term borrowings	4	**19**	–	–
Other non-current liabilities	5	**860**	1,915	892
Deferred tax liabilities		**4,458**	5,551	4,905
Total non-current liabilities		**5,337**	7,466	5,797
Current liabilities				
Trade and other payables	6	**27,284**	30,300	29,594
Current tax liabilities		**908**	819	669
Short-term borrowings	4	**14,539**	14,751	17,778
Total current liabilities		**42,731**	45,870	48,041
Total liabilities		**48,068**	53,336	53,838
EQUITY				
Share capital		**7,146**	7,119	7,120
Share premium account		**7,286**	7,236	7,239
Other reserves		**10,448**	10,448	10,448
Cashflow hedging reserve		**–**	(54)	–
Translation reserve		**931**	1,108	753
Retained earnings		**21,582**	19,074	21,345
Total equity attributable to equity holders of the parent		**47,393**	44,931	46,905
Total equity and liabilities		**95,461**	98,267	100,743

Consolidated Statement of Cash Flows

for the six months ended 31 December 2012

	Notes	Unaudited Six months to 31 December 2012 £'000	Unaudited Six months to 31 December 2011 £'000	Audited Year to 30 June 2012 £'000
Cash flows from operating activities				
Profit for the period		**216**	3,457	5,724
Adjustments for:				
Share based payments charge		**36**	36	72
Depreciation of property, plant and equipment		**400**	382	729
Amortisation of intangible assets and development expenditure		**2,351**	2,215	4,394
Loss on sale of property, plant and equipment		**–**	–	1
Impairment loss on available-for-sale investment		**–**	98	98
Finance income		**(2)**	(3)	(7)
Finance expense		**437**	688	1,316
Tax (credit) expense		**(31)**	518	319
Decrease (increase) in trade and other receivables		**5,483**	(1,967)	(5,498)
(Decrease) increase in trade and other payables		**(1,972)**	383	136
Cash generated from operations	7	**6,918**	5,807	7,284
Finance expense paid		**(515)**	(409)	(846)
Income taxes paid		**(62)**	(605)	(1,312)
Net cash generated from operating activities		**6,341**	4,793	5,126
Cash flows from investing activities				
Acquisition of subsidiaries, net of cash acquired	7	**(195)**	(3,823)	(3,960)
Acquisition of other business units	7	**(1,089)**	(2,729)	(3,173)
Development expenditure capitalised		**(1,371)**	(753)	(1,880)
Purchase of property, plant and equipment		**(528)**	(480)	(1,280)
Proceeds from sale of property, plant and equipment		**–**	–	1
Finance income received		**2**	3	7
Net cash absorbed by investing activities		**(3,181)**	(7,782)	(10,285)
Cash flows from financing activities				
Net proceeds from issue of share capital		**83**	4,988	5,026
Proceeds from long-term borrowings		**866**	1,050	4,050
Payment of long-term borrowings		**(1,902)**	(1,650)	(3,638)
Payment of finance lease liabilities		**(26)**	(40)	(51)
Dividends paid		**–**	–	(214)
Net cash (absorbed) generated from financing activities		**(979)**	4,348	5,173
Net change in cash and cash equivalents		**2,181**	1,359	14
Cash and cash equivalents at start of period		**21**	113	113
Exchange gains (losses) on cash and cash equivalents		**34**	(67)	(106)
Cash and cash equivalents at end of period		**2,236**	1,405	21

Consolidated Statement of Changes in Equity

for the six months ended 31 December 2012

	Share capital £'000	Share premium £'000	Other reserve £'000	Cashflow hedging reserve £'000	Translation reserve £'000	Retained earnings £'000	Total equity £'000
At 1 January 2011	6,443	2,795	10,448	(125)	1,100	14,662	35,323
Changes in equity for six months ended 30 June 2011							
Share-based payment credit	–	–	–	–	–	14	14
Proceeds on share issue	34	68	–	–	–	–	102
Own shares acquired	–	–	–	–	–	(31)	(31)
Dividends to equity holders	–	–	–	–	–	(64)	(64)
Total comprehensive income for the period	–	–	–	40	630	1,228	1,898
At 30 June 2011	6,477	2,863	10,448	(85)	1,730	15,809	37,242
Changes in equity for six months ended 31 December 2011							
Share-based payment debit	–	–	–	–	–	(165)	(165)
Proceeds on share issue	642	4,373	–	–	–	–	5,015
Own shares acquired	–	–	–	–	–	(27)	(27)
Total comprehensive income for the period	–	–	–	31	(622)	3,457	2,866
At 31 December 2011	7,119	7,236	10,448	(54)	1,108	19,074	44,931
Changes in equity for six months ended 30 June 2012							
Share-based payment credit	–	–	–	–	–	184	184
Proceeds on share issue	1	3	–	–	–	–	4
Movement in own shares held	–	–	–	–	–	34	34
Dividends to equity holders	–	–	–	–	–	(214)	(214)
Total comprehensive income for the period	–	–	–	54	(355)	2,267	1,966
At 30 June 2012	7,120	7,239	10,448	–	753	21,345	46,905
Changes in equity for six months ended 31 December 2012							
Share-based payment credit	–	–	–	–	–	11	11
Proceeds on share issue	26	47	–	–	–	–	73
Movement in own shares held	–	–	–	–	–	10	10
Total comprehensive income for the period	–	–	–	–	178	216	394
At 31 December 2012	7,146	7,286	10,448	–	931	21,582	47,393

Notes to the Unaudited Half Yearly Report

1 Basis of preparation

The consolidated interim financial information has been prepared in accordance with the accounting policies that are expected to be adopted in the Group's full financial statements for the year ending 30 June 2013 which are not expected to be significantly different to those set out in Note 1 of the Group's audited financial statements for the year ended 30 June 2012. These are based on the recognition and measurement principles of IFRS in issue as adopted by the European Union (EU) and are effective at 30 June 2013 or are expected to be adopted and effective at 30 June 2013. The financial information has not been prepared (and is not required to be prepared) in accordance with IAS 34. The accounting policies have been applied consistently throughout the Group for the purposes of preparation of this financial information.

The financial information in this statement relating to the six months ended 31 December 2012 and the six months ended 31 December 2011 has neither been audited nor reviewed pursuant to guidance issued by the Auditing Practices Board. The financial information for the year ended 30 June 2012 does not constitute the full statutory accounts for that period. The Annual Report and Financial Statements for the year ended 30 June 2012 have been filed with the Registrar of Companies. The Independent Auditors' Report on the Annual Report and Financial Statement for the year ended 30 June 2012 was unqualified, did not draw attention to any matters by way of emphasis, and did not contain a statement under 498(2) or 498(3) of the Companies Act 2006.

Notes to the Unaudited Half Yearly Report continued

2 Tax (credit) expense

	Unaudited Six months to 31 December 2012 £'000	Unaudited Six months to 31 December 2011 £'000	Audited Year to 30 June 2012 £'000
Current tax expense			
UK corporation tax and income tax of overseas operations on profits for the period	**311**	1,268	1,471
Adjustment in respect of prior periods	**–**	(195)	(72)
Total current tax expense	**311**	1,073	1,399
Deferred tax expense			
Origination and reversal of temporary differences	**(183)**	(457)	(769)
Effect of change in rate of deferred tax	**(159)**	(98)	(311)
Total deferred tax credit	**(342)**	(555)	(1,080)
Total tax (credit) expense	**(31)**	518	319

3 Earnings per share

The calculations of earnings per share are based on the profit for the financial period and the following numbers of shares:

	Unaudited Six months to 31 December 2012 Number of shares	Unaudited Six months to 31 December 2011 Number of shares	Audited Year to 30 June 2012 Number of shares
Weighted average number of shares:			
For basic earnings per share	**28,403,955**	28,134,239	28,242,505
Effects of employee share options and warrants	**503,263**	711,335	678,177
For diluted earnings per share	**28,907,218**	28,845,574	28,920,682

Adjusted earnings per share calculations have been computed because the directors consider that they are useful to shareholders and investors. These are based on the following profits and the above number of shares:

	Unaudited six months to 31 December 2012			Unaudited six months to 31 December 2011			Audited year to 30 June 2012		
	Earnings £'000	Per share amount basic p	Per share amount diluted p	Earnings £'000	Per share amount basic p	Per share amount diluted p	Earnings £'000	Per share amount basic p	Per share amount diluted p
Earnings per share (eps)	**216**	**0.8**	**0.7**	3,457	12.3	12.0	5,724	20.3	19.8
Amortisation of acquired intangibles (net of tax)	**1,221**	**4.3**	**4.2**	1,186	4.2	4.1	2,349	8.3	8.1
Acquisition costs (net of tax)	**27**	**0.1**	**0.1**	357	1.3	1.3	593	2.1	2.1
Exceptional reorganisation costs (net of tax)	**363**	**1.3**	**1.3**	105	0.3	0.3	415	1.5	1.4
Exceptional income (net of tax)	**–**	**–**	**–**	–	–	–	(562)	(2.0)	(1.9)
Adjusted eps	**1,827**	**6.5**	**6.3**	5,105	18.1	17.7	8,519	30.2	29.5

Notes to the Unaudited Half Yearly Report continued

4 Loans and borrowings

	Unaudited As at 31 December 2012 £'000	Unaudited As at 31 December 2011 £'000	Audited As at 30 June 2012 £'000
Non-current			
Bank loans and other facilities	**–**	–	–
Finance lease creditors	**19**	–	–
	19	–	–
Current			
Bank overdrafts	**–**	–	2,075
Bank loans and other facilities	**13,885**	14,101	15,052
Finance lease creditors	**14**	10	11
Loans from related parties	**640**	640	640
	14,539	14,751	17,778
Total borrowings	**14,558**	14,751	17,778

The bank loans and other facilities include a Multi-option facility which expires in December 2013.

5 Other non-current liabilities

	Unaudited As at 31 December 2012 £'000	Unaudited As at 31 December 2011 £'000	Audited As at 30 June 2012 £'000
Contingent consideration	**421**	1,849	342
Deferred consideration	**191**	–	184
Accruals	**248**	66	366
	860	1,915	892

6 Trade and other payables

	Unaudited As at 31 December 2012 £'000	Unaudited As at 31 December 2011 £'000	Audited As at 30 June 2012 £'000
Trade payables	**4,108**	4,808	4,943
Other payables	**433**	315	1,213
Deferred consideration	**90**	190	280
Accruals	**7,027**	7,912	5,127
Total financial liabilities, excluding loans and borrowings, classified as financial liabilities measured at amortised cost	**11,658**	13,225	11,563
Contingent consideration	**341**	2,436	1,687
Derivative financial instruments	**–**	37	1
Other tax and social security taxes	**3,977**	3,976	3,185
Deferred revenue	**11,308**	10,626	13,158
	27,284	30,300	29,594

Notes to the Unaudited Half Yearly Report continued

7 Notes to the cash flow statement

Cash generated from operations is stated after payments to regularise liabilities that were significantly outside normal statutory due dates and commercial terms at the date of acquiring companies, that the directors consider to be a cost of acquisition. In addition, cash flows from operations include acquisition costs and exceptional reorganisation costs arising as a result of acquisitions during the year. The adjusted cash generated from operations has been computed because the directors consider it more useful to shareholders and investors in assessing the underlying operating cash flow of the Group. The adjusted cash generated from operations is calculated as follows:

	Unaudited Six months ended 31 December 2012 £'000	Unaudited Six months ended 31 December 2011 £'000	Audited Year ended 30 June 2012 £'000
Cash generated from operating activities	**6,918**	5,807	7,284
Add:			
Regularising liabilities	**–**	1,180	1,236
Acquisition costs	**27**	257	593
Exceptional reorganisation costs	**318**	43	409
Exceptional income	**–**	–	(755)
Adjusted cash generated from operations	**7,263**	7,287	8,767

Acquisition of subsidiaries and other business units, net of cash acquired comprises:

	Unaudited Six months ended 31 December 2012 £'000	Unaudited Six months ended 31 December 2011 £'000	Audited Year ended 30 June 2012 £'000
Initial consideration	**–**	(7,820)	(7,820)
Cash balances acquired	**–**	1,455	1,455
Contingent and deferred consideration paid	**(1,284)**	(187)	(768)
	(1,284)	(6,552)	(7,133)

8 Notes to the Chairman's Statement

*1 Group adjusted profit from operations is calculated before amortisation of acquired intangibles of £1.82m (2011: £1.75m), acquisition costs of £0.03m (2011: £0.36m) and reorganisation costs of £0.48m (2011: £0.14m).

*2 Group contribution from acquisitions is calculated before amortisation of acquired intangibles of £1.07m (2011: £0.08m) and reorganisation costs of £0.13m (2011: £0.02m).

*3 Group adjusted profit before tax is calculated before amortisation of acquired intangibles of £1.82m (2011: £1.75m), acquisition costs of £0.03m (2011: £0.36m) and reorganisation costs of £0.48m (2011: £0.14m).

*4 Group adjusted earnings per share is calculated before amortisation of acquired intangibles (net of tax) of £1.22m (2011: £1.19m), acquisition costs (net of tax) of £0.03m (2011: £0.36m) and reorganisation costs (net of tax) of £0.36m (2011: £0.10m).

*5 Microsoft UK Division adjusted profit from operations is calculated before amortisation of acquired intangibles of £0.30m (2011: £0.20m), acquisition costs of £nil (2011: £0.11m).

*6 Retail Systems Group adjusted profit from operations is calculated before amortisation of acquired intangibles of £0.05m (2011: £nil), and acquisition costs of £nil (2011: £0.04m).

*7 International Division adjusted profit from operations is calculated before amortisation of acquired intangibles of £0.37m (2011: £0.60m), acquisition costs of £nil (2011: £0.10m) and reorganisation costs of £0.01m (2011: £nil).

*8 SYSPRO and Sage Division adjusted profit from operations is calculated before amortisation of acquired intangibles of £1.07m (2011: £0.88m), acquisition costs of £nil (2011: £0.15m) and reorganisation costs of £0.15m (2011: £0.02m).

*9 SYSPRO and Sage Division acquisitions adjusted profit from operations is calculated before amortisation of acquired intangibles of £0.21m (2011: £0.05m), acquisition costs of £nil (2011: £0.15m) and reorganisation costs of £0.12m (2011: £0.02m)

*10 SYSPRO adjusted profit from operations is calculated before amortisation of acquired intangibles of £0.61m (2011: £0.61m).

*11 Managed Services Division adjusted profit from operations is calculated before amortisation of acquired intangibles of £0.08m (2011: £0.08m).

*12 Head office costs are calculated before acquisition costs of £0.03m (2011: £nil) and reorganisation costs of £0.31m (2011: £0.12m).

9 The above information is being sent to the shareholders and is available from the Company's website, www.k3btg.com, and from its registered office: Baltimore House, 50 Kansas Avenue, Manchester M50 2GL.

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