K3 Business Technology Group plc

Unaudited Second Half Yearly Report for the six months to 30 June 2017

k3 business technology

World Class Software. World Class Service.

Contents

AIM: KBT
k3btg.com

Financial Key Points

- Revenues of £84.6m for the 12 months to 30 June 2017 (2016: £89.2m)
  – recurring revenues remained high at £40.8m (2016: £41.6m) – c.48.2% of total
  – K3 own IP and related revenues rose by 27% to £27.1m (2016: £21.3m) – 32.0% of total (2016: 23.8%)
- Adjusted loss before tax*1 for the 12 months to 30 June 2017 of £2.63m (2016: adjusted profit before tax*1 of £8.80m) / Reported loss before tax of £10.56m (2016: profit before tax of £4.53m)
- Adjusted loss per share*2 for the 12 months to 30 June 2017 of 7.4p (2016: adjusted earnings per share*2 of 23.5p).
  Basic loss per share of 24.5p (2016: basic earnings per share of 12.6p)
- Pro-forma net debt*3 of £6.6m at 30 June 2017
  – taking into account the equity placing and warrants exercised (yielding a total of £8.4m together), and debt-to-equity conversion (of £0.6m) completed on 5 July 2017

Operational Key Points

- Good level of contract wins from SME-related activities across all supply chain verticals
- NextGen, the new, in-house developed multi-platform solution, seeing first successes
  – pilot project with major European retailer, Hunkemoller, has resulted in roll-out of NextGen across its stores
  – a number of other customers are engaged in the pre-sales process for the solution
- Global Accounts activities set to benefit from ongoing expansion of IKEA franchisee network
- New business pipeline has been refined and is encouraging at £70.3m
- Board views prospects positively

*1 Calculated before amortisation of acquired intangibles of £2.93m (2016: £2.73m), exceptional reorganisation costs and write-downs of £5.36m (2016: £1.05m), acquisition costs of £0.05m (2016: £0.49m) and exceptional income of £0.41m (2016: nil).

*2 Calculated before amortisation of acquired intangibles (net of tax) of £2.23m (2016: £2.19m), exceptional reorganisation costs (net of tax) of £4.29m (2016: £0.84m), acquisition costs (net of tax) of £0.05m (2016: £0.49m) and exceptional income (net of tax) of £0.41m (2016: nil).

*3 Pro-forma net debt (which is gross debt net of cash and cash equivalents) at 30 June 2017 calculated after Placing and Warrants exercised of £8.4m and Debt to Equity conversion of £0.6m both on 5 July 2017.

Joint Report of the Chairman and Chief Executive Officer

"Our review of K3's resources is progressing well. Our objectives are to increase focus on the development and sale of the Group's own intellectual property, and develop multiple "niche" software solutions"

Introduction

This is my first statement as Chairman since assuming the role in early July 2017, and we are pleased to report on the progress being made to reshape the Company and position it for sustainable growth and a return to profitability.

Background

As we have previously reported, K3's recent financial performance in Enterprise-related activities has been disappointing and, in mid-May, the new management team commenced a review of K3's resources, with the intention of refocusing the Group's growth strategy around the existing profitable, cash generative business units and our large SME customer base.

In early July, we completed an equity placing to support this process, and to enable us to operate with full flexibility as we make and implement strategic decisions to benefit the Company's future.

"We have delivered cost savings of approximately £3.7m on an annualised basis"

Resources Review and Refocused Operations

Our review of K3's resources is progressing well. Our objectives are to increase focus on the development and sale of the Group's own intellectual property, and develop multiple "niche" software solutions capable of deployment in an agnostic way across a wide range of Enterprise Resource Planning ("ERP") solutions. This will improve the quality of the Group's earnings and will help to drive contracted, recurring revenues. The industry's increasing shift towards the subscription/consumption-based model, and away from 'on-premise' solutions with large, upfront licence payments, will help to increase the visibility of the Group's revenues.

We expect our review process to be completed before the end of the year, and will provide a further update in due course.

Together with our initiatives to refocus the Group's activities, we commenced a programme to simplify and more closely integrate the Group's operations. This centralisation strategy will promote better cross-selling of products and improve operational efficiencies. Over the past 12 months, we have materially reduced our cost base, delivering cost savings of approximately £3.7m on an annualised basis. This programme is ongoing and we anticipate making further cost savings as we complete the streamlining of the Group's operations.

Focus on Cash Generation

We continue to focus on cash generation and are making good progress in improving working capital, primarily by reducing debtor days and accrued income.

Pro-forma net debt as at 30 June 2017 was £6.6m. This takes into account the equity placing and open offer of shares completed in early July 2017, which raised a net of £7.76m, as well as an exercise of warrants of £0.66m and debt-to-equity conversion of £0.64m. Excluding this, reported net debt at 30 June 2017 was £15.6m (30 June 2016: £8.9m; 31 December 2016: £12.51m).

Performance

As previously reported, financial results for both the six and 12 month periods were significantly impacted by a number of high value contract tenders not closing as expected. This deterioration in large contract wins in the Enterprise space was due to softening end-markets, particularly for large retailers, as well as lengthening decision-making process for large deals, driven by the shift towards cloud delivery and away from 'on-premise' solutions. As a result, there was a marked year-on-year reduction in software licence revenues, with gross margin also affected by excess resource capacity in services and implementation.

By contrast, the Group's SME-related activities performed well across all of our supply chain verticals, and we secured a continuing good level of contract wins in the six months to 30 June 2017. The SME-focused Retail business performed very strongly, with RSG, Merac and DdD all contributing to the growth.

In addition, we achieved very encouraging sales of our own IP, with new customers including Jack Wolfskin, the Royal Horticultural Society and F-Engel. Sales of Pebblestone in particular were strong. K3 Product and Product-related revenues represented approximately 32.0% of the Group's total in the 12 months to 30 June 2017 (2016: 23.8%) and 35.0% in the six months to 30 June 2017 (six months to 30 June 2016: 25.0%).

The development of NextGen, our 'next generation', multi-platform solution, has been an important step for us as we drive own IP sales. The platform will deploy a range of products, including our high value applications such as mobile Retail solutions. Importantly, it gives us the ability to easily integrate our solutions with a wide range of ERP systems. Our pilot project, for a mobile Retail solution with a large European fashion retailer, Hunkemoller, has progressed very well, and Hunkemoller is now committed to rolling out NextGen across its business over the coming months. A number of other potential customers are engaged in a pre-sales process for NextGen.

Our Global Accounts business, which includes our relationship with Inter IKEA Systems B.V. (the owner and franchisor of the IKEA concept, and the largest customer in the Group) and the Inter IKEA Concept franchisees, continued to perform well. We are supporting the ongoing expansion of the IKEA franchisee network and expect to see a substantial increase in their service delivery requirements.

The SYSPRO business also delivered good results and remains a strong contributor to the Group's cash flows. SYSPRO customer renewals continue to be high, at 98% for the 12 month period (2016: 98%). The Sage business gained traction in the higher end X3 product offering and won some notable deals. Business Solutions restructured its cost base to focus on the Microsoft Dynamics/Navision SME space and is now seeing an improvement in its profitability.

The performance of our hosting and managed services operation, Starcom, was affected by the softness in the Enterprise activities, as well as the loss of MyLocal in June 2016. Going forward, it will benefit from the Group's simplified organisational structure and tighter focus on driving cross-selling across its various products.

As we have previously reported, the move towards cloud-based consumption licensing will drive a change in the rate of reported revenue growth and have a beneficial long-term impact. Income from contracts will be recognised over longer periods, rather than upfront as with the traditional model of perpetual software licences. The lifetime value of customer relationships under this new model has the potential to be significantly higher than before. The pace of uptake of consumption-based ERP has increased this year, with K3 successfully completing first sales of Microsoft Dynamics and "ax|is Fashion" on this basis. As the rate of growth of consumption-based agreements increases, the Group will start to monitor and report on new KPI's to quantify their importance.

Dividend

The Board intends to maintain a progressive dividend policy and expects to propose a dividend for the 17 month period to 30 November 2017, subject to trading.

Board Changes

A number of Board changes took place in the twelve months to 30 June 2017. David Bolton, previously Chairman, and Lars-Olof Norell, previously Non-Executive Director, both retired from the Company.

In October 2016, Adalsteinn Valdimarsson assumed the role of Chief Executive Officer, having joined K3 as a Non-Executive Director in July 2016. Robert Price, who joined K3 as Chief Financial Officer in October 2016 (in a non-board capacity), was appointed to the Board as Finance Director in July 2017.

Outlook

We believe that the changes and initiatives from the new management team over the last year have put K3 on a sustainable track for improvement in the quality of its earnings and cash flow generation.

Our investment in the NextGen 'born-in-the-cloud' platform is an important step forward. It opens up further opportunities for the Group to sell its own IP as the platform readily integrates with a wide range of ERP systems. NextGen also makes us more flexible and fleet of foot in addressing customers' changing needs, and corresponds with customers' increasing interest in consumption-based products and services. This cloud-based approach promotes closer customer relationships and supports our objective of further increasing our large recurring income streams.

We have materially reduced the cost base of the business and created a more streamlined structure that supports cross-selling opportunities. We will be continuing with our cost efficiency programme and our strategic review should be substantially completed before the end of 2017, at which point we will provide a further update.

Looking ahead, we are encouraged by our new business pipeline. We have taken the opportunity to refine our reporting of new business prospects, and while this has meant removing certain prospects from the pipeline, it makes for an overall stronger picture of the potential order book. Currently, the pipeline stands at £70.3m.

We remain confident of K3's prospects.

Stuart Darling
Chairman

Adalsteinn Valdimarsson
Chief Executive Officer

27 September 2017

Financial Results for the 12 months to 30 June 2017

"The change in accounting reference date has been made in order to place shareholders in a better position to assess the Company's trading prospects"

Change of Accounting Reference Date and Financial Year End

Following the Board's decision to change the Company's accounting reference date and financial year end to 30 November, from 30 June, this report covers both the six month period to 30 June 2017 and the twelve month period to the same date.

The change in the accounting reference date has been made, as previously highlighted, in order to place shareholders in a better position to assess the Company's trading prospects when full year and interim results are published, given the Company's strong seasonal trading patterns, with December and June both historically key selling months.

We have also taken the decision to change the way we report on the Group's activities to better reflect the operational structure of the business. We have therefore moved away from an analysis by industry vertical to reporting the financial performance of the Group as a whole. We will continue to highlight certain key performance indicators, including revenue generated by K3's own intellectual property.

Overview

	Revenue 2017 £m	Revenue 2016 £m	Adjusted Profit 2017 £m	Adjusted Profit 2016 £m
Sales Divisions	**84.61**	89.18	**(0.56)**	10.33
Head office	**–**	–	**(1.25)**	(0.83)
Total	**84.61**	89.18	**(1.81)**	9.50

	Revenue 2017 £m	Revenue 2016 £m	Gross Profit 2017 £m	Gross Profit 2016 £m	Gross Margin 2017 %	Gross Margin 2016 %
Software licences	**10.65**	16.23	**6.67**	11.01	**62.6%**	67.8%
Services	**26.08**	25.74	**5.55**	8.12	**21.3%**	31.5%
Recurring*	**40.76**	41.62	**28.11**	28.04	**69.0%**	67.4%
Hardware and other	**7.12**	5.59	**2.29**	1.37	**32.2%**	24.5%
Total	**84.61**	89.18	**42.62**	48.54	**50.4%**	54.4%

**Recurring revenues comprise software maintenance renewals, support contracts, and hosting & managed services.*

	2017	2016
Adjusted profit from operations*1 (£m)	**(1.81)**	9.50
Recurring revenue as % of total revenues	**48.2%**	46.7%
Customer adds (like-for-like)	**339**	198

K3 Intellectual Property

We highlight the revenue generated by K3's own IP below. They are included in the figures above.

The percentage of K3 product-related revenues over the 12 months to 30 June 2017 has increased significantly to 32.0% (2016: 23.8%). This largely reflected the benefit of the acquisitions of DdD and Merac, in April and July 2016 respectively.

	Revenue 2017 £m	Revenue 2016 £m
K3 Product Licence[I]	**8.41**	10.76
K3 Product Related[II]	**18.67**	10.51
Total K3 Product	**27.08**	21.27
Gross profit (£m)	**16.26**	14.08
Gross margin (%)	**60.1%**	66.2%
K3 product Revenue % of Total Revenue	**32.0%**	23.8%

I) K3 Product Licence revenue includes initial and annual software licences.
II) K3 Product Related revenue represents the additional identifiable revenues which flow directly from our K3 Product sales.

*See note 9 on page 19 for further details

Group revenues for the 12 months to 30 June 2017 totalled £84.6m (2016: £89.2m). The year-on-year decrease was mainly accounted for by reduced software licence sales in the Enterprise space. Software licence gross margins were also lower at 62.7% (2016: 67.8%), driven by lower "ax|is" sales in the Enterprise space.

We currently recognise revenues from all multi-year deals on a traditional licence basis, where the majority of revenues are recognised upfront. Going forward revenue will be recognised over the licence period as dictated by contracts and as deployment becomes mostly consumption. For illustrative purposes, the table below shows previously reported revenues and what those revenues would have been had the revenue been recognised on a consumption basis over the licence period rather than upfront.

	12 months to June 2017	2016
Revenue – reported (£m)	**84.6**	89.2
Revenue – restated excluding multi-year deals (£m)	**85.5**	85.3
Recurring Revenue % – reported	**48.2%**	46.7%
Recurring Revenue % – restated excluding multi-year deals	**49.1%**	47.0%

Reported recurring revenues remain high as a proportion of the Group's total, comprising almost half of all income. Gross margins on recurring revenues increased to 69.0% (67.4%), reflecting the growth in income generated by K3 Product sales, including DdD and Merac.

Services revenues increased, helped by greater activity within Global Accounts. However, the gross margin percentage contracted significantly. This was due to margin pressures in the six months to December 2016, when we experienced an increase in the number of contractors needed to deliver the high level of contract wins from June 2016, followed by excess contractor capacity in the six months to June 2017 as a result of reduced deal flow, especially in the Enterprise space.

Revenues, gross profit and gross margin generated by Hardware and other activity all showed positive gains. This largely reflected buoyant sales of DdD's own point-of-sale hardware, sold alongside cloud-based software.

Adjusted loss from operations*[1] for the 12 months to 30 June 2017 was £1.8m (2016: adjusted profit from operations*[1] of £9.5m), with the adjusted loss from operations*[2] in the six months to 30 June 2017 being £2.2m (2016: adjusted profit from operations*[2] of £4.4m).

We incurred £5.4m (2016: £1.0m) of exceptional costs over the year. These related to our re-organisation programme and included a £2.0m non-cash write-off of capitalised development costs.

The amortisation charge for acquired intangibles was £2.93m (2016: £2.73m). Finance expenses were £0.82m (2016: £0.70m).

Adjusted loss before tax*[3] for the 12 months to 30 June 2017 was £2.63m (2016: adjusted profit before tax*[3] £8.80m) and reported loss before tax was £10.56m (2016: profit before tax £4.53m).

Adjusted loss per share*[4] was 7.4p (2016: adjusted earnings per share*[4] 23.5p). Basic loss per share was 24.5p (2016: earnings per share 12.6p). There was a net tax credit for the year of £1.77m (2016: net tax expense £0.43m), after the benefit of a £1.46m deferred tax credit (2016: £0.42m).

*See note 9 on page19 for further details

Cash flow and banking

Net debt at 30 June 2017 was £15.6m (30 June 2016: £8.9m; 31 December 2016: £12.51m) and, taking into account the equity placing, warrants exercised and debt-to-equity conversion completed on 5 July 2017, *pro forma* net debt on that date is calculated at £6.6m.

Cashflow from operating activities was £0.9m for the 12 months (2016: £4.0m), following exceptional restructuring costs of £3.4m (2016: £1.0m). There was a material inflow of £2.2m (2016: £5.8m outflow) into working capital, a reflection of a tighter approach to working capital management that we intend to build on in the future.

Depreciation was similar to the prior 12 months at £1.0m (2016: £1.0m) and amortisation increased to £8.2m (2016: £5.1m), following a £2.0m exceptional write-off of previously capitalised development costs.

Software development costs in the 12 months to 30 June 2017 increased marginally to £4.9m (2016: £4.6m) and capital expenditure reduced to £0.8m (2016: £0.9m). Over the 12 month period, we made one acquisition, purchasing Merac in July 2016, and received a refund of deferred consideration of £0.4m for DdD, which had been paid into escrow in April 2016, in the 6 months to 30 June 2017.

Central Costs

Head office costs include directors' costs, human resources, accounting and legal personnel, and costs associated with the Plc. Costs are stated net of recovery of elements recharged to the operating units. Costs for the year[*5] increased to £1.25m (2016: £0.83m), which primarily reflected the centralisation of functions.

*See note 9 on page 19 for further details

Consolidated Income Statement
for the six and twelve months ended 30 June 2017

	Notes	Unaudited Six months to 30 June 2017 £'000	Unaudited Six months to 30 June 2016 £'000	Unaudited Year to 30 June 2017 £'000	Audited Year to 30 June 2016 £'000
Revenue		**41,634**	46,884	84,608	89,175
Adjusted (loss)/profit from operations		**(2,257)**	4,394	(1,811)	9,501
Amortisation of acquired intangibles		**(1,440)**	(1,139)	(2,926)	(2,734)
Acquisition costs		**(9)**	(492)	(51)	(492)
Exceptional reorganisation costs	2	**(2,620)**	(199)	(5,363)	(1,046)
Exceptional income	2	406	–	406	–
(Loss)/profit from operations		**(5,920)**	2,564	(9,745)	5,229
Finance expense		**(400)**	(314)	(817)	(701)
(Loss)/profit before taxation		**(6,320)**	2,250	(10,562)	4,528
Tax expense	3	**954**	(19)	1,767	(425)
(Loss)/profit for the period		**(5,366)**	2,231	(8,795)	4,103

All of the (loss)/profit for the period is attributable to equity holders of the parent.

	Notes				
(Loss)/Earnings Per Share	4				
Basic		**(14.9)p**	6.7p	(24.5)p	12.6p
Diluted		**(14.8)p**	6.6p	(24.2)p	12.3p

Consolidated Statement of Comprehensive Income

for the six and twelve months ended 30 June 2017

	Unaudited Six months to 30 June 2017 £'000	Unaudited Six months to 30 June 2016 £'000	Unaudited Year to 30 June 2017 £'000	Audited Year to 30 June 2016 £'000
(Loss)/profit for the period	**(5,366)**	2,231	(8,795)	4,103
Other comprehensive income				
Exchange differences on translation of foreign operations	**543**	2,370	1,018	3,073
Other comprehensive income, net of tax	**543**	2,370	1,018	3,073
Total comprehensive (expense)/income for the period	**(4,823)**	4,601	(7,777)	7,176

All of the total comprehensive (expense)/income for the period is attributable to equity holders of the parent. All of the other comprehensive (expense)/income will be reclassified subsequently to profit or loss when specific conditions are met. None of the items within other comprehensive (expense)/income had a tax impact.

Consolidated Statement of Financial Position

as at 30 June 2017

	Notes	Unaudited As at 30 June 2017 £'000	Audited As at 30 June 2016 £'000
ASSETS			
Non-current assets			
Property, plant and equipment		**2,328**	2,389
Goodwill		**51,018**	48,793
Other intangible assets		**24,302**	26,369
Deferred tax assets		**1,388**	423
Available-for-sale investments		**98**	98
Total non-current assets		**79,134**	78,072
Current assets			
Trade and other receivables		**34,433**	40,923
Cash and cash equivalents		**2,821**	2,772
Total current assets		**37,254**	43,695
Total assets		**116,388**	121,767
LIABILITIES			
Non-current liabilities			
Long-term borrowings	5	**17,761**	8,272
Deferred tax liabilities		**3,267**	3,753
Total non-current liabilities		**21,028**	12,025
Current liabilities			
Trade and other payables	6	**29,615**	32,824
Current tax liabilities		**–**	132
Short-term borrowings	5	**697**	3,376
Total current liabilities		**30,312**	36,332
Total liabilities		**51,340**	48,357
EQUITY			
Share capital		**9,000**	9,000
Share premium account		**21,586**	21,586
Other reserves		**10,448**	10,448
Translation reserve		**2,094**	1,076
Retained earnings		**21,920**	31,300
Total equity attributable to equity holders of the parent		**65,048**	73,410
Total equity and liabilities		**116,388**	121,767

Consolidated Statement of Cash Flows

for the six and twelve months ended 30 June 2017

	Notes	Unaudited Six months to 30 June 2017 £'000	Unaudited Six months to 30 June 2016 £'000	Unaudited Year to 30 June 2017 £'000	Audited Year to 30 June 2016 £'000
Cash flows from operating activities					
(Loss)/profit for the period		**(5,366)**	2,231	(8,795)	4,103
Adjustments for:					
Share based payments charge		**24**	24	47	28
Depreciation of property, plant and equipment		**482**	478	1,001	971
Amortisation of intangible assets and development expenditure		**5,240**	2,314	8,188	5,077
Loss on sale of property, plant and equipment		**–**	4	–	4
Finance income		**–**	14	(2)	(4)
Finance expense		**400**	300	819	705
Tax expense		**(954)**	19	(1,767)	425
Decrease (increase) in trade and other receivables		**3,379**	(5,446)	6,086	(5,977)
(Decrease) increase in trade and other payables		**(2,688)**	591	(3,851)	170
Cash generated from operations	7	**517**	529	1,726	5,502
Finance expense paid		**(243)**	(397)	(944)	(789)
Income taxes received/(paid)		**6**	(476)	102	(688)
Net cash generated from/(utilised in) operating activities		**280**	(344)	884	4,025
Cash flows from investing activities					
Acquisition of subsidiaries, net of cash acquired	7	**232**	(7,376)	(975)	(7,401)
Development expenditure capitalised		**(2,178)**	(2,473)	(4,859)	(4,642)
Purchase of property, plant and equipment		**(495)**	(358)	(781)	(931)
Proceeds from sale of property, plant and equipment		**–**	15	–	15
Finance income received		**–**	6	2	6
Net cash absorbed by investing activities		**(2,441)**	(10,186)	(6,613)	(12,953)
Cash flows from financing activities					
Net proceeds from issue of share capital		**–**	13,097	–	13,175
Proceeds from long-term borrowings		**1,182**	–	17,315	–
Payment of long-term borrowings		**–**	(1,464)	(10,885)	(2,928)
Payment of finance lease liabilities		**(26)**	(8)	(51)	(12)
Dividends paid		**(630)**	(477)	(630)	(477)
Net cash generated from financing activities		**526**	11,148	5,749	9,758
Net change in cash and cash equivalents		**(1,635)**	618	20	830
Cash and cash equivalents at start of period		**4,462**	2,118	2,772	1,895
Exchange gains on cash and cash equivalents		**(6)**	36	29	47
Cash and cash equivalents at end of period		**2,821**	2,772	2,821	2,772

Consolidated Statement of Changes in Equity
for the six months ended 30 June 2017

	Share capital £'000	Share premium £'000	Other reserve £'000	Translation reserve £'000	Retained earnings £'000	Total equity £'000
At 1 January 2016	7,965	9,524	10,448	(1,294)	29,522	56,165
Changes in equity for six months ended 30 June 2016						
Profit for the period	–	–	–	–	2,231	2,231
Other comprehensive income for the period	–	–	–	2,370	–	2,370
Total comprehensive income	–	–	–	2,370	2,231	4,601
Share-based payment credit	–	–	–	–	24	24
Options exercised	12	45	–	–	–	57
Issue of new shares	1,023	12,017	–	–	–	13,040
Movement in own shares held	–	–	–	–	–	–
Dividends to equity holders	–	–	–	–	(477)	(477)
At 30 June 2016	9,000	21,586	10,448	1,076	31,300	73,410
Changes in equity for six months ended 31 December 2016						
Loss for the period	–	–	–	–	(3,429)	(3,429)
Other comprehensive income for the period	–	–	–	475	–	475
Total comprehensive income	–	–	–	475	(3,429)	(2,954)
Share-based payment credit	–	–	–	–	23	23
Movement in own shares held	–	–	–	–	(8)	(8)
At 31 December 2016	9,000	21,586	10,448	1,551	27,886	70,471
Changes in equity for six months ended 30 June 2017						
Loss for the period	–	–	–	–	(5,366)	(5,366)
Other comprehensive income for the period	–	–	–	543	–	543
Total comprehensive income	–	–	–	543	(5,366)	(4,823)
Share-based payment credit	–	–	–	–	24	24
Movement in own shares held	–	–	–	–	6	6
Dividends to equity holders	–	–	–	–	(630)	(630)
At 30 June 2017	9,000	21,586	10,448	2,094	21,920	65,048

Notes to the Unaudited Second Half Yearly Report

1 Basis of preparation

As announced in May 2017, the Company has changed of its accounting reference date and financial year-end from 30 June to 30 November.

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 17 month period ending 30 November 2017 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 2016. 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 November 2017 or are expected to be adopted and effective at 30 November 2017. 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 30 June 2017, the 12 months ended 30 June 2017 and the six months ended 30 June 2016 has neither been audited nor reviewed pursuant to guidance issued by the Auditing Practices Board. The financial information for the year ended 30 June 2016 does not constitute the full statutory accounts for that period. The Annual Report and Financial Statements for the year ended 30 June 2016 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 2016 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.

As mentioned previously, the Group will be adopting IFRS 15, 'Revenue from contracts with customers' which replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations, with effect from 1 December 2017. The standard establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The Group is currently undertaking a review of the full impact of IFRS 15 and consider that there may be a significant impact on the revenue recognition policies currently adopted by the Group. Detailed quantitative analysis of the impact of adopting this new standard will be provided in the financial statements for the period ending 30 November 2017.

Going concern

The consolidated interim financial information has been prepared on a going concern basis.

The Directors have prepared cash flow forecasts for the Group, including sensitivity analysis on key assumptions. These forecasts show that the Group expects to meet its liabilities from cash resources, taking into account all risks and uncertainties. At the period end the Group had cash and cash equivalents of £2.8m.

In July 2017, the Company raised a net £7.76m from a placing and open offer of 5,790,322 shares. In addition, Mr PJ Claesson, a Director of the Company, exercised 700,000 warrants raising £0.66m and converted a loan of £0.64m into 457,142 shares.

As a result, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Directors consider that the adoption of the going concern basis is appropriate.

2 Profit from operations

During the 12 month period to 30 June 2017, reorganisation costs have been incurred relating to the reorganisation programme to create more unified, streamlined operations and reduced cost base. This was at a cost of £5.4m (2016: £1.0m) including a £2m non cash write off of capitalised development costs.

During the six-month period to 30 June 2017, contingent consideration not required to be paid of £0.4m was released and is included as exceptional income (six months 30 June 2016 and year ended 30 June 2016: £nil).

3 Tax expense

	Unaudited Six months to 30 June 2017 £'000	Unaudited Six months to 30 June 2016 £'000	Unaudited Year to 30 June 2017 £'000	Audited Year to 30 June 2016 £'000
Current tax expense/(income)				
UK corporation tax and income tax of overseas operations on profits for the period	**426**	299	(181)	866
Adjustment in respect of prior periods	**(125)**	–	(125)	(25)
Total current tax expense	**301**	299	(306)	841
Deferred tax (income)/charge				
Origination and reversal of temporary differences	**(1,126)**	(280)	(1,332)	(94)
Effect of change in rate of deferred tax	**(129)**	–	(129)	(322)
Total deferred tax income	**(1,255)**	(280)	(1,461)	(416)
Total tax expense	**(954)**	19	(1,767)	425

Notes to the Unaudited Second Half Yearly Report continued

4 (Loss)/earnings per share

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

	Unaudited Six months to 30 June 2017 Number of shares	Unaudited Six months to 30 June 2016 Number of shares	Unaudited Year to 30 June 2017 Number of shares	Audited Year to 30 June 2016 Number of shares
Weighted average number of shares:				
For basic earnings per share	**35,905,881**	33,211,866	35,905,881	32,439,624
Effects of employee share options and warrants	**361,371**	500,188	424,148	798,049
For diluted earnings per share	**36,267,252**	33,712,054	36,330,029	33,237,673

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 30 June 2017			Unaudited Six months to 30 June 2016		
	Earnings £'000	Per share amount basic p	Per share amount diluted p	Earnings £'000	Per share amount basic p	Per share amount diluted p
(Loss)/earnings per share (eps)	(5,366)	(14.9)	(14.8)	2,231	6.7	6.6
Amortisation of intangibles (net of tax)	1,169	3.3	3.2	915	2.8	2.7
Acquisition costs (net of tax)	9	–	–	492	1.5	1.5
Exceptional reorganisation costs (net of tax)	2,122	5.9	5.9	161	0.5	0.5
Exceptional income (net of tax)	(406)	(1.1)	(1.1)	–	–	–
Adjusted eps	(2,472)	(6.8)	(6.8)	3,799	11.5	11.3

	Unaudited Year to 30 June 2017			Audited Year to 30 June 2016		
	Earnings £'000	Per share amount basic p	Per share amount diluted p	Earnings £'000	Per share amount basic p	Per share amount diluted p
(Loss)/earnings per share (eps)	(8,795)	(24.5)	(24.2)	4,103	12.6	12.3
Amortisation of intangibles (net of tax)	2,230	6.2	6.1	2,190	6.8	6.6
Acquisition costs (net of tax)	51	0.1	0.1	492	1.5	1.5
Exceptional reorganisation costs (net of tax)	4,290	11.9	11.8	837	2.6	2.5
Exceptional income (net of tax)	(406)	(1.1)	(1.1)	–	–	–
Adjusted eps	(2,630)	(7.4)	(7.3)	7,622	23.5	22.9

5 Loans and borrowings

	Unaudited As at 30 June 2017 £'000	Audited As at 30 June 2016 £'000
Non-current		
Bank loans (secured)	**17,687**	8,234
Finance lease creditors	**74**	38
	17,761	8,272
Current		
Bank loans (secured)	**–**	2,718
Finance lease creditors	**57**	18
Loans from related parties	**640**	640
	697	3,376
Total borrowings	**18,458**	11,648

6 Trade and other payables

	Unaudited As at 30 June 2017 £'000	Audited As at 30 June 2016 £'000
Trade payables	**6,749**	8,192
Other payables	**430**	713
Accruals	**9,060**	9,548
Total financial liabilities, excluding loans and borrowings, classified as financial liabilities measured at amortised cost	**16,239**	18,453
Contingent consideration	**–**	912
Deferred consideration	**–**	25
Other tax and social security taxes	**3,628**	4,266
Deferred revenue	**9,748**	9,168
	29,615	32,824

Notes to the Unaudited Second Half Yearly Report continued

7 Notes to the cash flow statement

Cash generated from operations is stated after exceptional reorganisation costs and acquisition costs. 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 30 June 2017 £'000	Unaudited Six months ended 30 June 2016 £'000	Unaudited Year ended 30 June 2017 £'000	Audited Year ended 30 June 2016 £'000
Cash generated from operating activities	**517**	529	1,726	5,502
Add:				
Exceptional reorganisation costs	**620**	199	3,363	1,046
Acquisition costs	**9**	300	51	300
Adjusted cash generated from operations	**1,146**	1,028	5,140	6,848

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

	Unaudited Six months ended 30 June 2017 £'000	Unaudited Six months ended 30 June 2016 £'000	Unaudited Year ended 30 June 2017 £'000	Audited Year ended 30 June 2016 £'000
Initial consideration	**–**	(6,802)	(1,506)	(6,802)
Cash balances acquired	**–**	345	324	345
Contingent consideration (paid into)/repaid from escrow	**232**	(863)	232	(863)
Contingent and deferred consideration paid	**–**	(56)	(25)	(81)
	232	(7,376)	(975)	(7,401)

8 Events after the reporting date

In July 2017, the Company raised a net £7.76m from a placing and open offer of 5,790,322 shares. In addition, Mr PJ Claesson, a Director of the Company, exercised 700,000 warrants raising £0.66m and converted a loan of £0.64m into 457,142 shares. The Company now has issued 42,946,665 Ordinary shares.

9 Notes to the Financial Results

*1 Group adjusted loss from operations for the 12 months to 30 June 2017 is calculated before amortisation of acquired intangibles of £2.93m (2016: £2.73m), exceptional reorganisation costs of £5.36m (2016: £1.05m), acquisition costs of £0.05m (2016: £0.49m) and exceptional income of £0.41m (2016: nil).

*2 Group adjusted profit from operations for the 6 months to 30 June 2017 is calculated before amortisation of acquired intangibles of £1.44m (2016: £1.14m), exceptional reorganisation costs of £2.62m (2016: £0.20m), acquisition costs of £0.01m (2016: £0.49m) and exceptional income of £0.41m (2016: nil).

*3 Group adjusted loss before tax is calculated before amortisation of acquired intangibles of £2.93m (2016: £2.73m), exceptional reorganisation costs of £5.36m (2016: £1.05m), acquisition costs of £0.05m (2016: £0.49m) and exceptional income of £0.41m (2016: nil).

*4 Group adjusted loss per share is calculated before amortisation of acquired intangibles (net of tax) of £2.23m (2016: £2.19m), exceptional reorganisation costs (net of tax) of £4.29m (2016: £0.84m), acquisition costs (net of tax) of £0.05m (2016: £0.49m) and exceptional income (net of tax) of £0.41m (2016: nil).

*5 Head office costs are calculated before exceptional reorganisation costs of £1.19m (2016: £0.11m), and acquisition costs of £0.05m (2016: £0.20m).

10 The above information is being sent to 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.

K3 Business Technology Group plc
Baltimore House, 50 Kansas Avenue, Manchester M50 2GL
www.k3btg.com