K3 Business Technology Group plc

Unaudited Half Yearly Report for the six months to 31 December 2016

k3 business technology

World Class Software. World Class Service.

Contents

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Financial Key Points

Revenue

£42.97m

2015: £42.29m

Adjusted
Profit Before Tax[*1]

£0.03m

2015: £4.72m

Adjusted
Earnings Per Share[*2]

(0.4)p

2015: 12.0p

Operational Key Points

- Major reorganisation programme implemented:
  - streamlined management structure will promote better cross-selling of products and services
  - non-recurring cost of £2.74m but annualised benefits are expected to exceed this cost
- Continuing focus on driving sales of products with significant own intellectual property, and cloud hosting and managed services offering
- Post period – major new order won with British Heart Foundation worth over £2.00m
- Pipeline of potential new deals remains strong at £82.0m (2015: £56.5m)
- Board remains confident in Group's growth prospects, with delayed deals now starting to come through, and is focused on driving cash generation and further efficiencies

*1 Calculated before amortisation of acquired intangibles of £1.49m (2015: £1.60m), exceptional reorganisation costs of £2.74m (2015: £0.85m) and acquisition costs of £0.04m (2015: nil).

*2 Calculated before amortisation of acquired intangibles (net of tax) of £1.06m (2015: £1.28m), exceptional reorganisation costs (net of tax) of £2.19m (2015: £0.68m) and acquisition costs (net of tax) of £0.04m (2015: nil).

Chairman's Statement

"Very encouragingly, we are seeing deals we had expected to close in the period now coming through. These include a major deal with the British Heart Foundation, secured through our retail sales team."

Overview

K3's trading performance in the first half is in line with revised management expectations but, as previously reported, it is not as strong as originally expected. The anticipated sales in December which, together with June, is typically a key selling period, did not come through, with order slippage across both our Retail and Manufacturing & Distribution activities. We believe the lengthening sales cycle that we have seen in major orders reflected industry-wide pressures. In particular, the shift towards cloud delivery, away from on-premise technology, is lengthening the decision-making process by customers. While this transition to cloud-based consumption licensing benefits us in the long term, particularly with customer 'stickiness' and life-time values, it also creates near term challenges.

The shortfall in expected software deals, as well as overhead investment, largely accounted for the reduction in adjusted profit from operations[*1] to £0.45m (2015: £5.11m) on revenues of £42.97m (2015: £42.29m). Services margins also reduced as we used external resource to implement the strong level of orders closed in June 2016.

While we did not sign the expected level of new contracts in the period, we are pleased to report that the pipeline of order prospects nonetheless remains strong at £82.0m (2015: £56.0m). Very encouragingly, we are also seeing deals we had expected to close in the period, now coming through. These include a major deal with the British Heart Foundation, secured through our retail sales team, initially worth over £2.0m.

The evolution of the Group towards a new model of higher 'own IP' sales is progressing well. It is encouraging that gross margins generated by K3's own IP increased by 21.7% in the period to £7.58m. We are also continuing to invest in widening our sales channels for our own IP through global channel partner relationships.

We are pleased with the increase in recurring revenues, which rose by 7.6% to £21.22m (2015: £19.72m), helped by both inorganic and organic growth. These sales continue to account for approximately half the Group's overall income and are derived from annual software licence renewals, support contracts and hosting. Our margin on recurring revenue also increased to 70.7% from 70.0%.

"We are pleased to report that the pipeline of order prospects ... remains strong"

*See note 9 on page 24 for further details

The new management team, led by CEO, Adalsteinn Valdimarsson, who assumed his role in October, made strategically important changes to the Group's operational structure in the period. As previously announced, these changes have been implemented to create a more streamlined platform for ongoing growth and to enable us to better capitalise on opportunities. These include more effective cross-selling of our products across our 3,700 strong customer base. The key changes in this reorganisation programme are now largely complete and have resulted in a one-off cost of approximately £2.7m, which has been recognised in this period. However the synergy benefits are expected to exceed this cost on an annualised basis.

The tighter focus on cross-selling and simplified organisational structure has resulted in our largest ever combined AX delivery and hosted customer, Fortnum & Mason. We are also seeing our Global Accounts (IKEA franchisees) take up additional K3 solutions and services. We have developed a 'Next Generation' platform, combining IP from the DdD acquisition with our existing integration platform, which will support our entire product offering. We are currently piloting it with a major European fashion retailer.

Our combined hosting and managed services operation, Starcom, is performing well and contributed sales of £5.11m (2015: £5.41m) and adjusted profit from operations[*2] of £0.30m (2015: £0.49m). This is after the loss of MyLocal, which went into administration last year, and despite the impact of deal slippage. We are focusing on driving Starcom sales especially though cross-selling. The Fortnum & Mason contract was the second largest order for our cloud hosting and managed services business and there are further contracts being implemented in the coming months with both new and existing customers.

While the slippage in orders in the first half has been disappointing, we believe that prospects for the Group remain very promising. We have a clear vision for ongoing product development and have invested in the business to better capture opportunities. The closing of the major contract with the British Heart Foundation, as well as a good level of smaller wins with SMEs since the period end, is especially encouraging and helps to underpin prospects for the second half.

Financial Results

	Revenue (£m)		Gross Margin (£m)		Gross Margin (%)	
	Six months to 31 December 2016 £m	Six months to 31 December 2015 £m	Six months to 31 December 2016 £m	Six months to 31 December 2015 £m	Six months to 31 December 2016 %	Six months to 31 December 2015 %
Software licences	**4.41**	6.88	**2.77**	4.54	**62.8%**	66.0%
Services	**14.01**	13.19	**3.61**	4.55	**25.8%**	34.5%
Recurring*	**21.22**	19.72	**14.99**	13.81	**70.7%**	70.0%
Hardware and other	**3.33**	2.50	**1.11**	0.62	**33.2%**	24.8%
Total	**42.97**	42.29	**22.48**	23.52	**52.3%**	55.6%

	Six months to 31 December 2016	Six months to 31 December 2015	% change
Adjusted profit from operations*1 (£m)	**0.45**	5.11	-91%
Recurring revenue* as % of total revenues	**49.4%**	46.6%	+6%

**Recurring revenue: software maintenance renewals, support contracts, and hosting and managed services.*

K3 Intellectual Property

We highlight the revenue generated by K3's own IP below, which is included in the revenues above.

	Revenue	
	Six months to 31 December 2016 £m	Six months to 31 December 2015 £m
K3 Product Licence[i)]	**3.88**	4.89
K3 Product Related[ii)]	**8.62**	4.67
Total K3 Product	**12.50**	9.56
Gross margin (£m)	**7.58**	6.26
Gross margin (%)	**60.6%**	65.5%

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.

"Our focus on cash conversion has had renewed vigour with the working capital movements in the cash flow £2.5m favourable to H1 last year."

*See note 9 on page 24 for further details

For the six months to 31 December 2016, revenues totalled £42.97m (2015: £42.29m). Recurring revenues, from software maintenance renewals, support contracts, hosting and managed services, accounted for almost half this income at 49.4% (2015: 46.6%) and increased by 7.6% to £21.22m (2015: £19.72m), boosted by the acquisition of DdD in April 2016. Services revenue was up 6.2% to £14.01m (2015: £13.19m), reflecting strong activity levels after the excellent close to the last financial year although gross margin was lower. Software licence sales reduced to £4.41m (2015: £6.88m), against softer trading conditions.

Reflecting lower software licence sales and reduced service margins, gross margin decreased by 4.4% to £22.48m (2015: £23.52m) and the gross percentage margin was 52.3% (2015: 55.6%). Services margins were affected by the requirement to resource externally for implementations. However, the gross margin on recurring income rose by 8.5% to £14.99m, benefiting from the higher margin on our hosting and managed services businesses. Overhead costs[*3] increased in the short term to £22.0m (2015: £18.4m), as we invested in the DdD and Merac acquisitions and in our channel partner strategy. We expect overhead costs to reduce materially as the impact of previous and new initiatives feed through.

The operational reorganisation, announced in the autumn of 2016, resulted in a non-recurring cost of approximately £2.74m (2015: £0.85m). As previously reported, the annualised benefits are likely to exceed this cost. While the major elements of the restructuring were completed in the first half, we will continue to look for cost efficiencies.

Adjusted profit from operations[*1] was £0.45m (2015: £5.11m), which mainly reflected deal slippage and overhead investment. Adjusted profit before tax[*4] decreased to £0.03m (2015: £4.72m) and adjusted loss per share[*5] was (0.4)p (2015: earnings of 12.0p).

Reported loss before tax was £4.24m (2015: profit before tax of £2.28m) and the basic loss per share was 9.6p (2015: earnings of 5.9p). There was a net tax credit for the period of £0.81m (2015: charge of £0.41m) after the benefit of a £0.21m deferred tax credit (2015: £0.14m).

Cash flow and banking

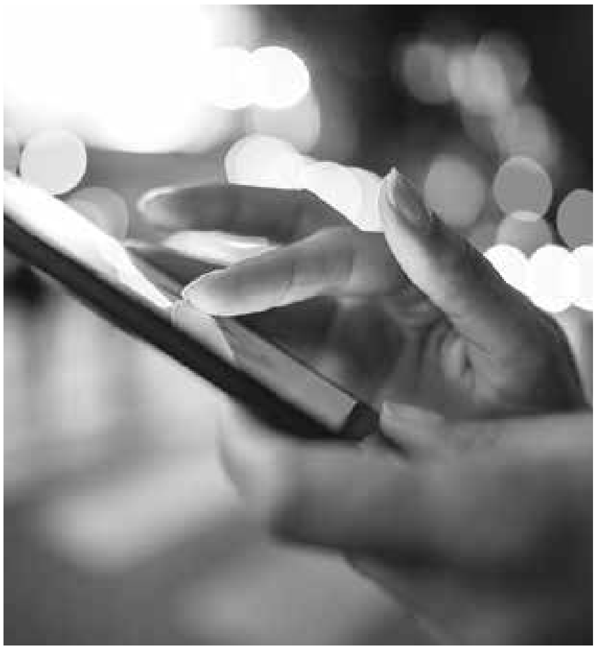
During October 2016 the Group completed a refinancing programme to take advantage of favourable interest rates. Cash flow from operations was £1.21m (2015: £4.97m) reflecting lower adjusted profit from operations[*1] and the operational reorganisation. Working capital inflows were solid at £1.54m (2015: outflow £0.95m) reflecting management focus on working capital and cash creation. Our focus on cash conversion has had renewed vigour with the working capital movements in the cash flow £2.5m favourable to H1 last year. Net debt at 31 December 2016 stood at £12.51m (2015: £10.45m).

The expenditure on capitalised development increased to £2.68m (2015: £2.17m) as we continued to execute our strategy of building our own product IP. Expenditure on fixed assets was lower at £0.29m (2015: £0.57m) and consideration on acquisitions amounted to £1.21m (2015: £0.03m).

The net cash outflow for finance expenses increased to £0.70m (2015: £0.39m) as a result of charges associated with the re-financing.

Dividend

In line with the Group's dividend policy, no interim dividend will be declared but the Directors intend to propose a progressive final dividend.



*See note 9 on page 24 for further details

Board Changes

As previously announced, we were pleased to welcome Adalsteinn Valdimarsson as Chief Executive Officer on 1 October 2016. Adalsteinn joined K3 in July 2016 as a Non-executive Director and has over 20 years' experience in the software sector. He has founded and led the expansion of a number of product-based software companies and also has significant experience in retail software and of the Microsoft Dynamics platform. We also made a number of senior management team changes, including the appointment of Robert Price as Chief Financial Officer in October 2016. Robert replaced Brian Davis whom we take this opportunity to thank for his dedicated contribution over the last nine years.

As Adalsteinn assumed his new role, I became Chairman and Lars-Olof Norell, previously Chairman, become a Non-executive Director. Lars-Olof will be retiring from the Board on 31 May and, ahead of this, we would like to thank him for his contribution to K3. We would also like to welcome Stuart Darling to the Board as a Non-executive Director from 3 April. Stuart has extensive senior level financial and commercial experience in the technology sector and with growing companies.

Change of Financial Year End

Given the Company's strong seasonal trading patterns, with December and June representing key selling months, the Board is considering changing the Company's financial year end in order to provide shareholders with greater visibility on year end results. An announcement will be made in due course about this decision.

Outlook

While the trading environment in the first half resulted in contract slippages and therefore a shortfall in the Group's trading performance, the pipelines across the Group continue to build and we are now starting to see major deals close. We continue to invest in product and have also completed important strategic changes that will better position K3 to capitalise on its opportunities. We expect to make good progress with our growth plans despite the soft first half.

As we have previously reported, we are evolving K3 so that an increasing proportion of the Group's sales will comprise higher margin own IP product and will be cloud-delivered. We also continue to view channel partners as an important route to market. All these initiatives will drive the quality of the Group's earnings.

While the market shift towards cloud-based subscription models, away from the traditional on-premise model, is causing some disruption to the sales cycle, the lifetime value of such contracts has the potential to be significantly higher and K3 is well placed to benefit as a result.

Overall, we are confident of K3's growth opportunities and will remain focused on cost efficiencies and cash generation, and on driving cross-Group synergies and capitalising on our own IP.

David Bolton
Chairman

27 March 2017

Operational Review

"We are optimistic about prospects for the business. The transition to focusing on selling solutions with more of our own higher margin IP embedded in the overall offering will help to drive both profitability and recurring revenues."

Results Overview By Industry Sector

The operational results for the Group are summarised by industry sector as follows:

	Revenue		Adjusted profit	
	Six months to 31 December 2016 £m	Six months to 31 December 2015 £m	Six months to 31 December 2016 £m	Six months to 31 December 2015 £m
Retail*6	**20.94**	19.72	**(0.79)**	2.51
Manufacturing & Distribution*7	**22.03**	22.57	**1.88**	2.99
Head Office	**–**	–	**(0.64)**	(0.39)
Total	**42.97**	42.29	**0.45**	5.11

"The operational reorganisation that we have now largely completed will support our growth strategy"

*See note 9 on page 24 for further details

Retail Activities

Results Overview

	Revenue (£m)		Gross Margin (£m)		Gross Margin (%)	
	Six months to 31 December 2016 £m	Six months to 31 December 2015 £m	Six months to 31 December 2016 £m	Six months to 31 December 2015 £m	Six months to 31 December 2016 %	Six months to 31 December 2015 %
Software licences	**2.51**	4.50	**1.87**	3.13	**74.6%**	69.6%
Services	**8.12**	7.68	**1.94**	2.34	**23.9%**	30.5%
Recurring*	**7.66**	6.20	**5.67**	4.39	**73.9%**	70.8%
Hardware and other	**2.65**	1.34	**1.00**	0.40	**37.9%**	29.9%
Total	**20.94**	19.72	**10.48**	10.26	**50.0%**	52.0%

	Six months to 31 December 2016	Six months to 31 December 2015	% change
Adjusted profit from operations*6 (£m)	**(0.79)**	2.51	-131%
Recurring revenue* as % of total revenues	**36.6%**	31.4%	+17%

**Recurring revenue: from software maintenance renewals, support contracts, and hosting and managed services.*

Intellectual Property

K3 Retail's own IP, which is included in the revenues above, is:

	Revenue	
	Six months to 31 December 2016 £m	Six months to 31 December 2015 £m
K3 Product Licence[i)]	**2.33**	3.13
K3 Product Related[ii)]	**8.49**	4.49
Total K3 Product	**10.82**	7.62
Gross margin (£m)	**6.01**	4.47
Gross margin (%)	**55.5%**	58.7%

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 24 for further details

"The DdD and Merac acquisitions are performing well"

Retail Performance

Our Retail operations generated increased sales of £20.94m (2015: £19.72m). This was below expected levels, with high margin software licence sales significantly reduced at £2.51m (2015: £4.50m). This also largely accounted for the adjusted loss from operations[*6] of £0.79m (2015: profit of £2.51m). While customer demand remained very healthy, the general shift in the marketplace towards the consumption/subscription model (illustrated by Microsoft releasing the latest version of AX initially only via the cloud) has slowed customer decision-making and the expected level of major contract agreements in the key selling period to December 2016 did not materialise. However, major deals remain in the pipeline, which is up by 80% year-on-year to £47m (2015: £26m) and we are seeing encouraging signs of deals coming through including the major new contract with the British Heart Foundation, worth initially in excess of £2,0m, which covers over 700 retail outlets.

Services sales were higher year-on-year at £8.12m (2015: £7.68m) following very successful sales in June 2016, which included major contracts with Selco, Fortnum & Mason and Ann Summers. However, gross margin decreased to 23.9% (2015: 30.5%), with this mainly resulting from the need to use external contracting resource for implementations.

Recurring revenues increased to £7.66m (2015: £6.20m), partly reflecting the benefits of the acquisitions of Merac (in July 2016) and of DdD (in April 2016), both of which are performing well.

DdD powered by k3

Merac

A key focus remains on our own IP and delivering the full potential of our "ax|is fashion" and "Pebblestone fashion" products. Revenue attributable to our own IP increased by 42.0% to £10.82m year-on-year (2015: £7.62m). Our own IP content also drove the increase in gross margins on software licence sales. These rose to 74.6% from 69.6%. We are continuing to invest in our channel partner strategy.

In the second quarter we signed our largest hosting contract on the back of a previous AX software sale. This re-enforces our belief that there are significant synergies to capitalise on across the Group as we sell our solution suites to customers.

Our business with IKEA continued to be strong in the period, with a good mix of software licence sales, support and services revenues from Inter IKEA and the concept franchisees. We are also exploring opportunities to leverage our relationship with these Global Accounts and are encouraged to see them adopt some of our wider K3 solutions and services.

Our SME-focused businesses are performing well and in line with management expectations. Sales included the first point-of-sale solution in Antarctica with the British Antarctic Survey in September. The DdD and Merac acquisitions are performing well, and we are investing in DdD's 'born in the cloud' IP to use it as a core part of our 'Next Generation' of solutions.

We have been focusing on business efficiency improvements across the Retail division and the benefits are beginning to bear fruit.

Retail Prospects

We remain very positive about the global sales potential of our "ax|is fashion" offering, our other own IP products and our elevated status as a member of the Microsoft Dynamics Inner Circle. We are continuing to focus on driving sales both directly and indirectly through an international network of channel partners. Our pipeline for the second half of the financial year at £47m (2015: £26m) has increased significantly and includes potential deals across the range of our product portfolio.

*See note 9 on page 24 for further details

Manufacturing and Distribution Activities

Results Overview

	Revenue (£m)		Gross Margin (£m)		Gross Margin (%)	
	Six months to 31 December 2016 £m	Six months to 31 December 2015 £m	Six months to 31 December 2016 £m	Six months to 31 December 2015 £m	Six months to 31 December 2016 %	Six months to 31 December 2015 %
Software licences	**1.90**	2.39	**0.90**	1.41	**47.2%**	59.0%
Services	**5.89**	5.50	**1.67**	2.21	**28.4%**	40.2%
Recurring*	**13.55**	13.52	**9.33**	9.42	**68.8%**	69.7%
Hardware and other	**0.69**	1.16	**0.10**	0.22	**15.0%**	19.0%
Total	**22.03**	22.57	**12.00**	13.26	**54.5%**	58.8%

	Six months to 31 December 2016	Six months to 31 December 2015	% change
Adjusted profit from operations*7 (£m)	**1.88**	2.99	-37%
Recurring revenue* as % of total revenues	**61.5%**	59.9%	+3%

**Recurring revenue from software maintenance renewals, support contracts, and hosting and managed services.*

Intellectual Property

Manufacturing and Distribution's own IP which is included in the revenues above, is:

	Revenue	
	Six months to 31 December 2016 £m	Six months to 31 December 2015 £m
K3 Product Licence[i)]	**1.55**	1.76
K3 Product Related[ii)]	**0.13**	0.18
Total K3 Product	**1.68**	1.94
Gross margin (£m)	**1.57**	1.80
Gross margin (%)	**93.1%**	92.8%

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.

"Prospects for the second half look encouraging with a strong pipeline of opportunities"

*See note 9 on page 24 for further details

Manufacturing and Distribution Performance

Our Manufacturing and Distribution activities generated total revenues of £22.03m (2015: £22.57m). The adjusted profit from operations*7 of £1.88m (2015: £2.99m) was impacted by order slippage in some units as well as reduced gross margin in services revenues. While expected deals slipped, the pipeline at the end of the first half remained strong, standing at c. £35m (2015: £30m).

Recurring revenues continue to comprise the dominant income stream and accounted for 61.5% of this segment's revenue (2015: 59.9%). This high margin revenue also accounts for approximately 63.9% of the Group's total recurring income and it generates significant cash flows for the investment activities for the whole Group.

Recurring revenue was slightly higher than last year at £13.55m (2015: £13.52m), with SYSPRO maintenance and support renewals continuing to account for the major part. SYSPRO renewal rates remained high at 98% (2015: 98%) and, as annual renewals are billed in October, revenues and cash flows from this segment are significantly weighted to the first half of the financial year.

Services revenues rose 7.1% to £5.89m (2015: £5.50m) reflecting the ongoing delivery of contracts across all product lines.

Our SYSPRO business performed steadily and we have recently enlarged the sales team with the expectation of increased new business. We expect sales of our own IP products (Dataswitch, APS and Orchard Warehouse Management) which have historically only been linked to SYSPRO sales, to grow strongly as in March 2017 we have included them in our Independent Software Vendor ("ISV") offering and have started to sell them through our global channel partners.

The movement to the cloud-based consumption model generated our first sale of 'Dynamics 365 for Operations', formerly AX7. K3 Business Solutions has won Business Industry Today's "Company of the year award". The Sage business has maintained its Sage 'Platinum' accreditation and its pipeline looks promising for the second half of the year. We are also now seeing Sage deals start to close. The CRM business continued to perform well with international projects, and our focus on cross-selling is generating opportunities for this business across the Group.

Our combined hosting and managed services operation, Starcom, is performing well and, contributed sales of £5.11m (2015: £5.41m) and adjusted profit from operations*8 of £0.30m (2015: £0.49m). Hosting and managed services contributed £3.95m of recurring revenues in the period (2015: £3.79m). The range of cloud hosting activities that we offer across a variety of products and price points is proving attractive to customers and we remain very optimistic about continuing growth prospects. We anticipate that Starcom hosting and managed services will be one of the major beneficiaries from the new cross-selling programme.

Manufacturing and Distribution Prospects

Our Manufacturing and Distribution activities generate predictable recurring revenues and cash flows. Prospects for the second half look encouraging with a strong pipeline of opportunities worth c. £35m (2015: £30m). In addition, we continue to focus on growing our cloud hosting and managed services business.

*See note 9 on page 24 for further details

Central Costs

Head Office

Head office costs*[9] for the period were £0.64m (2015: £0.39m) with costs stated net of recovery of elements recharged to the operating units.

Reflecting the importance of our IP and channel partner strategy, during the period, we established a central R&D and technology team. This team is focused on developing our 'Next Generation' of products, combining our industry expertise and best practice with the latest technology.

Outlook

We are optimistic about prospects for the business. The transition to focusing on selling solutions with more of our own higher margin IP embedded in the overall offering will help to drive both profitability and recurring revenues. The operational reorganisation that we have now largely completed will support our growth strategy. Designed to create a more unified and cohesive approach to the way we sell our IT solutions, the reorganisation will boost cross-selling, particularly for the cloud opportunity, and also drive efficiencies.

We will continue to focus on working capital improvement and on cash conversion by improving the working capital flows. With the recent deal closures and the encouraging size of the pipeline, we look forward to providing a further update on trading in due course.

Adalsteinn Valdimarsson
Chief Executive Officer

*See note 9 on page 24 for further details

Consolidated Income Statement
for the six months ended 31 December 2016

	Notes	Unaudited Six months to 31 December 2016 £'000	Unaudited Six months to 31 December 2015 £'000	Audited Year to 30 June 2016 £'000
Revenue		**42,974**	42,291	89,175
Adjusted profit from operations		**446**	5,107	9,501
Amortisation of acquired intangibles		**(1,486)**	(1,595)	(2,734)
Acquisition costs		**(42)**	–	(492)
Exceptional reorganisation costs	2	**(2,743)**	(847)	(1,046)
(Loss)/profit from operations		**(3,825)**	2,665	5,229
Finance income		**2**	18	4
Finance expense		**(419)**	(405)	(705)
(Loss)/profit before taxation		**(4,242)**	2,278	4,528
Tax expense	3	**813**	(406)	(425)
(Loss)/profit for the period		**(3,429)**	1,872	4,103

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

	Notes			
Earnings Per Share	4			
Basic		**(9.6)p**	5.9p	12.6p
Diluted		**(9.4)p**	5.8p	12.3p

Consolidated Statement of Comprehensive Income
for the six months ended 31 December 2016

	Unaudited Six months to 31 December 2016 £'000	Unaudited Six months to 31 December 2015 £'000	Audited Year to 30 June 2016 £'000
(Loss)/profit for the period	**(3,429)**	1,872	4,103
Other comprehensive income			
Exchange differences on translation of foreign operations	**475**	703	3,073
Other comprehensive income, net of tax	**475**	703	3,073
Total comprehensive (expense)/income for the period	**(2,954)**	2,575	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 31 December 2016

	Notes	Unaudited As at 31 December 2016 £'000	Unaudited As at 31 December 2015 £'000	Audited As at 30 June 2016 £'000
ASSETS				
Non-current assets				
Property, plant and equipment		**2,274**	2,414	2,389
Goodwill		**49,970**	43,808	48,793
Other intangible assets		**27,212**	20,483	26,369
Deferred tax assets		**572**	636	423
Available-for-sale investments		**98**	98	98
Total non-current assets		**80,126**	67,439	78,072
Current assets				
Trade and other receivables		**39,313**	32,522	40,923
Cash and cash equivalents		**4,462**	2,118	2,772
Total current assets		**43,775**	34,640	43,695
Total assets		**123,901**	102,079	121,767
LIABILITIES				
Non-current liabilities				
Long-term borrowings	5	**16,282**	9,131	8,272
Other non-current liabilities	6	**–**	494	–
Deferred tax liabilities		**3,684**	2,964	3,753
Total non-current liabilities		**19,966**	12,589	12,025
Current liabilities				
Trade and other payables	7	**32,773**	29,531	32,824
Current tax liabilities		**–**	354	132
Short-term borrowings	5	**691**	3,440	3,376
Total current liabilities		**33,464**	33,325	36,332
Total liabilities		**53,430**	45,914	48,357
EQUITY				
Share capital		**9,000**	7,965	9,000
Share premium account		**21,586**	9,524	21,586
Other reserves		**10,448**	10,448	10,448
Translation reserve		**1,551**	(1,294)	1,076
Retained earnings		**27,886**	29,522	31,300
Total equity attributable to equity holders of the parent		**70,471**	56,165	73,410
Total equity and liabilities		**123,901**	102,079	121,767

Consolidated Statement of Cash Flows

for the six months ended 31 December 2016

	Notes	Unaudited Six months to 31 December 2016 £'000	Unaudited Six months to 31 December 2015 £'000	Audited Year to 30 June 2016 £'000
Cash flows from operating activities				
(Loss)/profit for the period		**(3,429)**	1,872	4,103
Adjustments for:				
Share based payments charge		**23**	4	28
Depreciation of property, plant and equipment		**519**	493	971
Amortisation of intangible assets and development expenditure		**2,948**	2,763	5,077
Loss on sale of property, plant and equipment		**–**	–	4
Finance income		**(2)**	(18)	(4)
Finance expense		**419**	405	705
Tax expense		**(813)**	406	425
Decrease (increase) in trade and other receivables		**2,707**	(531)	(5,977)
(Decrease) increase in trade and other payables		**(1,163)**	(421)	170
Cash generated from operations	8	**1,209**	4,973	5,502
Finance expense paid		**(701)**	(392)	(789)
Income taxes received/(paid)		**96**	(212)	(688)
Net cash generated from operating activities		**604**	4,369	4,025
Cash flows from investing activities				
Acquisition of subsidiaries, net of cash acquired	8	**(1,207)**	(25)	(7,401)
Development expenditure capitalised		**(2,681)**	(2,169)	(4,642)
Purchase of property, plant and equipment		**(286)**	(573)	(931)
Proceeds from sale of property, plant and equipment		**–**	–	15
Finance income received		**2**	–	6
Net cash absorbed by investing activities		**(4,172)**	(2,767)	(12,953)
Cash flows from financing activities				
Net proceeds from issue of share capital		**–**	78	13,175
Proceeds from long-term borrowings		**16,133**	–	–
Payment of long-term borrowings		**(10,885)**	(1,464)	(2,928)
Payment of finance lease liabilities		**(25)**	(4)	(12)
Dividends paid		**–**	–	(477)
Net cash generated from/(absorbed by) financing activities		**5,223**	(1,390)	9,758
Net change in cash and cash equivalents		**1,655**	212	830
Cash and cash equivalents at start of period		**2,772**	1,895	1,895
Exchange gains on cash and cash equivalents		**35**	11	47
Cash and cash equivalents at end of period		**4,462**	2,118	2,772

Consolidated Statement of Changes in Equity
for the six months ended 31 December 2016

	Share capital £'000	Share premium £'000	Other reserve £'000	Translation reserve £'000	Retained earnings £'000	Total equity £'000
At 1 July 2015	7,949	9,462	10,448	(1,997)	27,633	53,495
Changes in equity for six months ended 31 December 2015						
Profit for the period	–	–	–	–	1,872	1,872
Other comprehensive income for the period	–	–	–	703	–	703
Total comprehensive income	–	–	–	703	1,872	2,575
Share-based payment credit	–	–	–	–	4	4
Options exercised	16	62	–	–	–	78
Movement in own shares held	–	–	–	–	13	13
At 31 December 2015	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

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 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 June 2017 or are expected to be adopted and effective at 30 June 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 31 December 2016 and the six months ended 31 December 2015 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.

2 Profit from operations

During the period, reorganisation costs have been incurred which relate to a major reorganisation to streamline the management structure to promote ongoing growth through better cross-selling of products and services. This was at a cost of £2.74m (2015: £0.85m).

3 Tax expense

	Unaudited Six months to 31 December 2016 £'000	Unaudited Six months to 31 December 2015 £'000	Audited Year to 30 June 2016 £'000
Current tax expense			
UK corporation tax and income tax of overseas operations on profits for the period	**(607)**	542	866
Adjustment in respect of prior periods	**–**	–	(25)
Total current tax expense	**(607)**	542	841
Deferred tax income			
Origination and reversal of temporary differences	**(77)**	(136)	(94)
Effect of change in rate of deferred tax	**(129)**	–	(322)
Total deferred tax income	**(206)**	(136)	(416)
Total tax expense	**(813)**	406	425

Notes to the Unaudited Half Yearly Report continued

4 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 2016 Number of shares	Unaudited Six months to 31 December 2015 Number of shares	Audited Year to 30 June 2016 Number of shares
Weighted average number of shares:			
For basic earnings per share	**35,901,357**	31,683,967	32,439,624
Effects of employee share options and warrants	**479,288**	508,458	798,049
For diluted earnings per share	**36,380,645**	32,192,425	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 31 December 2016			Unaudited Six months to 31 December 2015			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	Earnings £'000	Per share amount basic p	Per share amount diluted p
Earnings per share (eps)	**(3,429)**	**(9.6)**	**(9.4)**	1,872	5.9	5.8	4,103	12.6	12.3
Amortisation of acquired intangibles (net of tax)	**1,061**	**3.0**	**2.9**	1,275	4.0	4.0	2,190	6.8	6.6
Acquisition costs (net of tax)	**42**	**0.1**	**0.1**	–	–	–	492	1.5	1.5
Exceptional reorganisation costs (net of tax)	**2,194**	**6.1**	**6.0**	678	2.1	2.1	837	2.6	2.5
Adjusted eps	**(132)**	**(0.4)**	**(0.4)**	3,825	12.0	11.9	7,622	23.5	22.9

5 Loans and borrowings

	Unaudited As at 31 December 2016 £'000	Unaudited As at 31 December 2015 £'000	Audited As at 30 June 2016 £'000
Non-current			
Bank loans (secured)	**16,203**	9,127	8,234
Finance lease creditors	**79**	4	38
	16,282	9,131	8,272
Current			
Bank loans (secured)	**–**	2,796	2,718
Finance lease creditors	**51**	4	18
Loans from related parties	**640**	640	640
	691	3,440	3,376
Total borrowings	**16,973**	12,571	11,648

6 Other non-current liabilities

	Unaudited As at 31 December 2016 £'000	Unaudited As at 31 December 2015 £'000	Audited As at 30 June 2016 £'000
Accruals	**–**	494	–
	–	494	–

Notes to the Unaudited Half Yearly Report continued

7 Trade and other payables

	Unaudited As at 31 December 2016 £'000	Unaudited As at 31 December 2015 £'000	Audited As at 30 June 2016 £'000
Trade payables	**5,420**	5,887	8,192
Other payables	**412**	292	713
Accruals	**10,552**	8,302	9,548
Total financial liabilities, excluding loans and borrowings, classified as financial liabilities measured at amortised cost	**16,384**	14,481	18,453
Contingent consideration	**938**	56	912
Deferred consideration	**175**	25	25
Other tax and social security taxes	**5,171**	4,194	4,266
Deferred revenue	**10,105**	10,775	9,168
	32,773	29,531	32,824

8 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 31 December 2016 £'000	Unaudited Six months ended 31 December 2015 £'000	Audited Year ended 30 June 2016 £'000
Cash generated from operating activities	**1,209**	4,973	5,502
Add:			
Exceptional reorganisation costs	**2,391**	847	1,046
Acquisition costs	**42**	–	300
Adjusted cash generated from operations	**3,642**	5,820	6,848

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

	Unaudited Six months ended 31 December 2016 £'000	Unaudited Six months ended 31 December 2015 £'000	Audited Year ended 30 June 2016 £'000
Initial consideration	**(1,506)**	–	(6,802)
Cash balances acquired	**324**	–	345
Contingent consideration paid into escrow	**–**	–	(863)
Contingent and deferred consideration paid	**(25)**	(25)	(81)
	(1,207)	(25)	(7,401)

9 Notes to the Chairman's Statement and Operational Review

*1 Group adjusted profit from operations is calculated before amortisation of acquired intangibles of £1.49m (2015: £1.60m), exceptional reorganisation costs of £2.74m (2015: £0.85m) and acquisition costs of £0.04m (2015: nil).

*2 Starcom adjusted profit from operations is calculated before amortisation of acquired intangibles of £0.16m (2015: £0.16m).

*3 Overhead costs are calculated before amortisation of acquired intangibles of £1.49m (2015: £1.60m), exceptional reorganisation costs of £2.74m (2015: £0.85m) and acquisition costs of £0.04m (2015: nil).

*4 Group adjusted profit before tax is calculated before amortisation of acquired intangibles of £1.49m (2015: £1.60m), exceptional reorganisation costs of £2.74m (2015: £0.85m) and acquisition costs of £0.04m (2015: nil).

*5 Group adjusted earnings per share is calculated before amortisation of acquired intangibles (net of tax) of £1.06m (2015: £1.28m), exceptional reorganisation costs (net of tax) of £2.19m (2015: £0.68m) and acquisition costs (net of tax) of £0.04m (2015: nil).

*6 Retail adjusted (loss)/profit from operations is calculated before amortisation of acquired intangibles of £0.83m (2015: £0.31m) and exceptional reorganisation costs of £1.09m (2015: £0.65m).

*7 Manufacturing and Distribution adjusted profit from operations is calculated before amortisation of acquired intangibles of £0.66m (2015: £1.29m) and exceptional reorganisation costs of £0.53m (2015: £0.20m).

*8 Starcom adjusted profit from operations is calculated before amortisation of acquired intangibles of £0.16m (2015: £0.16m).

*9 Head office costs are calculated before exceptional reorganisation costs of £1.12m (2015: nil) and acquisition costs of £0.04m (2015: nil).

10 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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