

► BUY - K3 Capital (K3C)

Thursday 17th March 2022



STOCK TICKER
K3C



SECTOR
INVESTMENT BANKING &
INVESTMENT SERVICES



MARKET CAP
£200.28M

K3 offer income and growth

When investing in small caps, the term 'income & growth' is often seen as an oxymoron...

After all, why would a small, growing business choose to pay out a dividend rather than reinvest in further growth?

However, every now and again you find a company that manages to strike the perfect balance between rewarding shareholders with a progressive dividend and maintaining robust levels of organic growth, and we believe **K3 Capital (K3C)** is the perfect example...

K3 is a M&A (mergers and acquisitions) house for SME's which has diversified through strategic acquisitions to cover debt restructuring, tax advice and insolvency.

The shares look attractively priced, with double-digit earnings per share (EPS) growth and a market-leading dividend yield.

Building an 'end-to-end platform' of services for SME's

Having started as an M&A specialist, K3's ambitious CEO, John Rigby has opportunistically grown the business into a diversified financial services powerhouse...

K3's M&A division is the UK market leader in company sales and its tax advisory division one of the most established R&D tax reclaim businesses in the UK.

In 2020, during the height of the pandemic, Mr Rigby managed to pull off a game-changing merger with restructuring and advisory firm Quantuma.

The deal, worth £42m, has more than doubled K3's top line revenues from £15m in 2020 to £47.2m in 2021.

Quantuma is major player in the insolvency market with a 5% national share, behind only Begbies Traynor (BEG) - a stock we also hold in our AIM Investor portfolio.

The withdrawal government support and the unwinding of legislative changes is providing a strong tailwind for the insolvency and debt restructuring market.



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K3 have launched a debt advisory business to help M&A customers finance bids, and John Rigby's vision of an 'end-to-end platform of services' is taking shape.

Commenting on the Quantuma deal, Mr Rigby said:

"It creates a group with diversified income streams, recurring revenues, multiple and complementary channels to market and significant cross selling opportunities."



M&A outlook remains strong

When the pandemic first hit, there was a huge amount of uncertainty around the UK M&A market, and it was a driving force behind K3's decision to diversify the business with the acquisition of Quantuma.

However, rather than M&A activity dwindle as first thought, it's been quite the opposite with K3 enjoying a record period - with its M&A division delivering revenue growth of 66% to £9.8m (H1FY22).

Most of the growth in M&A was organic, with appointments up 47% and mandates growing 75% resulting in the number of offers rising 36%.

In its February Half-Year report, K3 said:

"Our M&A Division continues to see strong KPI performance, with growing transaction fee pipelines underpinning our expectations for H2 and beyond..."

December was the most profitable month within the M&A division in FY22 to date."



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Rock-solid financials

K3's financials are in rude health...

As the Quantuma merger continues to bed in, top-line revenue has surged 73% during the last half-year (H1 FY22) and adjusted earnings (EBITDA) have followed suit, up 62% to £9.4m.

K3 have outlined ambitious growth targets over the next five years with EBITDA from the existing businesses set to increase from an estimated £16m this financial year to £23m by May 2023 and to between £33m-£36m by May 2026.

In addition to this more than doubling of organic earnings, K3 plan to add another £10m-£17m through acquisitions, taking total EBITDA to between £50m-£53m - making K3's mid-tier PE ratio of 12.3 (forward) look very attractive.

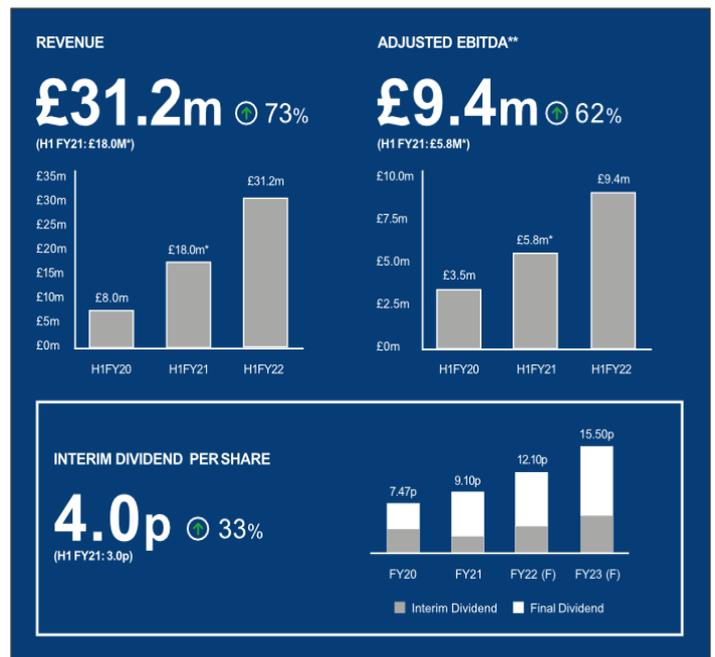
And based on discounted cashflow analysis, the shares are trading at a 'deep discount' to fair value of £9.90p.

K3 run a debt-free balance sheet with net cash of £8.83m, and in their recent Half-Year report reiterated their commitment to a "progressive dividend policy"...

K3's Full-Year 2021 pay-out will be 9.10p per share and this is forecast to increase by 70% over the next two years - putting K3 on a forward dividend yield of 5.43%.

And whilst current year dividend cover looks relatively thin at 0.84 (TTM), it is forecast to rise to 1.55 in-line with K3's projected earnings growth.

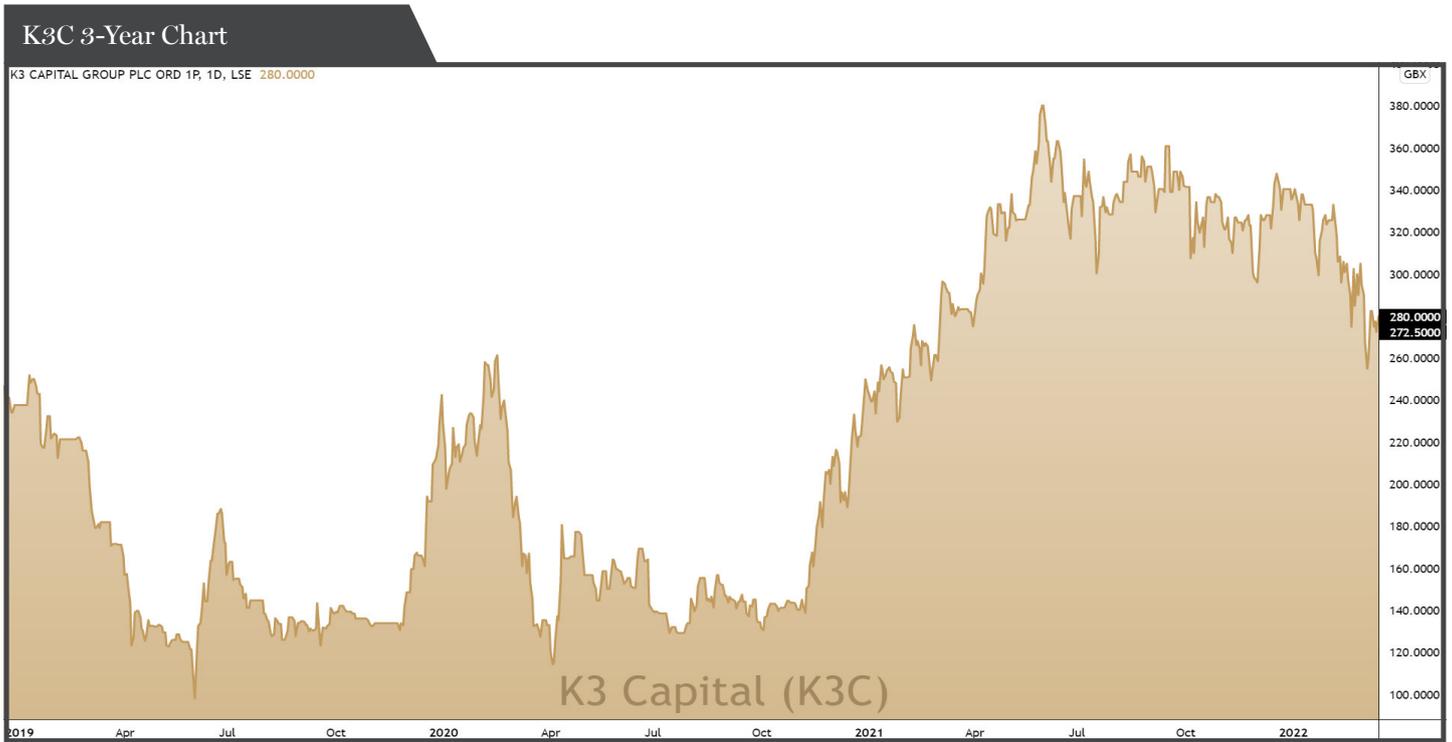
In summary, K3 is a well-run business which looks to reward investors as they grow, and we're happy to be along for the ride!



K3 capital group plc

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4

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