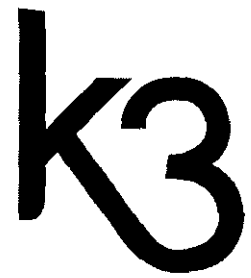


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Annual Report and Financial Statements **2005**
K3 BUSINESS TECHNOLOGY GROUP PLC



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COMPANIES HOUSE 26/05/2006

K3 Business Technology Group plc

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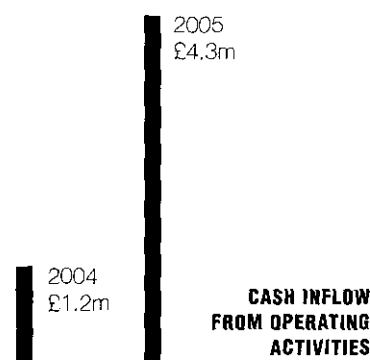
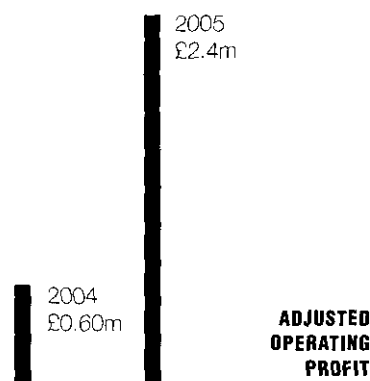
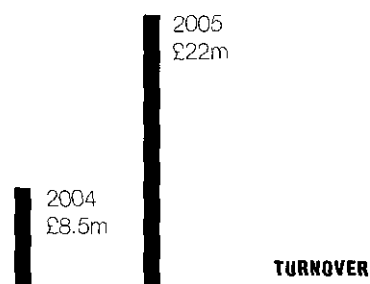
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FINANCIAL HIGHLIGHTS

	2005 £000	2004 £000
Turnover	22,029	8,529
Operating profit (loss)	656	(33)
Adjusted operating profit ¹	2,408	603
Increase in shareholders' funds	3,805	4,031
Cash inflow from operating activities	4,267	1,244
(Loss) earnings per share	(1.4p)	10.0p
Adjusted earnings per share ²	11.2p	4.5p

TRADING HIGHLIGHTS

- Success of diversification strategy beginning to show through as the group now has a presence in retail and distribution markets as well as the manufacturing sector.
- Acquisition of Information Engineering Group ("IEG") in June 2005 strengthened the manufacturing business.
- Record operating profits reflected the full impact of the two acquisitions made in 2004 (Elucid and K3 Landsteinar) and a partial contribution of a third acquisition (IEG).
- Strong performance from retail and manufacturing software businesses.
- The Board continues to view the group's prospects very positively.



*1 Calculated before amortisation of goodwill and intangibles of £1.75m (2004: amortisation of goodwill £0.64m).

*2 Calculated before amortisation of goodwill and intangibles of £1.75m and loss on disposal of operations of £0.14m (2004: amortisation of goodwill of £0.64m and profit on disposal of operations of £1.25m).

Current Directors and Advisers

George Boy Matthews (Chairman) age 50

George has over 20 years experience within the IT sector. Until his retirement in September 2001, he was Chief Executive Officer of Sherwood International plc, a leading supplier of technology solutions to the global insurance marketplace.

Per Johan Claesson (non-executive) age 54

Johan was appointed a director in March 2001. He is a Swedish national whose principal business interests are in property development and real estate and is a director of a number of listed companies. He has a controlling interest in and is Chairman of Claesson and Anderzen AB ("C&A").

Nigel Andrew Makeham (Chief Executive) age 51

Andy was appointed Chief Executive in March 2001. He has over 20 years experience running or working in IT companies, most recently with Kewill Systems plc where he was a divisional sales and marketing director.

David John Bolton FCA (Chief Finance Officer) age 54

David was appointed Chief Finance Officer of the group in September 1998. Having qualified as a chartered accountant in the mid-1970s with Ernst and Young, he has held various finance positions in quoted and unquoted companies, most notably BTR where he spent 12 years.

Russell Edward Dorset (Chief Operating Officer) age 39

Russell joined K3 as Sales Director of the Business Systems Division in January 2001. He was appointed to the Board in March 2003 and became Chief Operating Officer in September 2004. He has a broad experience of the IT, commercial and industrial sectors. He was previously Sales Director for an operating company within Misys, and Ramesys where he led their development within the food retail sector. More recently he worked within the e-business applications division of Nortel.

Current Directors:

DJ Bolton

PJ Claesson (non-executive)

RE Dorset

NA Makeham

GB Matthews (Chairman)

Company Secretary:

DJ Bolton

Registered Office:

Linden Business Centre, Linden Road, Colne,
Lancashire, BB8 9BA

Nominated Advisor and brokers:

Bridgewell Securities Limited, Old Change House,
128 Queen Victoria Street, London, EC4V 4BJ

Auditors:

BDO Stoy Hayward LLP, Manchester

Solicitors:

Addlestone Keane, Carlton Tower, 34 St Pauls Street,
Leeds, LS1 2QB

Walker Morris, 12 Kings Court, Leeds, LS1 2HL

Bankers:

Royal Bank of Scotland plc, 3/4 Syer House,
Stafford Court, Stafford Park 1, Telford,
Shropshire, TF3 3BD

Registrars:

Capita Registrars, Northern House, Woodsome Park,
Fenay Bridge, Huddersfield, HD8 0LA

Registered Number:

2641001

Chairman's Statement

OVERVIEW

The group's results for 2005 are a most encouraging endorsement of the strategy we initiated in 2004 to diversify and extend the business into the related sectors of distribution and retail software. The group is now well positioned to benefit from enhanced opportunities for earnings growth.

Results for the year ended 31 December 2005 reflect full year contributions from the two acquisitions we made in 2004, K3 Landsteinar, our retail software solutions business, and K3 Elucid, our distribution software solutions business. Our latest acquisition, Information Engineering Group ("IEG"), which we purchased in June 2005, made a contribution for only part of the year.

Our latest acquisition was Information Engineering Group ("IEG") which we purchased in June 2005.

K3 Landsteinar, the retail software solutions business, performed very strongly and demonstrated year on year growth of 23%. Its contribution accounted for 57% of group turnover for the year. K3 Elucid's performance was mixed, with trading in the second half stronger than the first. This business accounted for 8% of group turnover. The addition of IEG, one of only two distributors in the UK of the SYSPRO range of ERP software, has significantly strengthened our manufacturing software business. Its SYSPRO offering complements our existing activities and we have already achieved cross-selling opportunities with our existing manufacturing software solutions business. Trading at both IEG and our existing manufacturing software business was very strong, with IEG's performance boosted by a major contract win with Doncaster Group.

K3 Landsteinar, the retail software solutions business, performed very strongly and demonstrated year on year growth of 23%.

FINANCIAL RESULTS

Turnover on continuing operations almost tripled from £8.12m in 2004 to £22.03m in 2005 reflecting the impact of our acquisitions. Adjusted operating profit¹ on continuing operations increased more than four-fold from £0.59m to £2.41m. After amortisation of goodwill and intangibles of £1.75m (2004: £0.64m), operating profit was £0.66m (2004: loss of £0.03m).

The losses on disposal of operations of £0.09m (profit on disposal of £1.25m in 2004) related to the disposal of the Crewe business.

Adjusted profit before tax³ for the year was £2.12m (2004: £0.55m) and adjusted earnings per share² were 11.2p (2004: 4.5p). After taking into account amortisation of goodwill and intangibles of £1.75m (2004: £0.64m) and an exceptional loss of £0.09m (2004: exceptional profit of £1.25m), profit before tax was £0.28m (2004: £1.16m) and loss per share was 1.4p (2004: earnings per share 10.0p).

At 31 December 2005, the group had a cash balance of £0.87m compared with £0.40m at 31 December 2004, having negotiated a bank loan of £1m in December 2005.

DIVIDEND

The Directors do not propose to pay a dividend (2004: £nil).

¹ Calculated before amortisation of goodwill and intangibles of £1.75m (2004: amortisation of goodwill of £0.64m)

² Calculated before amortisation of goodwill and intangibles of £1.75m and loss on disposal of operations of £0.14m (2004: amortisation of goodwill of £0.64m and profit on disposal of operations of £1.25m)

³ Calculated before amortisation of goodwill and intangibles of £1.75m and loss on disposal of operations of £0.09m (2004: amortisation of goodwill of £0.64m and profit on disposal of operations of £1.25m)

REVIEW OF OPERATIONS

Retail Software Business

K3 Landsteinar delivered a very strong performance, securing 12 new contracts over the year worth a total of £7.53m. The most notable win was a contract with Carpetright plc agreed in May 2005. This contract resulted in significant growth in consultancy services which increased to £7.14m in 2005 and helped to lift total revenues for the year to £12.66m (2004: £2.93m for the three months post-acquisition from October to December). Adjusted operating profit^{*4} grew to £1.22m (2004: £0.44m for the three months post-acquisition, from October to December).

The Carpetright contract will help to underpin the business's performance in 2006 as we continue to deliver further services and software licences to support Carpetright's 450 store roll-out programme. Whilst the trading environment for retailers is more challenging, we enter 2006 with a strong pipeline of prospects and believe that the Microsoft Navision-based retail solution we offer remains one of the best solutions for mid-tier retailers in the market.

The Carpetright contract will help to underpin the business's performance in 2006.

*4 Calculated before amortisation of goodwill and intangibles of £0.95m (2004: £0.23m)

Chairman's Statement continued

Distribution Software Business

After a slower than expected start to 2005, trading in the second half of the year regained momentum and revenues grew from £0.81m at the half year stage to £1.80m at the year end (2004: £1.30m for nine months). Whilst the business recorded an adjusted operating loss⁵ of £0.08m for the year as whole (2004: profit for nine months £0.13m), which was disappointing, this included one-off costs relating to an investment in a new warehouse management module and a reorganisation in the second half.

Manufacturing Software Business

The acquisition of IEG in June 2005 transformed this business, both in terms of critical mass and by the added sales opportunities that IEG's status as one of only two SYSPRO distributors in the UK has created for the existing manufacturing software business. Whilst IEG made only a partial contribution to the year's results of this business, the combined businesses generated sales of £7.57m with an adjusted operating profit⁶ of £1.27m (2004: £0.02m). For the period since its acquisition (23 June 2005), IEG contributed revenue of £3.61m and an adjusted operating profit⁷ of £0.74m.

The acquisition of IEG in June 2005 transformed the manufacturing business.

⁵ Calculated before amortisation of goodwill and intangibles of £0.08m (2004: £0.07m)
⁶ Calculated before amortisation of goodwill and intangibles of £0.72m (2004: £0.30m)
⁷ Calculated before amortisation of goodwill and intangibles of £0.42m

We continue to seek appropriate acquisitions that will further strengthen the group and we continue to view the group's prospects very positively.

The existing Walton business saw adjusted operating profits⁸ rise to £0.53m (2004: £0.02m) on revenues slightly ahead at £3.96m (2004: £3.88m). The profit improvement was helped by cost savings resulting from the synergies with IEG and the completion of the CRM investment, together with lower central costs allocated against the business.

IEG traded very strongly, helped by a £2m contract win with Doncaster Group, a leading manufacturer of precision components and assemblies for the aerospace, power generation, specialty automotive and medical orthopaedic industries. IEG is supplying and implementing SYSPRO software in 13 of Doncaster's manufacturing sites in the UK and US. For the period under review, this contract delivered sales of £1.36m but it should bring additional new sales worth £0.58m for 2006 with the potential for further revenues later in the year. IEG continues to enjoy a high level of annual licence billings which are made in the last quarter of each year.

There is an encouraging pipeline for both businesses and we expect another good performance in 2006.

OUTLOOK

Each of our businesses ended 2005 on a strong note. Sales prospects are good and there are growth opportunities in our key sectors. We continue to seek appropriate acquisitions that will further strengthen the group and we continue to view the group's prospects very positively.

George Matthews

Chairman

⁸ Calculated before amortisation of goodwill of £0.30m (2004: £0.30m)

Operating Review

Our goal is to become the UK's market leading supplier of Microsoft-based supply chain management solutions to small and medium sized companies. In the last 18 months, we have built on K3's dominant position within the SME manufacturing sector by acquiring businesses that extend our footprint across the faster growing and complementary sectors of distribution and retail systems.

The group today provides a well-balanced business model, delivering a strong mix of safe recurring licence income combined with high growth opportunities.

The resultant group today provides a well-balanced business model, delivering a strong mix of safe recurring licence income (in the manufacturing sector) combined with higher growth opportunities in the distribution and retail sectors.

In addition to our leading position within the SME manufacturing systems marketplace, we are now Microsoft's largest reseller of Navision software and one of Microsoft's leading UK business solutions (MBS) partners, with a strong presence in the retail and distribution sectors.

It is also pleasing to note that over the course of 2005 each of our three trading businesses secured their largest new orders to date.

Microsoft®
GOLD CERTIFIED

Partner

RETAIL SOFTWARE BUSINESS

K3 Landsteinar focuses on delivering Microsoft's Navision business solution to mid-tier retailers, and our success in this sector makes us Microsoft's largest Navision reseller in the UK. We offer retailers a complete 'end-to-end' solution through a single integrated software suite. This means that the same software is running at head office, at the store and on the individual EPOS (Electronic Point of Sale) tills. The solution therefore typically delivers lower cost of ownership than traditional retail solutions and provides retailers with greater data accuracy and improved sales analysis. The suite is also easier to support.

In the course of the year, K3 Landsteinar won 12 major new retail contracts worth £7.53m, including significant second half orders from Gamestation (electronic games), Adidas (sportswear), James Cropper (papermakers) and Housing Units (furniture). These new orders together with implementation and roll out programmes at Carpetright and Moss Pharmacy (now Alliance Pharmacy) helped deliver record results and year on year sales growth of 23% over 2004.

The Carpetright implementation should enter its 'roll out' phase during 2006 when it will be implemented in 450 stores throughout the UK. Each store will require software licences and consultancy services. The implementation should therefore help to underpin revenues throughout 2006 and into 2007.

DISTRIBUTION SOFTWARE BUSINESS

Following a disappointingly slow first half, we undertook a reorganisation and introduced new management. This led to a significantly improved second half with seven new contracts awarded. Of particular note was our contract with Scotts of Stow, one of the leading names in the catalogue and mail order space, worth £0.30m. This contract, awarded at the beginning of 2005, is the business's largest order thus far.

During 2005, we formed our own web development unit, specialising in creating integrated web and back office solutions. Successful projects have now been implemented at Joe Browns (fashion retail www.joebrowns.co.uk), Inverawe (speciality smoked foods www.smokedsalmon.co.uk), and Bright Minds (educational toys www.brightminds.co.uk).

MANUFACTURING SOFTWARE BUSINESS

As previously reported, in June 2005 we acquired IEG for an initial consideration of £3.81m, with deferred consideration of up to £2.25m. IEG distributes and implements SYSPRO

manufacturing, financial and distribution software throughout the UK. SYSPRO (one of the world's most successful global ERP solutions for SME manufacturers, with 12,000 customers in 60 countries) is a Microsoft-based software suite which provides customers with real-time information throughout the supply chain process. IEG's other services include project management, implementation consultancy, training and support.

The acquisition has brought us a business with high levels of recurring revenue. Furthermore, its SYSPRO offering provides a natural upgrade solution for our existing manufacturing customers. We have already realised some cost saving benefits as a result of its integration and we expect to make further cost savings this year.

IEG's SYSPRO offering provides a natural upgrade solution for our existing manufacturing customers.

Whilst our Walton-on-Thames business continued to prove that its existing products, supported by our Microsoft CRM offering, remain very attractive to customers, the introduction of the SYSPRO product helped to lift sales at the Walton business by 5% in the second half. In the six months of selling the SYSPRO product, the Walton business delivered four new deals worth some £0.49m, including two recently concluded deals to Arcam (£0.15m) and Microfiltrex (£0.15m). This is most encouraging.

We begin 2006 with confidence. IEG's contract win with Doncaster Group to roll out the SYSPRO product across 13 sites supported a strong performance in the six months since its acquisition and underpins the business's performance in 2006. In addition, IEG's pipeline remains strong and we believe that further cross-selling opportunities and realisable synergies are still available.

Andy Makeham

Chief Executive

Financial Review

GROUP RESULTS

- Full year turnover on continuing activities increased to £22.03m from £8.12m in 2004. This reflected the full year impact of the acquisition of Elucid (in April 2004) and K3 Landsteinar (in October 2004) and six-months from IEG acquired in June 2005.
- The group registered an adjusted operating profit⁴ of £2.41m (2004: £0.60m).
- Operating profit for the year was £0.66m (2004: operating loss of £0.03m).
- The amortisation of goodwill of £1.75m (2004: £0.64m) includes amortisation of Landsteinar over eight years and in respect of the ERP businesses, Elucid and IEG which is over a period of ten years.
- A loss on disposal of £0.09m in 2005 relates to the disposal in 2004 of the manufacturing software operation based at Crewe. A profit on disposal of £1.25m was reported on this disposal in 2004.
- The loss for the year was £0.21m. (2004: profit of £1.10m).
- Adjusted earnings per share⁵ was 11.2p. (2004: 4.5p).
- Loss per share was 1.4p (2004: earnings per share of 10.0p including profit on disposal of business at Crewe).
- The directors do not propose to pay a dividend (2004: £nil).

BALANCE SHEET

- Fixed assets increased from £10.51m to £16.35m reflecting the acquisition of IEG. Goodwill on the acquisition was £7.47m with an adjustment to goodwill on acquisitions made in 2004 of £0.02m and a total amortisation charge of £1.75m. Intangible fixed assets acquired with IEG were £0.19m together with tangible fixed assets of £0.12m. Additions to tangible fixed assets were £0.26m and depreciation was £0.34m with £0.11m of assets disposed of. Investments in 2004 of £0.02m relate to a 1% interest by Landsteinar in Partner Power International, now written down to £nil.
- Net current liabilities of £3.11m (2004: £3.17m) include £4.17m of deferred income relating to licence and support charges billed but not yet recognised as income (2004: £2.98m).
- The cash in hand at 31 December 2005 was £0.87m (2004: £0.40m), having negotiated a bank loan of £1m in December 2005.
- Shareholders' funds increased by £3.81m reflecting share capital issued of £2.15m for the acquisition of IEG, £1.35m in respect of a placing of 1.55m shares in October 2005 (net of costs of £0.06m) and £0.54m on conversion of a loan due to a related party, together with the loss for the year of £0.21m and the purchase of treasury shares of £0.02m under the employee share ownership plan.

⁴ Calculated before amortisation of goodwill and intangibles of £1.75m (2004: amortisation of goodwill of £0.64m)

⁵ Calculated before amortisation of goodwill and intangibles of £1.75m and loss on disposal of operations of £0.14m (2004: amortisation of goodwill of £0.64m and profit on disposal of operations of £1.25m)

CASH FLOW

- The group's cash inflow in the year was £0.47m (2004: outflow of £0.82m).
- The group's inflow from operating activities in the year was £4.27m (2004: £1.24m).
- Net interest amounted to a cash outflow of £0.28m (2004: £0.10m).
- Capital expenditure less disposal proceeds was £0.11m (2004: £0.01m).
- Net cash outflow on acquisitions and disposals was £5.15m (2004: £2.34m) including payment of deferred consideration of £1.69m (2004: £0.01m).
- A placing of 1,555,555 shares at £0.90 in September 2005 generated a cash inflow after costs of £1.35m.
- In December 2005 the group negotiated a bank loan of £1m which is repayable over three years.

RISK MANAGEMENT AND TREASURY

- The group operates clearly established treasury procedures as part of its overall accounting procedures. These are summarised in the Accountability and Audit section of the Board Report on Corporate Governance on pages 18 to 20.

David Bolton

Chief Finance Officer

Directors' Report

The directors present their annual report on the affairs of the group, together with the financial statements and auditors' report, for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The principal activities of the group and the company are the supply of computer software and consultancy.

The subsidiary undertakings principally affecting the profits or net assets of the group in the year are listed in note 12 to the financial statements.

BUSINESS REVIEW

The consolidated results of the year are shown on page 24.

Further details of the group's performance during the year and expected future developments are contained in the operating and financial reviews.

The group's financial risk management objectives and policies are disclosed in the Board Report on Corporate Governance on pages 14 to 21.

RESULTS AND DIVIDENDS

The audited financial statements for the year ended 31 December 2005 are set out on pages 24 to 53. The group's loss for the year after taxation was £0.21m (2004: profit of £1.10m).

No dividend will be paid (2004: £nil).

DIRECTORS

The directors who served during the year were as follows:

DJ Bolton
PJ Claesson
RE Dorset
NA Makeham
GB Matthews

Mr RE Dorset retires by rotation and offers himself for re-election.

SUPPLIER PAYMENT POLICY

The company's policy, which is also applied by the group, is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment. Trade creditors of the company at 31 December 2005 were equivalent to 62 (2004: 57) days' purchases, based on the average daily amount invoiced by suppliers during the year.

CHARITABLE AND POLITICAL CONTRIBUTIONS

Charitable contributions during the year amounted to £800 (2004: £2,500). There were no political contributions during the year or prior year.

SUBSTANTIAL SHAREHOLDINGS

On 28 March 2006, the company had been notified, in accordance with sections 198 to 208 of the Companies Act 1985, of the following interests in the ordinary share capital of the company.

Name of holder	Number	Percentage Held
PJ Claesson	3,591,448	20.2%
Altenberg Reval AS	840,000	4.7%
Giab AB	800,000	4.5%
G Wigglesworth	697,906	3.9%
DJ Bolton	612,300	3.5%
NA Makeham	599,139	3.4%
P McCarthy	1,588,005	9.0%
AA Latham	578,442	3.3%

DISABLED EMPLOYEES

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the group continues and that appropriate training is arranged. It is the policy of the group that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

EMPLOYEE CONSULTATION

The group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the group. This is achieved through informal discussions between management and other employees at a local level.

AUDITORS

On 19 December 2005 Deloitte & Touche LLP resigned as auditors of the company and the directors appointed BDO Stoy Hayward LLP to fill the casual vacancy.

The Notice of Annual General Meeting contains a resolution to re-appoint BDO Stoy Hayward LLP as auditors for the ensuing year.

Linden Business Centre
Linden Road
Colne
Lancashire, BB8 9BA

By order of the Board

DJ Bolton 

Secretary

28 March 2006

Board Report on Corporate Governance

The Board supports the principles of good governance. In fulfilling their responsibilities, the directors believe that they govern the company in the best interests of the shareholders, whilst having due regard to the interests of the stakeholders in the group including, in particular, customers, employees and suppliers. Although as a company quoted on AIM it is not required to comply with the provisions of the July 2003 FRC Combined Code on Corporate Governance, the directors intend to comply with the provisions of the Combined Code in so far as they consider it appropriate having regard to the size of the group and have decided to provide corporate governance disclosures comparable with those required of a listed company.

THE BOARD

The group is headed by an effective board which meets on a monthly basis and is supplied in a timely manner with information of a quality to enable it to discharge its duties. The board has determined those matters which are retained for board sanction and those matters which are delegated to the executive management of the business. The types of decisions which are to be taken by the Board are

- approval of the financial statements and profit plans for the group;
- approval of any unbudgeted plans in accordance with prescribed authority levels;
- approval of all shareholders' circulars and announcements;
- approval of the appointment or termination of advisors to the group;
- the purchase or sale of any business or subsidiary;
- any new borrowings, facilities and related guarantees;
- any asset purchase or lease, hire purchase facility or rental agreement over prescribed authority limits;
- any donation to a political party, or any charitable donation exceeding £250.

The Board held meetings during each month of 2005. All meetings were attended by all the directors except that Mr Matthews was unable to attend the meeting in June and Mr Claesson was unable to attend the meeting in July.

The Board has established three standing sub-committees to assist in the discharge of corporate governance responsibilities. They are the nominations committee, remuneration committee and audit committee. The roles of each of the committees, their members and activities during the year are covered separately within this report.

During 2005, the Board comprised the Chairman, three executive and one non-executive directors, details of whom are included on page 2. The composition of the Board is designed to provide an appropriate balance of group, industry and general commercial experience and is reviewed as required to ensure that it remains appropriate to the nature of the group's activities.

The roles of the Chairman and Chief Executive are distinct and the offices are held by Mr GB Matthews and Mr NA Makeham respectively.

Appointments to the Board are the responsibility of the Nominations Committee.

Nomination Committee

The Nominations Committee comprises the Chairman, Mr GB Matthews, and the non-executive director, Mr PJ Claesson, and the Chief Executive, Mr NA Makeham, and is chaired by Mr GB Matthews.

Meetings are arranged as necessary and none were held during the year. The committee is responsible for nominating candidates (both executive and non-executive) for the approval of the Board to fill vacancies or appoint additional persons to the Board. Its terms of reference are available upon request and are placed on the company's website.

All directors receive induction on joining the Board covering the group's operations, goals and strategy, and their responsibilities as directors of the group. The company supports the directors in developing their knowledge and capabilities.

The directors have established a procedure, agreed by the Board, for directors in the furtherance of their duties to take independent professional advice, if necessary, at the company's expense.

The Combined Code requires that the Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. However, no formal evaluation was conducted during the year although informal evaluation of the performance of the individual executive directors was conducted by the Chairman.

All directors are subject to election by shareholders at the first opportunity after their appointment. All directors are required to submit themselves for re-election at least every three years. The terms and conditions of appointment of the non-executive director are available for inspection upon request.

REMUNERATION REPORT

Remuneration Committee

The Remuneration Committee comprises the Chairman, Mr GB Matthews, and the non-executive director, Mr PJ Claesson, and is chaired by Mr GB Matthews. It reviews the remuneration and contractual arrangements of the executive directors. The remuneration of the Chairman and the non-executive director is determined by the Board as a whole, based on a review of the current practices in other companies. Full details of the Directors' remuneration are included on pages 16 and 17. The committee met once during the year and the meeting was attended by both members of the committee. The terms of reference are available upon request and are placed on the company's website.

Remuneration

The salaries of the executive directors are determined after giving full consideration to the best practice provisions and after a review of the performance of the individual. It is the aim to reward directors competitively; consideration is, therefore, given to the median remuneration paid to senior management of comparable public companies. No director is involved in deciding his own remuneration.

Each of the executive directors has a service contract providing 12 months notice.

Mr Makeham can earn a bonus of up to 60% of his basic salary which is a performance-related bonus based on achieving budgeted operating profit before amortisation of goodwill and interest.

Mr Bolton can earn a bonus of up to 67% of his basic salary which is a performance-related bonus based on achieving budgeted operating profit before amortisation of goodwill and interest. In addition, Mr Bolton was able during 2005 to earn a bonus of 25% of fees received for financial management services recharged to third parties.

Mr Dorset can earn a bonus of up to 72% of his basic salary which is a performance related bonus based on achieving budgeted operating profit before amortisation of goodwill and interest.

Board Report on Corporate Governance continued

Directors' Emoluments

Name of director	Fees/basic salary £	Taxable benefits £	Annual bonuses £	Pension contributions £	2005 total £	2004 total £
<i>Chairman</i>						
GB Matthews	31,000	-	-	-	31,000	24,000
<i>Executive</i>						
NA Makeham	128,500	1,348	69,000	12,000	210,848	176,770
DJ Bolton	123,758	1,478	106,666	10,800	242,702	162,401
RE Dorset	100,000	11,105	69,000	10,000	190,105	165,403
<i>Non-executive</i>						
PJ Claesson	15,000	-	-	-	15,000	15,000
Aggregate emoluments	398,258	13,931	244,666	32,800	689,655	543,574

Directors' Interests

The directors who held office at 31 December 2005 had the following interests in the shares of the company.

	Ordinary shares of 25p each 31 December 2005 Number	Ordinary shares of 25p each 1 January 2005 Number
GB Matthews	100,000	100,000
NA Makeham	599,139	599,139
DJ Bolton	612,300	612,300
RE Dorset	13,186	13,186
PJ Claesson	3,591,448	2,943,128

None of the directors had any interests in the shares of other group companies. Between 31 December 2005 and 28 March 2006, there have been no changes in the interests of the directors.

Directors' Share Options

Aggregate emoluments disclosed above do not include any amounts for the value of options to acquire ordinary shares in the company granted to or held by the directors. Details of the options are as follows:

Name of director	1 January 2005	Granted	Exercised	31 December 2005	Exercise price	Gains on exercise 2005	Gains on exercise 2004
NA Makeham	200,000	-	-	200,000	75p	-	-
NA Makeham	50,000	-	-	50,000	62.5p	-	-
NA Makeham	60,000	-	-	60,000	100p	-	-
NA Makeham	-	50,000	-	50,000	94p	-	-

Directors' Share Options continued

Name of director	1 January 2005	Granted	Exercised	31 December 2005	Exercise price	Gains on exercise 2005	Gains on exercise 2004
DJ Bolton	51,272	-	-	51,272	98.5p	-	-
DJ Bolton	50,000	-	-	50,000	75p	-	-
DJ Bolton	40,000	-	-	40,000	62.5p	-	-
DJ Bolton	60,000	-	-	60,000	100p	-	-
DJ Bolton	-	50,000	-	50,000	94p	-	-
RE Dorset	20,000	-	-	20,000	75p	-	-
RE Dorset	20,000	-	-	20,000	67.5p	-	-
RE Dorset	40,000	-	-	40,000	62.5p	-	-
RE Dorset	80,000	-	-	80,000	100p	-	-
RE Dorset	-	50,000	-	50,000	94p	-	-

The options for each of the above directors are exercisable as follows:

NA Makeham	DJ Bolton	RE Dorset	Exercise Price	Exercisable if market price reaches at least
66,667	16,667	-	75p	100p
66,667	16,667	6,667	75p	125p
66,666	16,666	6,667	75p	150p
-	-	6,666	75p	175p
-	27,664	-	98.5p	100p
-	15,808	-	98.5p	125p
-	7,800	-	98.5p	150p
-	-	6,667	67.5p	125p
-	-	6,667	67.5p	150p
-	-	6,666	67.5p	175p
16,667	13,333	13,333	62.5p	100p
16,667	13,333	13,333	62.5p	125p
16,666	13,334	13,334	62.5p	150p
20,000	20,000	26,667	100p	125p
20,000	20,000	26,667	100p	150p
20,000	20,000	26,666	100p	175p

In addition, the directors hold options which are exercisable if the growth of earnings per share (eps) over the three year period ending 31 December 2007 achieves the following:

NA Makeham	DJ Bolton	RE Dorset	Exercise Price	Growth in eps is at least
12,500	12,500	12,500	94p	15%
12,500	12,500	12,500	94p	20%
25,000	25,000	25,000	94p	25%

Mr PJ Claesson is interested in warrants for 25p ordinary shares held by companies associated with him as follows:

Company	Number of warrants	Exercise price
CA Fastigheter AB	200,000	90p
Johan & Marianne Claesson AB	400,000	90p

Details of exercise periods of both the share options and the warrants are given in note 18 to the financial statements.

The market price of the ordinary shares at 31 December 2005 was 82p and the range during the year was 72.26p to 110.14p.

No director exercised share options during the current or previous year.

Board Report on Corporate Governance continued

Directors' Pension Entitlements

The company makes contributions to defined contribution schemes for each of the executive directors. There are no pension entitlements for the Chairman and the non-executive director.

Directors' Indemnity Cover

The group holds indemnity cover for its executive directors.

ACCOUNTABILITY AND AUDIT**Financial Reporting**

The Board recognises its responsibility to present a balanced and understandable assessment of the group's position and prospects, both within its interim and annual financial statements and in other price-sensitive public reports. The statement of the directors' responsibility in preparing the financial statements is made on page 22.

Going Concern

After making enquiries, the directors have formed a judgement, at the time of approving the financial statements, that there is a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. For this reason the directors continue to adopt the going concern basis in preparing the financial statements.

Internal Control

The Board recognises its ultimate accountability for maintaining an effective system of internal control which is appropriate in relation to both the scope and nature of the group's activities. The system covers all controls including:

- financial;
- operational;
- compliance; and
- risk management.

The responsibility for managing risks on a day to day basis lies with the executive directors.

The principal risks which the group faces can be categorised as follows:

Strategic

Changes in the business environment influence the group's development in terms of the strategies which it pursues and the products and services it offers. These changes may stem from market competition or economic and technological advancement.

Business environment

The group's customer base is mainly in the retail, distribution and manufacturing sectors and mainly in the United Kingdom. The environment in which the group offers its products and services is, therefore, dependent on the economic and other circumstances affecting these business sectors.

Financial

Whilst all risks may be considered to have a financial impact, the management of the group's financial resources represents a key area of focus. Financial risks are faced in ensuring sufficient funds are available to meet financial commitments as and when they fall due and protecting the group's financial strength against adverse movements in financial markets.

- Credit risk – The group's credit risk is primarily attributable to its trade debtors. The amounts presented in the balance sheet are net of allowances for doubtful debts, estimated by the group's management based on prior experience and their assessment of the current economic environment. The group operates in three key markets and hence the credit risk is concentrated to some extent on retail, manufacturing and distribution customers. The group manages credit risk by ensuring that outlays by the group are matched with receipts from

customers where possible and by tight control over contractual terms.

- Price risk – The group does not have any financial instruments which are exposed to price risk.
- Liquidity and cash flow - The group does have deferred consideration and a bank loan with set payment dates. The group ensures that it has sufficient funds to meet its obligations or commitments associated with its financial instruments by monitoring cash flow as part of its day to day control procedures and also more strategically to ensure that financing is in place with manageable repayment periods and that appropriate facilities are available to be drawn upon when the need arises.

Interest rate

Interest rate risk arises from the extent to which the group holds interest rate sensitive assets or is exposed to interest rate sensitive liabilities. The group maintains a balance of fixed and floating interest rates on its financing to manage this exposure.

Operational

These risks, which are inherent in all business activities, are those which mainly result from the potential breakdown of individual business units or the group's control of its human, physical and operating resources. The potential financial or reputational loss arising from failures in internal controls, flaws or malfunctions in computer systems and poor product design or delivery all fall within this category.

There is an ongoing process for identifying, evaluating and managing the significant issues faced by the group which has been in place throughout the year and up to 28 March 2006. It has been regularly reviewed by the Board and it accords with the Turnbull guidance.

The Board and senior management have a clear and consistent understanding of the key risks facing the business. Whilst they recognise that it is not possible to

eliminate risk completely, they have established an infrastructure of controls, systems, staff and processes which aim to minimise the likelihood of risks occurring or reduce the impact should they do so. The key elements of this infrastructure which enable the Board to review the effectiveness of the system of internal controls are as follows:

- establishment of a formal management structure, including the specification of matters reserved for decision by the Board;
- setting and reviewing the strategic objectives of the group;
- Board involvement in the setting and review of the annual budget;
- the regular review of the group's performance compared with budget and forecasts;
- pre and post investment appraisal of capital expenditure;
- integrity and competence of personnel as part of the control environment; and
- group reporting instructions and procedures including delegation of authority and authorisation levels, segregation of duties and other control procedures, and standardised accounting policies.

The Board and senior management are aware that any significant operational matters which raise cause for concern may have arisen because of or give rise to material internal control issues. There is a process in place whereby any member of management who becomes aware of an internal control issue can bring this to the attention of the Chief Finance Officer. There were no such issues raised during the year under review.

The Board acknowledges its responsibility for the group's system of internal control and for reviewing its effectiveness. The Board is committed to operating comprehensive processes to manage the key risks which face the business. They have established a framework of policies, systems and procedures to ensure that the nature and extent of the risk undertaken is commensurate with the commercial returns and,

where necessary, to ensure prudent risk-taking to protect shareholder value. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable but not absolute assurance against material misstatement or loss.

Audit Committee

The Audit Committee comprises the Chairman, Mr GB Matthews, and the non-executive director, Mr PJ Claesson, and is chaired by Mr GB Matthews. The committee met three times during the year and meetings were attended by both members of the committee. The role of the Audit Committee is to consider the appointment of the auditors, audit fees, scope of audit work and any resultant findings. It reviews external audit activities, monitors compliance with statutory requirements for financial reporting and reviews the half year and full year financial statements before they are presented to the Board for approval. The Chief Executive, Chief Finance Officer and external auditors attend meetings of the Audit Committee by invitation. The committee is also required to review the effectiveness of the group's internal control systems, to review the group's statement on internal control systems prior to endorsement by the Board and to consider, from time to time, the need for a "risk sub-committee" to assist in monitoring the group's internal control systems. Its terms of reference are available upon request and are placed on the company's website.

The Audit Committee considers and determines relevant action in respect of any control issues raised by the auditors. Given the size of the group and the close day to day control exercised by the executive directors and senior management, no formal internal audit department is considered necessary.

RELATIONS WITH SHAREHOLDERS

The company seeks to maintain good communication with shareholders. The executive directors make presentations to institutional shareholders covering the interim and full year results. Whilst most shareholder contact is with the executive directors, the Chairman and the non-executive director are available to meet major shareholders if requested to do so. The views of major shareholders are obtained through direct face-to-face contact and analysts' or brokers briefings.

The Board considers the AGM to be an important opportunity to communicate with shareholders and encourages their participation. The company despatches the notice of AGM, with explanatory notes describing items of special business, at least 21 working days before the meeting. All shareholders have the opportunity formally or informally to put questions to the company's AGMs. All directors attend the AGM and the Chairman of the Audit, Remuneration and Nominations Committees is available to answer questions from shareholders. At each AGM the Chairman advises shareholders of the proxy voting details on each of the resolutions which is dealt with on a show of hands.

AUDITORS' REMUNERATION

Fees for services provided by the auditors have been as follows:

	2005 £000	2004 £000
Audit services		
• Statutory audit	42	69
Further assurance services:		
Tax services		
• Advisory services	-	7
Other services		
• Other services	13	94
	55	170

Note: Fees in 2004 were payable to Deloitte & Touche LLP

During the year, the auditors provided non-audit services in relation to a statutory auditors' report in connection with the giving of financial assistance by a subsidiary undertaking. The Board considered the proposed non-audit services in advance to ensure that it was satisfied that neither the nature nor the scale of the non-audit services would impair the auditors' objectivity and independence.

COMPLIANCE WITH THE COMBINED CODE

Whilst the group is not required to comply with the provisions of the Combined Code, it has given considerable attention to the provisions set out therein. The group has not complied with all provisions required for listed companies, principally as it does not consider these appropriate given the size and nature of the group. However, the directors confirm that throughout the year ended 31 December 2005 the group has been in compliance with the Code provisions set out in Section 1 of the July 2003 FRC Combined Code on Corporate Governance, with the following exceptions:

- No director has been identified as a senior independent director. There is no alternative route for shareholders to raise their concerns other than the normal channels of the chairman, chief executive or chief finance officer. The directors consider this to be appropriate for the size of the group at present. (A.1.2) (A.3.3)
- The Chairman's performance has not been appraised by the non-executive director, nor have there been meetings of the non-executive directors as there is only one non-executive director. (A.1.3)
- The group has only one non-executive director, Mr PJ Claesson, who is not considered independent due to the size of his shareholding. (A.3.1) (A.3.2)
- The Nominations Committee, Remuneration Committee and Audit Committee each include only one non-executive director and he is not considered to be independent. (A.4.1) (B.2.1) (C.3.1)
- The Board has not conducted a performance evaluation of the Board, its committees or its individual directors although informal evaluation of the executive directors has been conducted by the Chairman. (A.6.1)
- The directors have not conducted a formal and documented review of the effectiveness of the group's system of internal controls during the year ended 31 December 2005. (C.2.1)
- The non-executive director has not met with major shareholders during 2005, although he was available to do so if requested. (D.1.1)

Directors' Responsibilities

United Kingdom company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group as at the end of the financial year and of the profit or loss of the group for that period.

In preparing the financial statements, the directors are required to: select suitable accounting policies and then apply them consistently; make judgements and estimates that are reasonable and prudent; and state whether applicable accounting standards have been followed.

OTHER MATTERS

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and group and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for the system of internal control, for safeguarding the assets of the company and group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Financial statements are published on the company's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the company's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

TO THE MEMBERS OF K3 BUSINESS TECHNOLOGY GROUP PLC

We have audited the financial statements of K3 Business Technology Group plc for the year ended 31 December 2005 which comprise the consolidated profit and loss account, consolidated statement of total recognised gains and losses, balance sheets, consolidated cash flow statement, and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective Responsibilities of Directors and Auditors

As described in the statement of directors' responsibilities, the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice). Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the annual report and consider whether it is consistent with the audited financial statements. This other information comprises of the Chairman's Statement, Operating Review, Financial Review, the Directors' Report and the Board Report on Corporate Governance. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Our report has been prepared pursuant to the requirements of the Companies Act 1985 and for no other purpose. No person is entitled to rely on this report unless such a person is a person entitled to rely on this report by virtue of and for the purpose of the Companies Act 1985 or has been expressly authorised to do so by our prior written consent. Save as above, we do not accept responsibility for this report to any other person or for any other purpose and we hereby expressly disclaim any and all such liability.

Basis of Audit Opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's and company's affairs as at 31 December 2005 and of the group's loss for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.


BDO Stoy Hayward LLP

Chartered Accountants and Registered Auditors

Manchester

28 March 2006

Consolidated Profit and Loss Account

FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	2005			Total	2004		Total
		Continuing operations	Discontinued operations			Continuing operations	Discontinued operations	
		Continuing operations £000	Acquisitions £000	£000		Continuing operations £000	£000	
Turnover	1	18,420	3,609	-	22,029	8,116	413	8,529
Cost of sales		(6,717)	(1,419)	-	(8,136)	(1,603)	(124)	(1,727)
Gross profit		11,703	2,190	-	13,893	6,513	289	6,802
Selling and distribution costs		(3,512)	(610)	-	(4,122)	(2,518)	(218)	(2,736)
Administrative expenses		(7,852)	(1,263)	-	(9,115)	(4,005)	(94)	(4,099)
Operating profit before amortisation of goodwill and intangibles		1,667	741	-	2,408	593	10	603
Amortisation of goodwill and intangibles		(1,328)	(424)	-	(1,752)	(603)	(33)	(636)
Operating profit (loss)		339	317	-	656	(10)	(23)	(33)
(Loss) profit on disposal of operations	2	-	-	(90)	(90)	-	1,248	1,248
Profit (loss) on ordinary activities before finance charges		339	317	(90)	566	(10)	1,225	1,215
Finance charges (net)	3	(243)	(44)	-	(287)	(55)	-	(55)
Profit (loss) on ordinary activities before taxation	4	96	273	(90)	279	(65)	1,225	1,160
Tax on profit (loss) on ordinary activities	7	(289)	(154)	(50)	(493)	(59)	-	(59)
(Loss) profit for financial year	19	(193)	119	(140)	(214)	(124)	1,225	1,101
(Loss) earnings per share								
	Notes	Continuing operations	Discontinued operations		Total	Continuing operations	Discontinued operations	Total
Basic	9	(0.5p)	(0.9p)		(1.4p)	(1.1p)	11.1p	10.0p
Diluted	9	(0.5p)	(0.9p)		(1.4p)	(1.1p)	11.1p	10.0p

There were no material recognised gains or losses in either year other than the (loss) profit for that year. Accordingly a consolidated statement of total recognised gains and losses has not been prepared.

Consolidated Balance Sheet

AS AT 31 DECEMBER 2005

	Notes	2005 £000	2004 £000
Fixed assets			
Development costs and intellectual property	10	162	-
Goodwill	10	15,682	9,919
Intangible fixed assets		15,844	9,919
Tangible assets	11	508	570
Investments	12	-	17
		16,352	10,506
Current assets			
Debtors	13	6,596	6,268
Cash at bank and in hand		874	403
		7,470	6,671
Creditors: Amounts falling due within one year			
Convertible debt	14	-	(500)
Other creditors	14	(10,583)	(9,345)
		(10,583)	(9,845)
Net current liabilities		(3,113)	(3,174)
Total assets less current liabilities		13,239	7,332
Creditors: Amounts falling due after more than one year	15	(2,439)	(337)
Net assets		10,800	6,995
Capital and reserves			
Called-up share capital	18	4,435	3,329
Share premium account	19	7,813	6,463
Other reserve	19	6,070	4,486
Treasury shares	19	(20)	-
Profit and loss account	19	(7,498)	(7,283)
Equity shareholders' funds	20	10,800	6,995

The financial statements on pages 24 to 53 were approved and authorised for issue by the board of directors on 28 March 2006 and signed on its behalf by:

NA Makeham

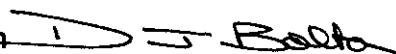
Director

28 March 2006



DJ Bolton

Director



Company Balance Sheet

AS AT 31 DECEMBER 2005

	Notes	2005 £000	2004 £000
Fixed assets			
Goodwill	10	2,239	1,909
Tangible assets	11	88	131
Investments	12	14,199	8,009
		16,526	10,049
Current assets			
Debtors	13	2,021	1,903
Cash at bank and in hand		544	-
		2,565	1,903
Creditors: Amounts falling due within one year			
Convertible debt	14	-	(500)
Other creditors	14	(6,471)	(4,794)
		(6,471)	(5,294)
Net current liabilities		(3,906)	(3,391)
Total assets less current liabilities		12,620	6,658
Creditors: Amounts falling due after more than one year	15	(2,309)	-
Net assets		10,311	6,658
Capital and reserves			
Called-up share capital	18	4,435	3,329
Share premium account	19	7,813	6,463
Other reserve	19	5,946	4,362
Treasury shares	19	(20)	-
Profit and loss account	19	(7,863)	(7,496)
Equity shareholders' funds		10,311	6,658

The financial statements on pages 24 to 53 were approved and authorised for issue by the board of directors on 28 March 2006 and signed on its behalf by:

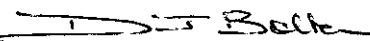
NA Makeham



Director

28 March 2006

DJ Bolton



Director

Consolidated Cash Flow Statement

FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	2005 £000	Restated 2004 £000
Net cash inflow from operating activities	21	4,267	1,244
Returns on investments and servicing of finance	22	(279)	(99)
Taxation	22	(80)	(76)
Capital expenditure and financial investment	22	(106)	(12)
Acquisitions and disposals	22	(5,153)	(2,344)
Cash outflow before financing		(1,351)	(1,287)
Financing	22	1,822	464
Increase (decrease) in cash in the year	23	471	(823)

The comparative amounts for 2004 have been restated as explained in note 21.

Statement of Accounting Policies

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year.

Basis of accounting

The financial statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards.

Basis of consolidation

The group financial statements consolidate the financial statements of K3 Business Technology Group plc and its subsidiary undertakings drawn up to 31 December each year. The results of subsidiaries acquired or sold are consolidated for the periods from or to the date on which control passed. Acquisitions are accounted for under the acquisition method.

Intangible assets - goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life, which is between eight and ten years. Provision is made for any impairment.

Negative goodwill is similarly included in the balance sheet and is credited to the profit and loss account in the periods in which the acquired non-monetary assets are recovered through depreciation or sale. Negative goodwill in excess of the fair values of the non-monetary assets acquired is credited to the profit and loss account in the periods expected to benefit.

As disclosed in notes 10 and 12 the group has hived up the trade and assets of a subsidiary undertaking into the parent undertaking. This results in the investment in a subsidiary which has no trade and hence provision would normally be made against that investment under UK GAAP. The company has however applied a true and fair override and transferred the investment into goodwill as allowed under the Companies Act 1985. The Board feels that this more

accurately reflects the fact that in substance there has been no loss of value to the company. Had the investment been written down, this would have resulted in a provision of £709,000 which is now being amortised over the remaining useful economic life of nine years.

Intangible assets - research and development

Research expenditure is written off as incurred. Development expenditure is also written off, except where the directors are satisfied as to the technical, commercial and financial viability of individual projects. In such cases, the identifiable expenditure is deferred and amortised over the period during which the group is expected to benefit. This period is between three and ten years. Provision is made for any impairment.

Intangible assets - intellectual property

Intellectual property is included at cost and depreciated in equal annual instalments over a period of five years which is its estimated useful economic life. Provision is made for any impairment.

Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets, at rates calculated to write off the cost of each asset on a straight-line basis over its expected useful life, as follows:

Plant and machinery,	
office equipment and fixtures	20-33% per annum
Motor vehicles	25% per annum

Investments

Fixed asset investments are shown at cost less provision for impairment. In the company balance sheet, for investments in subsidiaries acquired for consideration including the issue of shares qualifying for merger relief, cost is measured either by reference to the nominal value or the fair value of the shares where appropriate. Any premium is ignored when the nominal value is used.

Taxation

Current tax, including UK corporation tax, is provided at the amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that resulted in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the group's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured at the average tax rates that are expected to apply in the period in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

Turnover

Turnover is calculated net of value added tax and represents the total amount receivable by the group in respect of the sale of software licences, customised software, hardware and fees derived from installation, consultancy, training and support.

Income from the sale of software licences, customised software, hardware and installation is recognised upon delivery to a customer or on completion of contractual milestone performance obligations. Income from training and consultancy is recognised on performance of the service. Income from support is generally

invoiced in advance, termed 'deferred income', and taken to income in equal monthly instalments over the relevant periods.

Pension costs

For defined contribution schemes the amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Foreign currency

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction or, if hedged, at the forward contract rate. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date or, if appropriate, at the forward contract rate.

Leases

Assets held under finance leases and other similar contracts, which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and are depreciated over the shorter of the lease terms and their useful lives. The capital elements of future lease obligations are recorded as liabilities, while the interest elements are charged to the profit and loss account over the period of the lease to produce a constant rate of charge on the balance of capital repayments outstanding. Hire purchase transactions are dealt with similarly, except that assets are depreciated over their useful lives.

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

Notes to Financial Statements

1 Segment information

The directors consider there to be one class of business being computer software and consultancy.

Geographical segments:

The destination of turnover by geographical market is as follows:

	2005 £000	2004 £000
United Kingdom	19,513	7,685
Rest of Europe	2,321	750
Rest of World	195	94
	22,029	8,529

Turnover, profit and net assets of the group are attributable to United Kingdom operations, except for turnover of £1,120,000 (2004: £97,000), profit of £236,000 (2004: losses of £29,000) and net assets of £427,000 (2004: £6,000) which originated from operations in the Republic of Ireland.

2 (Loss) profit on disposal of operations

The loss on disposal of operations in 2005 of £90,000 relates to further unanticipated costs incurred regarding the disposal in 2004 of the manufacturing software operation based at Crewe to Azur Group Limited. The profit on disposal of this operation recognised in 2004 was £1,248,000.

The effect of the exceptional item reported after operating profit on the amounts charged to the profit and loss account for taxation was a charge of £50,000 (2004: £nil).

3 Finance charges (net)

	2005 £000	2004 £000
Interest payable and similar charges:		
Bank loans and overdrafts	48	2
Finance leases and hire purchase contracts	78	41
Other interest	70	-
On related party balances	99	79
	295	122
Less: investment income:		
Interest receivable and similar charges	(8)	(67)
	287	55

4 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging (crediting):

	2005 £000	2004 £000
Depreciation and amounts written off tangible fixed assets		
- owned	195	134
- held under finance leases and hire purchase contracts	146	81
Loss on disposal of tangible fixed assets	33	24
Research and development		
- current year	-	472
Amortisation of goodwill and intangibles	1,752	636
Operating lease rentals		
- plant and machinery	166	89
- other	291	162
Rentals receivable under operating leases	-	(20)
Auditors' remuneration for audit services		
- group	24	39
- company	18	30

In addition to the above, amounts payable to BDO Stoy Hayward LLP by the company and its UK subsidiary undertakings in respect of non-audit services were £13,000 (2004: £nil).

Notes to Financial Statements continued

5 Staff costs

The average monthly number of employees (including executive directors) was:

	Group		Company	
	2005 Number	2004 Number	2005 Number	2004 Number
Consultants and programmers	88	37	28	16
Sales and distribution	27	19	17	15
Administration	67	34	23	19
	182	90	68	50

Their aggregate remuneration comprised:

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
Wages and salaries	8,857	3,798	3,116	2,070
Social security costs	1,006	457	362	268
Other pension costs (see note 26)	197	89	109	59
	10,060	4,344	3,587	2,397

6 Directors' remuneration, interests and transactions*Aggregate remuneration*

The total amounts for directors' remuneration and other benefits were as follows:

	2005 £000	2004 £000
Emoluments	657	515
Contributions to personal pension schemes	33	29
	690	544

The aggregate emoluments of the highest paid director were £231,902 (2004: £166,270) and company pension contributions of £10,800 (2004: £10,500) were made to a money purchase scheme on his behalf.

Number of directors

	2005 Number	2004 Number
Retirement benefits are accruing to the following number of directors under:		
Money purchase schemes	3	3

Directors' interests and share options are disclosed in the Remuneration Report on pages 15 to 18.

7 Tax on profit on ordinary activities

The tax charge (credit) comprises:

	2005 £000	2004 £000
Current tax		
UK corporation tax	304	(21)
Foreign tax	35	-
	339	(21)
Adjustments in respect of prior years	(17)	(7)
Total current tax charge (credit)	322	(28)
Deferred tax		
Origination and reversal of timing differences	(73)	(8)
Utilisation of tax losses	263	95
Adjustments in respect of previous years	(19)	-
Total deferred tax charge (see note 17)	171	87
Total tax on profit on ordinary activities	493	59

The differences between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows.

	2005 £000	2004 £000
Profit on ordinary activities before tax	279	1,160
Tax on group profit on ordinary activities at standard UK corporation tax rate of 30% (2004: 30%)	84	348
Effects of:		
Expenses not deductible for tax purposes	331	78
Capital allowances in excess of depreciation	10	(1)
Capital loss relief	-	(385)
Movement on short term timing differences	2	-
Utilisation of tax losses	(41)	(20)
Lower rates of taxation on overseas earnings	(47)	(10)
Effects of research and development tax relief	-	(31)
Adjustment in respect of previous periods	(17)	(7)
Group current tax charge (credit) for the year	322	(28)

The group earns its profits primarily in the UK. Therefore the tax rate used for tax on profit on ordinary activities is the standard rate for UK corporation tax, currently 30%.

The group's planned level of capital investment is expected to remain at similar levels of investment. Therefore, it expects to be able to claim capital allowances in excess of depreciation in future years at a similar level to the current year.

Notes to Financial Statements continued

8 Loss attributable to K3 Business Technology Group plc

As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the parent company.

The loss for the financial year dealt with in the financial statements of the parent company, K3 Business Technology Group plc, was £367,000 (2004: £458,000).

9 (Loss) earnings per share

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

	2005 Number of shares	2004 Number of shares
Weighted average number of shares:		
For basic earnings per share	14,999,027	10,980,489
Exercise of share options	154,501	40,264
For diluted earnings per share	15,153,528	11,020,753

The alternative earnings per share calculations have been computed because the directors consider that they are useful to shareholders and investors. These were based on the following (losses) profits and the above number of shares.

	2005			2004		
	Earnings (losses) £000	Per share amount Basic p	Per share amount Diluted p	Earnings (losses) £000	Per share amount Basic p	Per share amount Diluted p
(Loss) earnings per share (eps)	(214)	(1.4)	(1.4)	1,101	10.0	10.0
Effect of amortisation of goodwill and intangibles	1,752	11.7	11.6	636	5.8	5.8
Eps before amortisation of goodwill and intangibles	1,538	10.3	10.2	1,737	15.8	15.8
Exceptional items (net of tax)	*140	0.9	0.9	*(1,248)	(11.3)	(11.4)
Eps per share before amortisation of goodwill and intangibles and exceptional items	1,678	11.2	11.1	489	4.5	4.4

* Relates to loss on disposal of the manufacturing software operation based at Crewe of £90,000 (2004: profit of £1,248,000) on which the tax charge was only £50,000 (2004: £nil) due to the availability of capital losses.

The basic and diluted loss per share are the same as the effect of share options is anti-dilutive.

Although the convertible 6% loan notes issued in relation to the Landsteinar acquisition (see note 14) were in-the-money at 31 December 2004, there was no intention to allow the notes to convert and, therefore, they have been excluded from the calculation of diluted earnings per share. The loan notes were repaid in full on 23 December 2005.

10 Intangible fixed assets

	Development costs and intellectual property £000	Group Goodwill £000	Total £000	Company Goodwill £000
Cost				
At 1 January 2005	-	11,366	11,366	3,012
Additions	-	7,463	7,463	709
Acquisition of subsidiary undertakings	190	-	190	-
Adjustments	-	24	24	-
At 31 December 2005	190	18,853	19,043	3,721
Amortisation				
At 1 January 2005	-	1,447	1,447	1,103
Charge for the year	28	1,724	1,752	379
At 31 December 2005	28	3,171	3,199	1,482
Net book value				
At 31 December 2005	162	15,682	15,844	2,239
At 31 December 2004	-	9,919	9,919	1,909

The additions to goodwill in the group arose on the acquisition of Information Engineering Group Limited. The additions to goodwill in the company arose on the transfer of the trade and net assets of K3 Elucid Limited to the parent company on 1 January 2005. (See note 12).

The adjustments of £24,000 during the year relate to additional costs incurred in relation to the acquisitions made in 2004.

Notes to Financial Statements continued

11 Tangible fixed assets

	Plant, office equipment and fixtures £000	Group Motor vehicles £000	Total £000	Plant, office equipment and fixtures £000	Company Motor vehicles £000	Total £000
Cost						
At 1 January 2005	682	286	968	464	-	464
Additions	264	-	264	23	-	23
Acquisition of subsidiary undertakings	15	108	123	-	-	-
Disposals	(260)	(181)	(441)	-	(12)	(12)
Intra-group transfers	-	-	-	81	38	119
At 31 December 2005	701	213	914	568	26	594
Depreciation						
At 1 January 2005	375	23	398	333	-	333
Charge for the year	216	125	341	88	10	98
Disposals	(232)	(101)	(333)	-	(6)	(6)
On intra-group transfers	-	-	-	66	15	81
At 31 December 2005	359	47	406	487	19	506
Net book value						
At 31 December 2005	342	166	508	81	7	88
At 31 December 2004	307	263	570	131	-	131
Leased assets included above:						
Net book value						
At 31 December 2005	74	151	225	-	7	7
At 31 December 2004	-	263	263	-	-	-

12 Fixed asset investments

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
Subsidiary undertakings	-	-	14,199	8,009
Other investments	-	17	-	-
	-	17	14,199	8,009

12 Fixed asset investments continued

Group

Investments in the group relate to a 1% interest held by K3 Landsteinar Limited in Partner Power International, an unlisted computer software marketing company incorporated in Denmark. Provision has been made against this investment in 2005.

	£000
Cost	
At 1 January and 31 December 2005	17
Amounts written off	
At 1 January 2005	-
During the year	17
At 31 December 2005	17
Net book value	
At 31 December 2005	-
At 31 December 2004	17

Company

The parent company and the group have investments in the following subsidiary undertakings, which principally affected the profits or net assets of the group. To avoid a statement of excessive length, details of investments which are not significant have been omitted.

*K3 Elucid Limited	*K3 Landsteinar Limited
*K3 Landsteinar (Ireland) Limited	*Miracle Hindsight Limited
*Information Engineering Group Limited	K3 Information Engineering Limited
Integrated Manufacturing Software Limited	*K3 Business Technology Group Trustees Company Limited

The principal activity of all the subsidiary undertakings is the supply of computer software and consultancy, with the exception of K3 Elucid Limited which became dormant on 1 January 2005 when its trade and assets were transferred to its parent company, and K3 Business Technology Group Trustees Company Limited which is the trustee for the group's employee share ownership plan.

All subsidiary undertakings are wholly owned and all shares consist of ordinary shares only, with the exception of K3 Information Engineering Limited where there are also preference shares.

All subsidiary undertakings operate in the United Kingdom and are registered in England and Wales, with the exception of K3 Landsteinar (Ireland) Limited and Integrated Manufacturing Software Limited which operate in the Republic of Ireland and are registered in the Republic of Ireland.

All the above group companies are included in the consolidation.

*Held directly by K3 Business Technology Group plc

Notes to Financial Statements continued

12 Fixed asset investments continued*Subsidiary undertakings*

	Company £000
Cost	
At 1 January 2005	13,919
Additions	6,899
Transfer to goodwill	(709)
At 31 December 2005	20,109
Amounts written off	
At 1 January and 31 December 2005	5,910
Net book value	
At 31 December 2005	14,199
At 31 December 2004	8,009

The amounts transferred to goodwill arose as a result of the transfer of the trade and net assets of K3 Elucid Limited to the parent company. There is a consequent increase in the goodwill held in the parent company.

Acquisition of the IEG companies

On 23 June 2005 the company acquired the entire issued share capital of Information Engineering Group Limited ("IEG"). The total initial consideration was £3.81m of which £1.66m was in cash with £2.15m in shares. £1.66m of cash was paid on completion with a further £0.55m paid on 30 November 2005 and £0.10m payable on 30 November 2006. Further consideration of up to £1.60m is payable based on IEG's profits during the two years ending 31 May 2007, of which £1.08m is the fair value of the current estimated amount payable. The fair value of the total consideration is estimated to be £5.54m.

12 Fixed asset investments continued

The following table sets out the book values of the identifiable assets and liabilities acquired and their values to the group:

	Book value £000	Fair value adjustments £000	Provisional fair value to the group £000
Fixed assets			
Intangible	190	-	190
Tangible	169	(52)	117
Current assets			
Debtors	1,632	302	1,934
Cash	74	-	74
Total assets	2,065	250	2,315
Creditors			
Bank overdrafts	(1,090)	-	(1,090)
Trade	(328)	-	(328)
Other	(532)	-	(532)
Accruals and deferred income	(1,637)	-	(1,637)
Total liabilities	(3,587)	-	(3,587)
Net liabilities	(1,522)	250	(1,272)
Goodwill			7,463
Costs of acquisition			(651)
Consideration			5,540
Satisfied by			
Cash consideration			1,663
Shares issued			2,150
Deferred cash consideration			650
Further deferred cash consideration			1,077
			5,540

Details of the fair value adjustments are as follows:

- credit of £52,000 to bring depreciation in line with group policy
- debit of £302,000 to create a deferred tax asset arising from losses which will be recoverable.

Net cash outflows in respect of the acquisition comprised:

	£000
Cash at bank and in hand acquired	74
Bank overdrafts acquired	(1,090)
	(1,016)

Notes to Financial Statements continued

12 Fixed asset investments continued

The subsidiary undertakings acquired during the year contributed £1,063,000 to the group's net operating cashflows, paid £44,000 in respect of net returns on investments and servicing of finance, paid £16,000 in respect of taxations, utilised £10,000 for capital expenditure and received £28,000 proceeds on the sale of fixed assets.

The consolidated profit and loss account for the period from 1 January to 22 June 2005 is summarised as follows:

	Total £000
Turnover	1,286
Cost of sales	(420)
Gross profit	866
Other operating expenses	(1,819)
Operating loss	(953)
Finance charge (net)	(32)
Loss on ordinary activities before taxation	(985)
Tax on loss on ordinary activities	302
Loss for the financial period	(683)

There were no recognised gains or losses other than the loss for the period.

Profit (loss) after tax for the year ended 31 December 2004, as disclosed in the financial statements, are as follows:

	£000
Information Engineering Group Limited	36
K3 Information Engineering Limited	(279)
Integrated Manufacturing Software Limited	85

13 Debtors

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
Amounts falling due within one year:				
Trade debtors	5,210	4,722	1,613	937
Amounts owed by subsidiary undertakings	-	-	-	209
Other debtors	161	879	103	644
Prepayments and accrued income	1,013	586	246	53
Deferred tax asset (see note 17)	212	81	59	60
	6,596	6,268	2,021	1,903

14 Creditors: Amounts falling due within one year

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
Convertible debt				
6% convertible loan notes	-	500	-	500
Other creditors				
Bank loans and overdrafts	311	-	311	6
Obligations under finance leases and hire purchase contracts (see note 15)	249	330	4	-
Other loans due to related parties (see note 27)	229	1,303	229	1,303
Trade creditors	1,221	1,071	285	149
Amounts owed to subsidiary undertakings	-	-	2,491	-
Corporation tax	223	-	98	-
Taxation and social security	1,536	1,032	401	282
Other creditors	262	103	53	49
Deferred consideration	70	696	70	696
Accruals	2,308	1,826	825	921
Deferred income	4,174	2,984	1,704	1,388
	10,583	9,345	6,471	4,794

The 6% convertible loan notes were issued as part of the consideration for the acquisition of K3 Landsteinar. They were repaid together with any accrued interest on 23 December 2005. In the event that the loan notes had not been repaid by 30 December 2005, the notes were convertible at the note holders' option into ordinary shares of the company at 70.35p per ordinary share.

Notes to Financial Statements continued

15 Creditors: Amounts falling due after more than one year

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
Bank loans	689	-	689	-
Obligations under finance leases and hire purchase contracts	130	337	-	-
Other loans due to related parties	513	-	513	-
Deferred consideration	1,107	-	1,107	-
	2,439	337	2,309	-

The bank loan is secured by a fixed and floating charge over the assets of the group.

At the year end, other borrowings were repayable as follows:

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
Bank loans				
Between one and two years	333	-	333	-
Between two and five years	356	-	356	-
	689	-	689	-
On demand or within one year	311	-	311	-
	1,000	-	1,000	-
Finance leases				
Between one and two years	105	250	-	-
Between two and five years	25	87	-	-
	130	337	-	-
On demand or within one year	249	330	4	-
	379	667	4	-
Other loans due to related parties				
Between one and two years	257	-	257	-
Between two and five years	256	-	256	-
	513	-	513	-
On demand or within one year	229	1,303	229	1,303
	742	1,303	742	1,303

16 Derivatives and other financial instruments

The group approach to risk management is summarised in the Accountability and Audit section of the Board Report on Corporate Governance on pages 18 to 20.

Interest rate profile

The group has overdraft facilities with its bankers to cover any seasonal financing requirements or timing differences and hence the interest profile has followed that of base rates throughout the year. The undrawn committed overdraft facility at the year end was £950,000 (2004: £700,000) which is renewable on an annual basis.

In December 2005 the group negotiated a bank loan of £1,000,000 (2004: £nil) on which interest is charged at 2.25% over base rate.

The group has a loan from CA Fastigheter AB of £710,000 (2004: £750,000) with an interest rate of 8.5%. It also took out a loan during the year from Mr PJ Claesson of £1,000,000 at an interest rate of 8.5%. This was repaid during the year. The group also has a standby facility from Mr Claesson for £250,000 (2004: £250,000). Should the facility be drawn upon, interest will be charged at 8.5%.

The group has entered into finance leases with an average interest rate of 19.1% (2004: 16.8%).

Financial assets

Approximately 13% of the group's assets are in currencies other than sterling. These balances are held in Euros and are partly hedged by amounts payable in Euros. Cash balances held in Euros in excess of amounts required to meet payables in Euros are converted into sterling at the prevailing exchange rate.

Financial instruments

At the year end the only financial assets held by the group were cash. All cash balances are at a floating rate of interest based upon bank base rates, held in sterling or Euros.

The group holds financial instruments to finance its potential investments and to manage interest rate risk arising from it. Consequently the main risk arising from the group's operation is interest rate movements. The group's objective is to manage the exposure to interest rate fluctuations.

Currency exposure

The group's sales are largely invoiced in sterling. Where products are purchased in a foreign currency, the exchange exposure on the resulting creditor is reduced as the group holds financial assets in the same currency, i.e. Euros.

The following table shows the group's exposures at the year end.

	2005		2004		
	Euros £000	US\$ £000	Euros £000	US\$ £000	Others £000
Net foreign currency monetary assets	764	17	1,104	-	-
Net foreign currency monetary liabilities	38	1	413	4	3

As permitted by FRS13, short term debtors and creditors have been excluded from the disclosures, other than currency disclosures. The directors consider the fair values of the financial assets and liabilities to be equal to their carrying amounts.

Notes to Financial Statements continued

17 Deferred taxation

	£000
Group	
At 1 January 2005	81
Charged to profit and loss account (see note 7)	(171)
Acquisition of subsidiary undertakings	302
At 31 December 2005	212

The following deferred taxation asset has been recognised:

	2005	2004
	£000	£000
Group		
Accelerated capital allowances	160	77
Other timing differences	14	2
Losses	38	2
Deferred tax asset	212	81

The group has not recognised tax losses of £609,000 (2004: £465,000) on the grounds that they may not be recovered in the foreseeable future.

	2005	2004
	£000	£000
Company		
Accelerated capital allowances	57	58
Other timing differences	2	2
Deferred tax asset	59	60

The company has not recognised tax losses of £nil (2004: £465,000) on the grounds that they may not be recovered in the foreseeable future.

The deferred tax assets have been recognised as they are expected to be recoverable against future taxable profits.

18 Called-up share capital

	2005 £000	2004 £000
<i>Authorised</i>		
20,000,000 ordinary shares of 25p each (2004: 20,000,000)	5,000	5,000
<i>Allotted, called-up and fully-paid</i>		
13,316,186 ordinary shares of 25p each (2004: 13,316,186)	3,329	3,329
2,263,158 ordinary shares of 25p each issued to acquire Information Engineering Group at 95p	566	-
605,820 ordinary shares of 25p each issued on conversion of a loan due to Mr PJ Claesson at 89.3p	151	-
1,555,555 ordinary shares of 25p each issued pursuant to a private placing at 90.0p	389	-
17,740,719 ordinary shares of 25p each (2004: 13,316,186)	4,435	3,329

Under the agreements to acquire K3 BTG Limited and K3 Business Technology Software Limited, warrants to subscribe for 3.6 million ordinary shares of 25p each were granted to Silversläggan AB. These warrants were exercisable until 28 March 2004 at a price of £1 per ordinary share of 25p each. None were exercised.

In connection with the loan made by CA Fastigheter AB to the company to assist it with the acquisition of K3 Landsteinar, the company issued 200,000 warrants for ordinary shares of 25p each. These are exercisable at the lower of £1.00 or the price which any shares are issued by the company by way of a rights issue or placing during the period up to 31 January 2006. The company issued shares under a placing at £0.90 in September 2005 and hence the warrants will be exercisable at £0.90. The warrants are exercisable until 29 June 2008 or the date on which the loan is repaid whichever is the later.

In connection with a loan made by Johan and Marianne Claesson AB to the company to assist it with the acquisition of IEG, the company issued 400,000 warrants for the ordinary shares of 25p each. These are exercisable at the lower of £1.00 or the price at which any shares are issued by the company by way of a rights issue or placing during the period up to 23 June 2006. The company issued shares under a place at £0.90 in September 2005 and hence the warrants are currently exercisable at £0.90. The warrants are exercisable until 22 June 2008.

Notes to Financial Statements continued

18 Called-up share capital continued

Options have been granted under the K3 Business Technology Group plc Executive Share Option Scheme 1994 and the K3 Business Technology Group plc Executive Share Option Scheme 2000 to subscribe for ordinary shares of the company as follows:

K3 Business Technology Group plc Executive Share Option Scheme 1994

Number of shares under option	Subscription price per share	Exercise period
27,664	98.5p	Between 12 March 2000 and 27 July 2009 and if the market price reaches at least 100p
15,808	98.5p	Between 12 March 2000 and 27 July 2009 and if the market price reaches at least 125p
7,800	98.5p	Between 12 March 2000 and 27 July 2009 and if the market price reaches at least 150p
37,500	94p	Between 21 June 2008 and 20 June 2015 and if the growth in the earnings per share over the three year period ending 31 December 2007 is between 15% and 20%
37,500	94p	Between 21 June 2008 and 20 June 2015 and if the growth in the earnings per share over the three year period ending 31 December 2007 is between 20% and 25%
75,000	94p	Between 21 June 2008 and 20 June 2015 and if the growth in the earnings per share over the three year period ending 31 December 2007 is in excess of 25%

No options were exercised by members of the 1994 Scheme during the year and none lapsed unexercised during the year. 150,000 share options at a subscription price of 94p were granted during the year.

K3 Business Technology Group plc Executive Share Option Scheme 2000

Number of shares under option	Subscription price per share	Exercise period
83,334	75p	Between 28 March 2004 and 27 March 2011 and if the market price reaches at least 100p
116,667	75p	Between 28 March 2004 and 27 March 2011 and if the market price reaches at least 125p
116,666	75p	Between 28 March 2004 and 27 March 2011 and if the market price reaches at least 150p
33,333	75p	Between 28 March 2004 and 27 March 2011 and if the market price reaches at least 175p
6,667	67.5p	Between 11 April 2005 and 10 April 2012 and if the market price reaches at least 125p
6,667	67.5p	Between 11 April 2005 and 10 April 2012 and if the market price reaches at least 150p
6,666	67.5p	Between 11 April 2005 and 10 April 2012 and if the market price reaches at least 175p

18 Called-up share capital continued

Number of shares under option	Subscription price per share	Exercise period
43,333	62.5p	Between 26 June 2006 and 25 June 2013 and if the market price reaches at least 100p
50,000	62.5p	Between 26 June 2006 and 25 June 2013 and if the market price reaches at least 125p
50,000	62.5p	Between 26 June 2006 and 25 June 2013 and if the market price reaches at least 150p
6,667	62.5p	Between 26 June 2006 and 25 June 2013 and if the market price reaches at least 175p
66,667	100p	Between 8 March 2007 and 7 March 2014 and if the market price reaches at least 125p
66,667	100p	Between 8 March 2007 and 7 March 2014 and if the market price reaches at least 150p
66,666	100p	Between 8 March 2007 and 7 March 2014 and if the market price reaches at least 175p
119,500	94p	Between 21 June 2008 and 20 June 2015 if the growth in the earnings per share over the three year period ending 31 December 2007 is between 15% and 20%
119,500	94p	Between 21 June 2008 and 20 June 2015 if the growth in the earnings per share over the three year period ending 31 December 2007 is between 20% and 25%
239,000	94p	Between 21 June 2008 and 20 June 2015 if the growth in the earnings per share over the three year period ending 31 December 2007 is in excess of 25%

No options were exercised by members of the 2000 Scheme during the year. 507,000 share options at a subscription price of 94p were granted during the year. 49,000 options lapsed unexercised during the year.

15,419 shares in K3 Business Technology Group plc are held by a subsidiary undertaking, K3 Business Technology Group Trustees Company Limited, as trustee of the group's employee share ownership plan.

Notes to Financial Statements continued

19 Reserves

	Share premium account £000	Other reserve £000	Treasury shares £000	Profit and loss account £000
Group				
At 1 January 2005	6,463	4,486	-	(7,283)
Retained loss for the year	-	-	-	(214)
Currency translation differences on foreign currency net investments	-	-	-	(1)
Treasury shares acquired	-	-	(20)	-
Share capital issued	1,400	1,584	-	-
Expenses of equity share issue	(50)	-	-	-
At 31 December 2005	7,813	6,070	(20)	(7,498)

	Share premium account £000	Other reserve £000	Treasury shares £000	Profit and loss account £000
Company				
At 1 January 2005	6,463	4,362	-	(7,496)
Retained loss for the year	-	-	-	(367)
Treasury shares acquired	-	-	(20)	-
Share capital issued	1,400	1,584	-	-
Expenses of equity share issue	(50)	-	-	-
At 31 December 2005	7,813	5,946	(20)	(7,863)

The other reserve comprises a merger relief reserve. The increase in the reserve during the year arose on the acquisition of Information Engineering Group Limited as the company has valued the investment by reference to the fair value of the shares issued.

Of the above reserves, the directors only consider the profit and loss account to be distributable.

The treasury shares are held by a wholly-owned subsidiary, K3 Business Technology Group Trustees Company Limited, as trustee of the group's employee share ownership plan. The treasury shares represent 15,419 shares held under an employee share ownership plan which will be issued to the employees when they choose to withdraw them. The current market value of these shares as at 28 March 2006 is £1.01.

20 Reconciliation of movements in group shareholders' funds

	2005	2004
	£000	£000
(Loss) profit for the financial year	(214)	1,101
Currency translation difference on foreign currency net investments	(1)	-
Issue of share capital	4,040	2,930
Purchase of treasury shares	(20)	-
Net addition to group shareholders' funds	3,805	4,031
Opening group shareholders' funds	6,995	2,964
Closing group shareholders' funds	10,800	6,995

21 Reconciliation of operating profit (loss) to operating cash flows

	2005	Restated
	£000	2004
		£000
Operating profit (loss)	656	(33)
Depreciation charges and fixed asset impairment	341	215
Loss on sale of tangible fixed assets	33	24
Amortisation of goodwill and intangibles	1,752	636
Write down of investments	17	-
Decrease (increase) in debtors	1,372	(445)
Increase in creditors	96	847
Net cash inflow from operating activities	4,267	1,244

The comparative amounts for 2004 have been restated to reflect loans due to related parties as financing cash flows, and loan notes payable under acquisitions as cash flows in relation to acquisitions, not as movements in operating cash flows.

Notes to Financial Statements continued

22 Analysis of cash flows

	2005 £000	Restated 2004 £000
<i>Returns on investments and servicing of finance</i>		
Interest received	8	67
Interest paid	(209)	(125)
Interest element of finance lease rentals	(78)	(41)
Net cash outflow	(279)	(99)
<i>Taxation</i>		
Tax paid	(80)	(76)
Net cash outflow	(80)	(76)
<i>Capital expenditure and financial investment</i>		
Purchase of tangible fixed assets	(180)	(69)
Sale of tangible fixed assets	74	57
Net cash outflow	(106)	(12)
<i>Acquisitions and disposals</i>		
Acquisition of subsidiary undertakings	(1,663)	(3,653)
Costs of acquisition of subsidiary undertakings	(696)	(160)
Net overdrafts acquired with subsidiary undertakings	(1,016)	(144)
Deferred consideration	(1,688)	(13)
Sale of business (net of costs)	(90)	1,721
Acquisition of investment	-	(95)
Net cash outflow	(5,153)	(2,344)
<i>Financing</i>		
Issue of ordinary share capital	1,350	-
Treasury shares purchased	(20)	-
New bank loan	1,000	-
New related party loan	1,000	750
Repayment of related party loans	(1,040)	(225)
Capital element of finance lease rental payments	(468)	(61)
Net cash inflow	1,822	464

23 Analysis and reconciliation of net debt

	Restated 1 January 2005	Cash flow	Acquisitions and disposals	Other non-cash changes	31 December 2005
	£000	£000	£000	£000	£000
Cash in hand, at bank	403	471	-	-	874
Debt due after one year	-	(689)	-	(513)	(1,202)
Debt due within one year	(1,303)	(271)	-	1,034	(540)
Finance leases	(667)	468	(92)	(88)	(379)
Net debt	(1,567)	(21)	(92)	433	(1,247)

	2005 £000	Restated 2004 £000
Increase (decrease) in cash in the year	471	(823)
Cash (inflow) outflow from increase/decrease in debt and lease financing	(492)	(464)
Change in net debt resulting from cash flows	(21)	(1,287)
Finance leases acquired with subsidiaries	(92)	(571)
Loans converted into equity	521	-
New finance leases	(88)	(106)
Movement in net debt in year	320	(1,964)
(Net debt) cash resources at 1 January 2005 (restated)	(1,567)	397
Net debt at 31 December 2005	(1,247)	(1,567)

24 Major non-cash transactions

During the year the group entered into finance lease arrangements in respect of assets with a total capital value of £88,000 (2004: £106,000). £521,000 of debt within one year was converted into equity and £513,000 of debt due within one year was renegotiated and now falls due after one year.

25 Financial commitments

Capital commitments are as follows:

	Group	
	2005 £000	2004 £000
Contracted for but not provided for		
Other	-	15

There were no capital commitments in the company at the end of either financial year.

Annual commitments under non-cancellable operating leases are as follows:

	2005		2004	
	Land and buildings £000	Other £000	Land and Buildings £000	Other £000
Group				
Expiry date				
- within one year	75	19	44	24
- between two and five years	137	143	185	44
- after five years	125	-	33	-
	337	162	262	68
Company				
Expiry date				
- within one year	60	3	-	9
- between two and five years	41	79	104	33
	101	82	104	42

Leases of land and buildings are typically subject to rent reviews at specified intervals and provide for the lessee to pay all insurance, maintenance and repair costs.

26 Pension arrangements

The group operates a defined contribution scheme and also makes contributions to personal pension schemes of certain senior employees and directors for which the total pension cost charge for the year amounted to £197,000 (2004: £89,000).

27 Related party transactions

At 1 January 2005 £533,000 remained outstanding to Mr PJ Claesson, a director of the company, in relation to deferred consideration and loan owed in connection with the acquisition of K3 BTG Limited and K3 Business Technology Software Limited. During the year further interest of £8,000 was accrued resulting in a total due of £541,000. This was satisfied by the issue of 605,820 ordinary shares of 25p each.

During the year the company received a loan of £1m from Johan and Marianne Claesson AB, a company connected with Mr PJ Claesson, a director of the company. The loan was made in connection with the acquisition of Information Engineering Group Limited in June 2005. The loan was repayable in twelve equal quarterly instalments commencing on 31 March 2006 subject to earlier repayments from proceeds from a future placing or from new bank loans raised. £810,000 was repaid in October 2005 from the proceeds of the placing (see note 18) and the remaining £190,000 plus accrued interest at 8.5% per annum of £27,570 was repaid in December 2005 from the proceeds of the bank loan (see note 14). In connection with the loan, the company issued 400,000 warrants for ordinary shares of 25p. These are exercisable at the lower of £1.00 or at the price at which any shares are issued by the company by way of a rights issue or placing during the period up to 23 June 2006. The shares issued pursuant to the placing in September 2005 were at £0.90 and hence the current exercise price of the warrants is £0.90.

Included within other loans due to related parties is a loan of £710,000 (2004: £750,000) from CA Fastigheter AB, a company connected with Mr PJ Claesson, a director of the Company. The loan was made in connection with the acquisition of K3 Landsteinar in October 2004. The terms of repayment of the loan were varied during the year such that the loan is now repayable in twelve equal quarterly instalments commencing on 31 March 2006 subject to earlier repayments from proceeds from a future placing or from new bank loans raised. The repayment of this loan from proceeds of a placing or bank loans is subordinate to the loan from Johan and Marianne Claesson AB. £40,000 was repaid in December 2005 from the proceeds of the bank loans (see note 14). Interest is charged at 8.5% per annum and amounted to £15,894 (2004: £nil) at the year end and is included with the loan within other loans due to related parties. In connection with the loan, the company issued 200,000 warrants for ordinary shares of 25p. These are exercisable at the lower of £1.00 or the price at which any shares are issued by the company by way of a rights issue or placing during the period up to 31 January 2006. The shares issued pursuant to the placing in September 2005 were at £0.90 and hence the current exercise price of the warrants is £0.90. The exercise period of the warrants was extended during the year from 29 September 2007 to the later of 29 June 2008 and the date upon which the loan is repaid.

In connection with the acquisition of K3 Landsteinar, Mr PJ Claesson has made available a standby-facility of £250,000 to assist the company with its working capital requirements. The facility was initially made available until 31 March 2006 and during the year this has been extended to 30 June 2006. Should it be drawn upon, interest will be charged at 8.5% per annum. As at 28 March 2006, the facility has not been drawn upon.

There were no other transactions with related parties during the year.

Notice of Annual General Meeting

Notice is hereby given that the annual general meeting of the Company will be held at the offices of Information Engineering Group, Churchgate House, 56 Oxford Street, Manchester M1 6EU on 24 May 2006 at 10.30 am at which the following business will be transacted.

Ordinary Business

1. To receive and adopt the directors' and auditors' reports and the financial statements for the year ended 31 December 2005.
2. To re-appoint Mr RE Dorset as a director in accordance with Article 96.
3. To re-appoint BDO Stoy Hayward LLP as auditors of the Company to hold office from the conclusion of this meeting until the conclusion of the next annual general meeting at which financial statements are laid before the Company and to authorise the directors to fix their remuneration.

Special Business

To consider and, if thought fit, pass the following resolutions, which will be proposed as ordinary resolutions:

4. That the authorised share capital of the Company be increased from £5,000,000 to £6,625,000 by the creation of 6,500,000 ordinary shares of 25p each.
5. That, in substitution for all existing and unexercised authorities, pursuant to section 80 of the Companies Act 1985 ("the Act"), the directors of the Company be generally and unconditionally authorised to exercise all or any powers of the Company to allot relevant securities (within the meaning of section 80(2) of the

Act) in the capital of the Company up to a maximum nominal amount of £1,528,393 (representing approximately one third of the issued ordinary share capital of the Company) provided that this authority shall unless previously revoked or varied by the Company in general meeting expire five years from the date of this resolution save that the Company may before the expiry make an offer or agreement which would or might require the relevant securities to be allotted after such expiry and the directors of the company may allot relevant securities in pursuance of such an offer or agreement as if the authority conferred hereby had not expired.

To consider and, if thought fit, pass the following resolution, which will be proposed as a special resolution:

6. That, pursuant to the resolution confirming authority under section 80 of the Companies Act 1985, the directors be and they are hereby empowered in accordance with section 95 of the Companies Act 1985 (the "Act"), to allot equity securities (as defined in section 94(2) of the Act) for cash pursuant to the authority conferred on them to allot relevant securities (as defined in section 80 of the Companies Act 1985) as if section 89(1) and subsections (1) – (6) of section 90 of the Act did not apply to any such allotment provided that this power shall be limited to:-

6.1 the allotment of equity securities in connection with or pursuant to an offer by way of rights, open offer or other pre-emptive offer to the holders of shares in the company and other persons entitled to participate therein in proportion (as nearly as practicable) to their respective holdings, subject to such exclusions or other

arrangements as the directors may consider necessary or expedient to deal with fractional entitlements or legal or practical problems under the laws of any territory or the regulations or requirements of any regulatory authority or any stock exchange in any territory; and

6.2 the allotment (otherwise than pursuant to subparagraph 6.1 of this resolution) of equity securities up to an aggregate nominal amount of £443,518.

The power hereby conferred shall expire on the date of the next annual general meeting of the Company after the passing of this resolution save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the board may allot equity securities in pursuance of such an offer or agreement as if the power conferred hereby had not expired.

Registered Office Dated 28 March 2006

Linden Business Centre	By Order of the Board
Linden Road	DJ Bolton
Colne	Secretary
Lancashire BB8 9BA	

Notes

1. A member entitled to attend and vote at the above annual general meeting may appoint one or more proxies to attend and, on a poll, vote in his place. A proxy need not be a member of the Company.
2. Completing and returning a form of proxy shall not preclude a shareholder from attending and voting at the meeting should he wish.
3. To be valid, the form of proxy (together with the power of attorney or other authority (if any) under which it is signed or notarially certified copy of such authority) must be deposited at Capita Registrars plc, Northern House, Woodsome Park, Fenay Bridge, Huddersfield, HD8 0LA no later than 10.30 am on 22 May 2006. A form of proxy is enclosed with this notice.
4. The Company, pursuant to regulations 34 of the Uncertified Securities Regulations 1995, specifies that only those shareholders registered in the register of members of the Company as at 10.30 am on 22 May 2006 or, in the event that the annual general meeting is adjourned, in the register of members 48 hours before the time of any adjourned meeting, shall be entitled to attend and to vote at the annual general meeting in respect of the number of shares registered in their name at that time. Changes to entries on the relevant register of securities at 10.30 am on 22 May 2006, or in the event that the annual general meeting is adjourned less than 48 hours before the time of any adjourned meeting, shall be disregarded in determining the rights of any person to attend or vote at the annual general meeting.

Notice of Annual General Meeting continued

5. On a show of hands every shareholder present in person has one vote, on a poll every shareholder has one vote for each share held by him. The necessary quorum at this meeting is two members present in person or by proxy and entitled to vote upon the business to be transacted.
6. Biographical details of Mr RE Dorset are included on page 2 to these financial statements.
7. The increase in the authorised share capital proposed in resolution 4 is requested to enable the directors to exercise the authorities sought under resolutions 5 and 6.
8. Resolution 5 would empower the directors to allot relevant securities for any reason up to an aggregate nominal amount of £1,528,393 representing approximately one third of the current issued Ordinary share capital of the Company.
9. Resolution 6 would empower the directors to allot equity securities for cash other than to existing Ordinary Shareholders pro rata to their existing holdings. Such power would be limited to the situations referred to in sub-paragraphs 6.1 and 6.2 of that resolution. Sub-paragraph 6.1 refers to rights issues and similar issues, where difficulties arise in offering relevant securities to certain overseas shareholders or where fractional entitlements arise. Sub-paragraph 6.2 permits allotment for cash (other than rights issues or similar) of ordinary shares up to an aggregate nominal amount of £443,518 representing approximately 10% of the current issued ordinary share capital of the Company. The resolution is proposed so as to give the directors greater flexibility to take advantage of business opportunities as they arise. The directors have no present intention of exercising the authority.
10. The register of interests of the directors in the share capital of the Company and copies of the contracts of service of directors with the Company or with any of its subsidiary undertakings will be available for inspection at the registered office of the Company during normal business hours (Saturdays and public holidays excepted) from the date of this notice until the conclusion of the annual general meeting and at the place of the annual general meeting from at least 15 minutes prior to and until the conclusion of the annual general meeting.

Five Year Summary

	2005 £000	2004 £000	2003 £000	2002 £000	2001 £000
PROFIT AND LOSS					
Turnover					
- continuing operations	22,029	8,116	7,002	7,916	6,393
- discontinued operations	-	413	-	172	1,579
	22,029	8,529	7,002	8,088	7,972
Operating profit before amortisation of goodwill and intangibles and exceptionals	2,408	603	1,074	975	710
Amortisation of goodwill and intangibles	(1,752)	(636)	(463)	(463)	(534)
Exceptional administrative expenses	-	-	(605)	-	-
Operating profit (loss)	656	(33)	6	512	176
(Loss) profit on disposal of operations	(90)	1,248	(100)	(173)	(1,463)
Finance charges	(287)	(55)	(105)	(73)	(86)
Profit (loss) on ordinary activities before taxation	279	1,160	(199)	266	(1,373)
Taxation	(493)	(59)	(130)	108	(246)
(Loss) profit for financial year	(214)	1,101	(329)	374	(1,619)

BALANCE SHEET

Fixed assets					
- intangible	15,844	9,919	3,354	3,817	4,280
- tangible	508	570	342	426	618
- investments	-	17	190	-	-
	16,352	10,506	3,886	4,243	4,898
Current assets	7,470	6,671	3,784	4,021	3,524
Creditors: Amounts falling due within one year	(10,583)	(9,845)	(4,706)	(4,920)	(5,265)
Net current liabilities	(3,113)	(3,174)	(922)	(899)	(1,741)
Creditors: Amounts falling due after more than one year	(2,439)	(337)	-	(51)	(85)
Provisions for liabilities and charges	-	-	-	-	(131)
Net assets	10,800	6,995	2,964	3,293	2,941

CASH FLOWS

Net cash inflow (outflow) from operating activities	4,267	1,244	1,365	471	(414)
Increase (decrease) in cash in the year	471	(823)	1,103	186	281

K3 BUSINESS TECHNOLOGY GROUP PLC

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