Research Report (Update)

KPS AG

HY-figures confirm growth course –

Estimates for FY2015/16 confirmed –

Target price unchanged despite dilution

Target price: 9.80 €

Rating: BUY

IMPORTANT NOTE:
Please take note of the disclaimer/risk warning, as well as the disclosure of potential conflicts of interest as required by section 34b of the Securities Trading Act (WpHG) from page 14

Date of completion: 06/06/2016 **Date of first publication: 07/06/2016**

GBC AG Investment Research

KPS AG*5a;6a;7;11

Rating: BUY
Target price: €9.80

Current price: €9.30
06/06/2016 / ETR
Currency: EUR

Key information:

ISIN: DE000A1A6V48
WKN: A1A6V4
Ticker symbol: KSC

Number of shares³: 37,291*
Market Cap³: 346.81
Enterprise Value³: 334.42
³in million / in mEUR
* after issuance of bonus shares

Free float: 21.20 %

Transparency level:
General Standard

Market segment:
Regulierter Markt

Accounting standard:
IFRS

Financial year: 30/9

Designated Sponsor:
DERO Bank

Analysts:

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* List of possible conflicts of interest on page 15

Company profile

Sector: Services

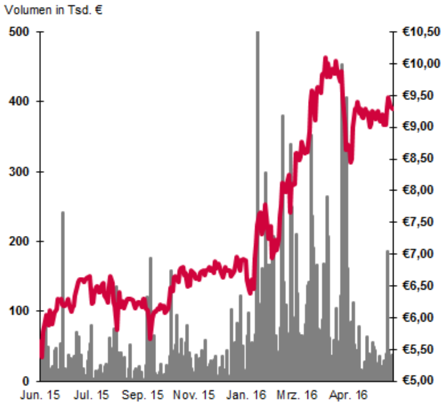
Focus: consulting for business transformation and process optimisation

Employees: 385 (due to: 31/03/2016)

Established: 2000

Registered office: Munich

Board of Management: Dietmar Müller, Leonardo Musso



KPS Consulting is a leading transformation consultancy for the retail and consumer products sectors and combines classic strategy, process, applications and technology consulting with implementation expertise. The KPS Rapid Transformation Method is proven to accelerate projects and KPS Transformation Architects use it for the integrated management of complex corporate transformations, as far as possible in tandem with strategy development, process design and implementation. KPS customers benefit from rapid and successful implementation and excellent project transparency, together with guaranteed top quality consulting and an optimal price-performance ratio. The company's headquarters are in Munich with further branches in Germany, Denmark and Switzerland. KPS Consulting was established in 2000 and employs around 600 consultants.

P&L in mEUR, financial year-end	30/9/2014	30/9/2015	30/9/2016e	30/9/2017e
Sales	111.08	122.92	141.35	155.50
EBITDA	17.48	19.65	23.30	26.10
EBIT	16.69	18.61	22.20	25.00
Net income	16.33	17.93	19.61	22.08

Key figures in EUR				
Earnings per share**	0.50	0.53	0.53	0.59
Dividend per share	0.28	0.30	0.35	0.40
*** issuance of bonus shares with a ratio of 10:1 already considered*				

Key Figures				
EV/Sales	2.99	2.71	2.35	2.14
EV/EBITDA	19.02	16.92	14.27	12.74
EV/EBIT	19.93	17.87	14.98	13.30
P/E	21.12	19.24	17.59	15.62
P/B		5.81		

Financial Calendar
16/08/2016: 9M-report 2015/16
31/01/2017: FY-report 2015/16

** Last research by GBC:
Date: publication/target price in EUR/rating
15/02/2016: RS / 9.80 / BUY
09/02/2016: RS / 9.80 / BUY
03/06/2015: RS / 8.35 / BUY
18/02/2015: RS / 8.35 / BUY
02/02/2015: RG / 7.70 / BUY
** The research studies indicated above may be viewed at www.gbc-ag.de, or requested from GBC AG, Halderstr. 27, D86150 Augsburg

Executive Summary

- In H1 2015/16, KPS AG has been able to maintain the high growth rate already shown in previous periods, growing by 20.3% to €68.83 million. €68.83 million also represented a new turnover record on a half-year basis.

- A significant driver of this was the management/transformation consulting segment, making up €60.26 million of the total turnover. But the products/licenses segment is also continuously increasing in importance and in H1 2015/16 at €6.64 million it made twice the contribution to turnover as in H1 2014/15. Especially the increasing abroad activities contributed a large share to this pleasant development. For example, significant growth in sales was achieved in Scandinavia and Switzerland.

- Another record was achieved in H1 2015/16 with an EBIT of €10.61 million. This represented a 37.8% increase over the previous year and was clearly disproportionate compared to the increase in sales. The EBIT margin improved correspondingly from 13.5% to 15.4%.

- In the context of the good half-year figures, the company confirmed its guidance for the whole FY 2015/16 and continues to predict sales of €140 million and an EBIT of €22 million.

- In the face of the €68.83 million already achieved in H1 2015/16, KPS AG would have to make around €71 million in H2 2015/16 in order to reach the target. To do so, the company would have to exceed the value achieved in H2 of the previous year by 10%. In the context of the 20% growth rate in H1, we believe this is a realistic proportion.

- To this extent, we also confirm our existing estimates and expect sales of €141.35 million and an EBIT of €22.20 million for FY 2015/16. We are also maintaining our expectations of continued growth for the following FY 2016/17. Internationalisation is likely to be increasingly a driver of growth in the coming years. KPS has only recently opened a branch in the Netherlands in order to be able to offer optimum service to customers there and in Belgium. In future, however, KPS AG is likely to help its customers transform their IT solutions even beyond European markets, which would be an additional growth driver in the coming years.

- **As a result of our estimates, we are keeping to our target price of €9.80. It is important to remember that we have already incorporated the expected dilution from the issuing of bonus shares at a ratio of 10:1. Our target price is based on a total of 37.29 million shares. The dilution effect, however, compensated for by a lower risk-free interest rate of 1.0% henceforth (previously: 1.5%). The BUY rating remains unchanged.**

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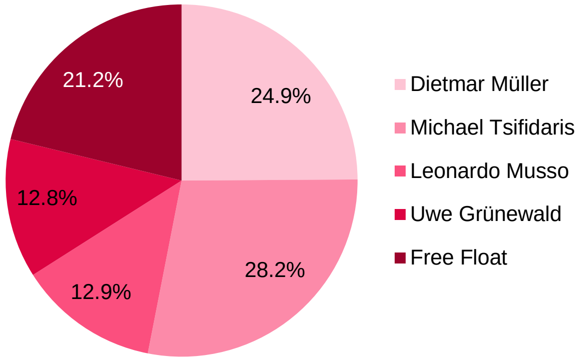
COMPANY

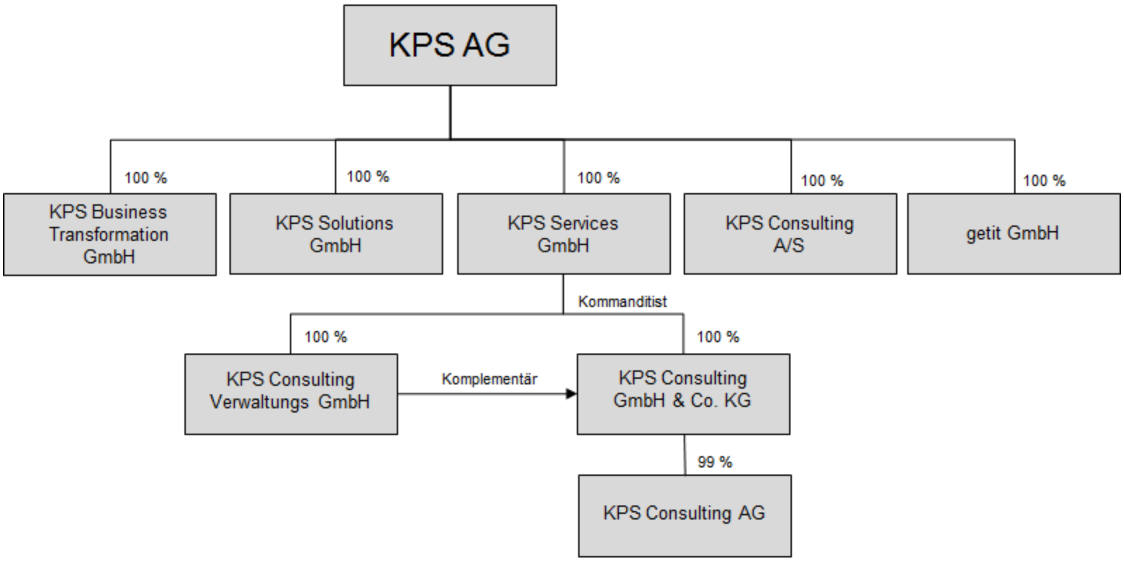
Shareholder Structure

Dietmar Müller	24.9%
Michael Tsifidaris	28.2%
Leonardo Musso	12.9%
Uwe Grünewald	12.8%
Free Float	21.2%
Total	100.0%

Source: KPS AG



Group Structure



Source: KPS AG

Important Customers

The KPS AG´s customer base encompasses a range of renowned companies. The focus is on the retail and consumer goods sectors. In the following selected references are dispayed:

Source: KPS AG

Business Development HY1 2015/16

P&L (in € millions)	HY1 2014/15	Change	HY1 2015/16
Net sales	57.23	+20.3 %	68.83
EBITDA (*margin*)	8.21 (*14.3 %*)	+36.2 %	11.18 (*16.2 %*)
EBIT (*margin*)	7.70 (*13.5 %*)	+37.8 %	10.61 (*15.4 %*)
Net profit	6.87	+35.1 %	9.27
EPS in €	0.20	+35.1 %	0.27

Source: KPS, GBC

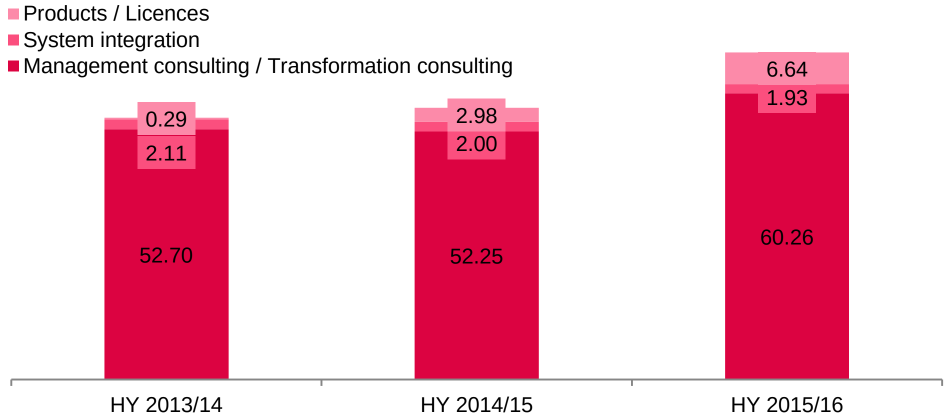
Sales performance

After a strong start to FY 2015/16 with sales growth of 23.7% in Q1 2015/16, KPS AG was also able to maintain the growth rate in Q2 2015/16 and reinforce this dynamic trend with growth of 17.0%. In total, growth in sales is rated at 20.3% for H1 2015/16, which means a new company record high of €68.83 million.

The driver of this growth remained the continued high success rate in winning transformation projects, especially with customers from the consumer goods and retail sectors. This showed that the strategic focus on process and implementation consultancy for omnichannel solutions on the basis of SAP and Hybris applications is the correct one. The takeover of getit in 2014 enhanced and extended this focus.

Not least, the strategic thrust towards internationalisation has become increasingly apparent. For example, overseas revenues in H1 2015/16 were already contributing €10.75 million, as against €5.39 million in the previous year. This is a doubling of sales in other countries than Germany. Growth in Scandinavia and Switzerland was particularly notable. As part of this internationalisation, KPS has recently opened a branch in Amsterdam, from which customers in Holland and Belgium can be served from now on.

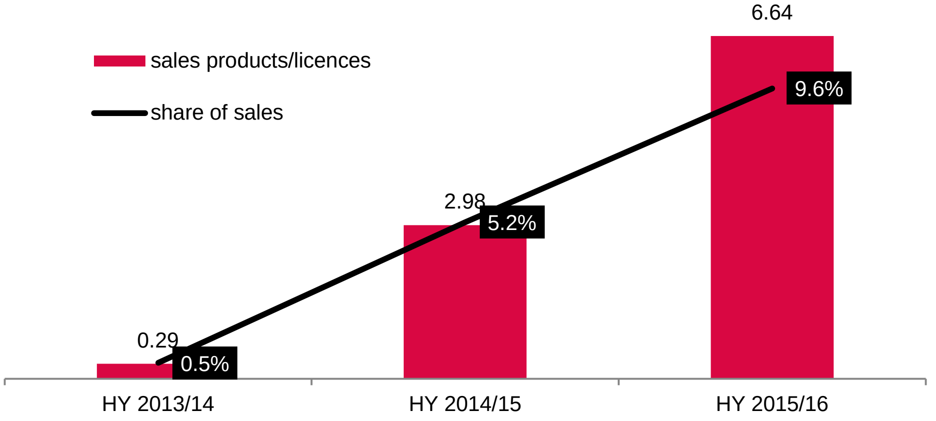
Development of Sales by segments (in m€)



Source: KPS, GBC

In terms of segment performance, the high levels of growth in products/licenses is particularly marked. In this segment, KPS AG distributes software licenses from well-known manufacturers such as SAP, IBM and SAPERION, as well as maintenance contracts, to round off its own range of services in consulting projects. It is only since 2014 that this business has been supplementing the KPS AG range, and it has been developing strongly since then. Sales in this segment have more than doubled compared with the previous half year, which has provided fresh impetus especially in terms of earnings. The maintenance business now makes up almost 10% of sales revenues with a tendency towards increasing yet further.

Development of sales (in m€) and share of sales in HY1 in the segment products/licences (maintenance and service segment)



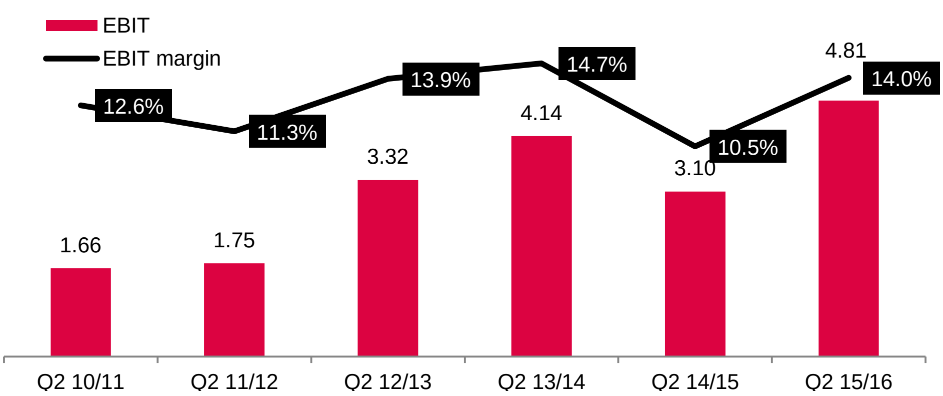
Source: KPS, GBC

Earnings performance

The good earnings performance in H1 2015/16 has also had a positive effect at the earnings level. EBIT was at €10.61 million in H1 2015/16, 37.8% above the previous year. The EBIT margin also posted an increase of 13.5% to 15.4%.

The distribution between Q1 and Q2 shows that the EBIT was somewhat higher in Q1 at €5.8 million. An EBIT of €4.8 million was achieved in Q2. However, a comparison with the previous year's EBIT values clearly shows that there was also a new record here. It should be noted that in the previous year, the relatively low EBIT value was caused by postponing contracts to the second half-year.

Development of earnings in Q2 (in m€)



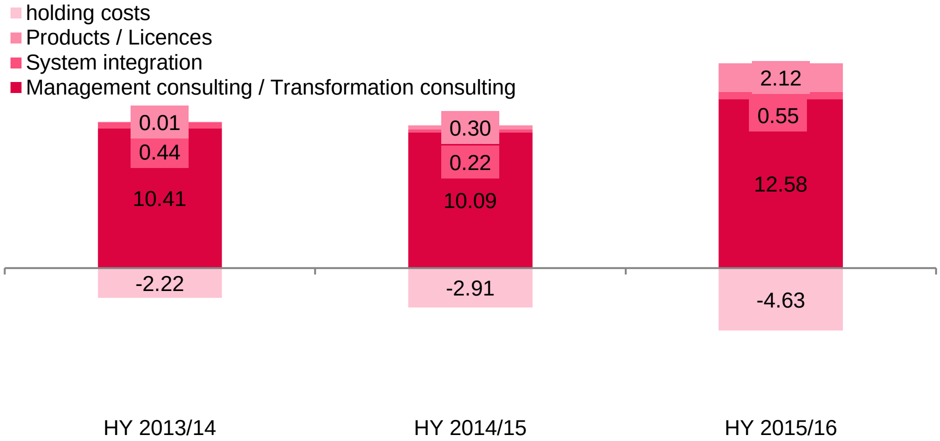
Source: KPS, GBC

At segment level, earnings from management/transformation consultancy continued to make up the majority of the EBIT. However, the largest growth was in the products/licenses segment, with an increase from €0.30 million to €2.12 million. This clearly shows that the products/licenses segment has now assumed great importance and is a significant factor in KPS AG's earnings performance. With an EBIT contribution of €2.12 million, the first half year has already almost reached the EBIT value of the whole of the previous year. With this in mind, continued significant EBIT contributions can be expected from the segment in the coming periods, especially as the segment EBIT margin, at 32%, meanwhile is higher than those of the two other segments. After the start of the expansion of the maintenance business in 2014, the area has now reached a level in which economies of scale come into effect, as can be seen from the margin situation. In addition to the strong earnings contribution from the maintenance business and its excellent scalability, long-term support to customers also has the advantage of creating lasting customer loyalty.

An examination of the segment also shows that the holding costs in H1 2015/16 increased markedly over the previous year, from €2.91 million to €4.63 million. This increase was caused in particular by the expansion of organisational structures. Staffing numbers were increased, including in administration, in order to meet the challenges of the company's greater size. The opening of the new site in Amsterdam and the preparation for further expansion plans also required greater staffing levels.

Regardless of the recent increase, when assessing the structural costs, it should be noted that they remain extremely low in comparison with the rest of the market, especially considering KPS AG's current number of employees and earnings level.

EBIT development by segment (in m€)



Source: KPS, GBC

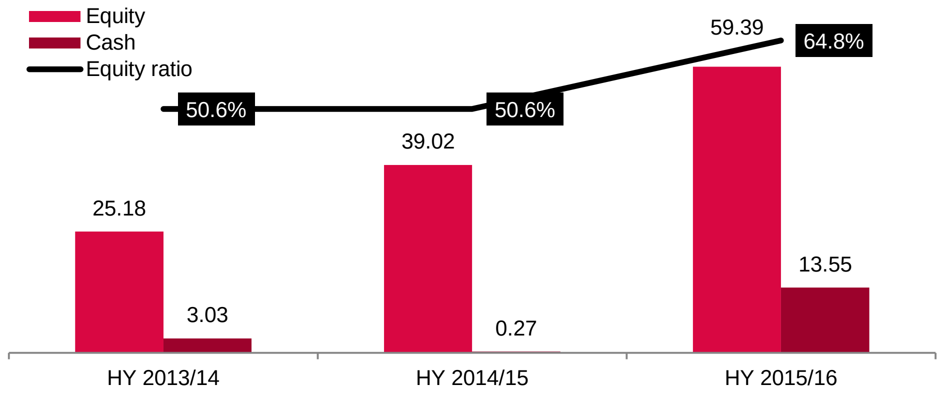
Overall, H1 2015/16 was very satisfactory, especially in terms of the growth dynamics. In terms of earnings, further clear growth was achieved, despite the expansion of the organisational structures. In addition, qualitative improvements can be seen which, in our opinion, will have positive effects in the coming periods.

Balance sheet and financial situation

KPS AG's balance sheet performance has also continued very positively in H1 2015/16. Equity increased from €39.20 million as of the previous year's reporting date to €59.39 million. The equity ratio also improved significantly alongside this, to a current level of almost 65%.

It should be noted that the dividend distribution for the previous business year has not yet taken place as of 31/03/2016. This amount is around €10.17 million, and correspondingly further reduced the equity capital in April 2016. However, even adjusted for this amount, equity capital has significantly increased compared with the previous year, which can be attributed to the good earnings situation.

Development of important balance sheet items (in m€)



Source: KPS, GBC

In line with the still-unpaid dividend distribution of €10.17 million as of 31/03/2016, liquid assets, at €13.55 million, were also significantly higher than the previous year's figure. However, higher growth is also posted here, taking the adjustment into consideration. We still rate KPS AG's balance-sheet situation as very robust and without any significant identifiable risks beyond the normal scope of regular business activity.

SWOT-analysis

Strengths	Weaknesses
• Strong market position with customers in the consumer products and retail sectors • Solid balance sheet ratios with a 58% equity ratio and €6.5 million net liquidity • Full utilisation of consulting staff and extensive order book • Rapid Transformation Method represents a competitive advantage • High level of tax loss carryforwards will also ensure a reduced tax burden in future years	• Low free float restricts tradability of the share • Currently still a high level of dependency on present management • The rising number of projects and project volumes require a sharp increase in the number of employees, which could lead to bottlenecks depending on the availability of personnel resources
Opportunities	**Threats**
• Takeover of getit GmbH has expanded KPS AG's product range in terms of digital business processing consulting and provides the potential for up-selling • SAP service partner status allows KPS to conclude SAP licensing and maintenance agreements which can have an additional impact on sales • The increasing expansion into foreign markets, in particular Scandinavia, harbours new revenue potential • Exploiting new customer sectors can generate additional potential sales	• Increasing price pressure in the consulting industry could bring consultants' daily rates under pressure • Competitors could copy Rapid Transformation and reduce the competitive advantage of KPS AG • A decline in winning assignments could result in sub-optimal capacity utilisation of the consulting staff • The loss of a major customer could have a negative impact on the revenue and earnings situation of KPS AG

Estimates and model assumptions

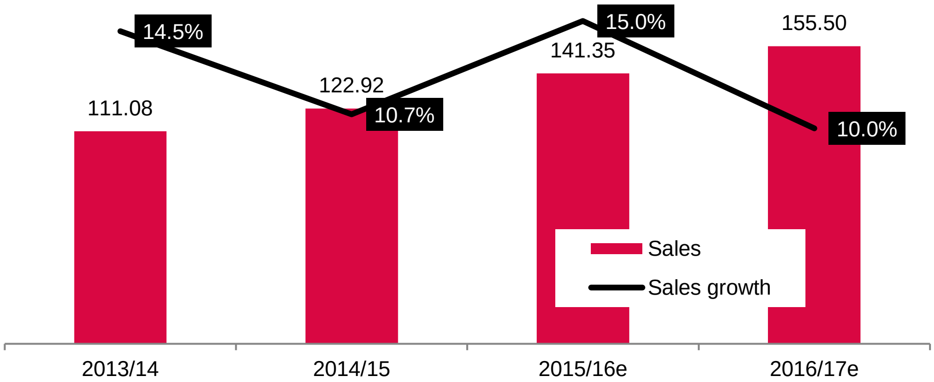
P&L (in million €)	FY 2014/15	FY 2015/16e	FY 2016/17e
Sales	122.92	141.35	155.50
EBITDA (margin)	19.65 (*16.0 %*)	23.30 (*16.5 %*)	26.10 (*16.8 %*)
EBIT (margin)	18.61 (*15.1 %*)	22.20 (*15.7 %*)	25.00 (*16.1 %*)
Net profit	17.93	19.61	22.08
EPS in €	0.53	0.53	0.59

Source: GBC

Sales estimates

The figures for H1 2015/16 were well within our expectations. The management has also confirmed the guidance for the whole FY 2015/16, i.e. that it intends to achieve sales of €140 million. The prerequisites for achieving this target are unchanged and remain very positive. KPS continues to possess a substantial order backlog which will last more than 18 months. This means that the management's visibility regarding H2 2015/16 is likely to be very good. In addition, the KPS consultants' capacity is currently at almost 100%, which points to a similarly dynamic H2 2015/16. In purely mathematical terms, it only needs a sales increase of around 10% over H2 of the previous year to achieve a value of €140 million. In the light of the growth in H1 2015/16, which is already at 20%, this seems to us to be more than realistic.

Expected development of sales (in m€)



Source: GBC

With this in mind, we confirm our sales estimates for the current FY 2015/16 of €141.35 million and expect continued growth of 15% compared with the previous year. We also anticipate that the growth momentum will continue next year and we expect sales to reach €155.50 million.

One of the essential growth drivers of the coming periods is likely to be international business. This includes not only supporting domestic clients moving into foreign markets but also, of course, providing support to overseas clients. KPS is already supporting a large number of clients based in regions such as Scandinavia, Switzerland and the Netherlands. In addition to this, however, times ahead are also likely to see sales generated outside of Europe, which is also a result of support provided to internationally oriented clients.

In our view, the maintenance business is also going to make a highly significant contribution to increased sales in the coming years. Since this area has only been in operation since 2014, the increasing number of projects is likely to lead to further growth. The turnover contribution here is already substantial. Maintenance revenues in particular are proving to be of a long-term recurring nature, which is likely to reinforce the sustainability of revenues that KPS AG has so far been able to achieve. And the maintenance segment is characterised not least by exceptionally high margins, which may support the corporate target of further increasing profitability.

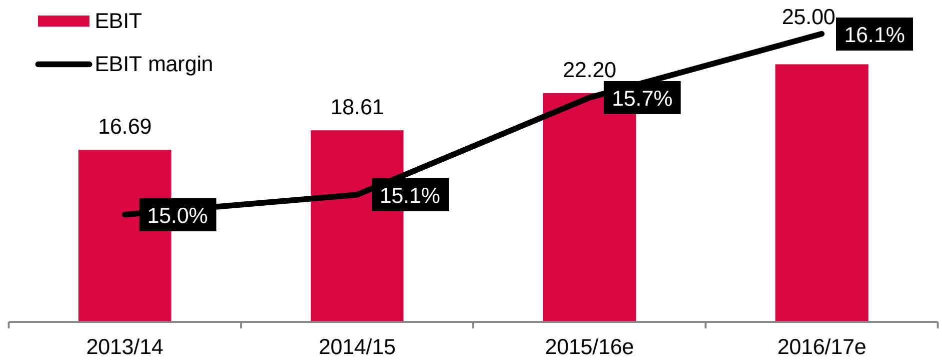
Earnings estimates

As part of the continuing sales growth, KPS AG is continuously increasing its staffing numbers. Employees are hired in the consultancy field in particular. The organisational structure of the administration functions, in particular, is also being aligned to the increasing size of the company. There will therefore continue to be significant increases in HR costs in particular.

Nevertheless, we expect that KPS AG will be able to increase its profit margins further, especially through economies of scale resulting from the increasing sales. In addition, the maintenance segment is of growing importance. An EBIT margin of over 30% was achieved here in H1 2015/16, which is significantly higher than the level of the consultancy segment. The expected further growth in this area is expected to bring with it correspondingly positive effects on the group EBIT and the group EBIT margin.

For this reason, management's guidance increase in EBIT to €22.0 million for FY 2015/16 seems entirely reasonable to us, and consequently we confirm our current estimate of €22.20 million. We therefore continue to expect an EBIT margin of 15.7%, once more above the previous year's level. In the medium term, we remain convinced that KPS AG can reach sustainable EBIT margins of around 17% on a full year basis. Nevertheless, we have initially included in our forecasts an expected EBIT of €25.00 million for FY 2016/17, which is equivalent to an EBIT margin of 16.1%.

Expected development of EBIT (in m€) and EBIT margin (in %)



Source: GBC

And last but not least, we also expect that the EBIT increases will be correspondingly reflected in the annual surplus. KPS AG has no debts and a high net cash position. Its interest costs are correspondingly very low. With this in mind, we expect that net profit of €22.08 million will be achieved in FY 2016/17 ahead, which corresponds to an EPS of €0.59 (with dilution by bonus shares taken into account). It should therefore also be possible to continue the trend towards increasing dividend distributions. Following €0.30 for FY 2014/15, we expect dividends of €0.35 and €0.40 for the next two financial years.

VALUATION

Model assumptions

We rated KPS AG using a three-stage DCF model. Starting with the concrete estimations for 2015/16 and 2016/17 in phase 1, in the second phase, from 2017/18 to 2022/23, our forecast uses value drivers. Here we expect a sales increase of 5.0 %. We have assumed an EBITDA margin target of 17.0%. We have taken into account tax rates of 15.0-30.0 % due to the outstanding losses carried forward in phase 2. Additionally, a residual value is determined in the third phase by using the perpetual annuity by the end of the forecast horizon. As the final value, we assume a growth rate of 2.0%.

Determination of capital costs

The weighted average cost of capital (WACC) of KPS AG is calculated using equity costs and debt costs. The market premium, the company-specific beta, as well as the risk-free interest rate have to be determined in order to determine the equity cost.

The risk-free interest rate is derived in accordance with the recommendations of the expert committee for company valuations and business administration (FAUB) of the IDW (Institut der Wirtschaftsprüfer in Deutschland e.V.) from the current interest rate yield curves for risk-free bonds. The zero bond interest rates according to the Svensson method published by the German Federal Bank form the underlying basis. To smooth out short-term market fluctuations, we use the average yields over the previous three months and round up the result to 0.25 basis points. **The value of the currently used risk-free interest rate is 1.00% (before: 1.50%).**

We set the historical market premium of 5.50% as a reasonable expectation of the market premium. This is supported by historical analyses of stock market returns. The market premium reflects the percentage by which the stock market is expected to be more profitable than low-risk government bonds.

According to GBC estimates, we have determined a beta of 1.30 (unchanged).

Based on these assumptions, equity costs are calculated to amount to 8.1 % (to date: 8.6 %) (beta multiplied by the risk premium plus the risk-free interest rate). Since we assume a sustainable weighting of the equity costs of 100 %, the resulting weighted average costs of capital (WACC) amount to 8.1 % (to date: 8.6 %).

Evaluation result

The discounting of future cash flows is based on the entity approach. In our calculation, the result for the corresponding weighted average costs of capital (WACC) is 8.1 %. The resulting fair value per share at the end of the 2016/17 financial year corresponds to the target price of € 9.80. In our estimates we already have considered the bonus shares with a ratio of 10:1, which will be issued during June 2016. Therewith we have calculated on a basis of 37.29 million shares. However, the resulting dilution is compensated by the lower risk free rate, leaving the target price unchanged.

DCF-Model

KPS AG - Discounted Cashflow (DCF) model scenario

Value driver of the DCF - model after the estimate phase:

consistency - phase	
Sales growth	5.0%
EBITDA-Margin	17.0%
Depreciation to fixed assets	3.5%
Working Capital to revenue	2.0%

final - phase	
Eternal growth rate	2.0%
Eternal EBITA - margin	16.4%
Eternal effective tax rate	30.0%

three-phase DCF - model:

phase	estimate		consistency						final
in €m	GJ 16e	GJ 17e	GJ 18e	GJ 19e	GJ 20e	GJ 21e	GJ 22e	GJ 23e	value
Sales	141.35	155.50	163.28	171.44	180.01	189.01	198.46	208.38	
Sales change	15.0%	10.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	2.0%
Sales to fixed assets	4.38	4.83	5.02	5.21	5.41	5.63	5.85	6.09	
EBITDA	23.30	26.10	27.76	29.14	30.60	32.13	33.74	35.43	
EBITDA-margin	16.5%	16.8%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	
EBITA	22.20	25.00	26.63	28.01	29.45	30.97	32.56	34.24	
EBITA-Margin	15.7%	16.1%	16.3%	16.3%	16.4%	16.4%	16.4%	16.4%	16.4%
Taxes on EBITA	-2.54	-2.88	-3.99	-5.60	-7.36	-9.29	-9.77	-10.27	
Taxes to EBITA	11.5%	11.5%	15.0%	20.0%	25.0%	30.0%	30.0%	30.0%	30.0%
EBI (NOPLAT)	19.66	22.12	22.64	22.40	22.09	21.68	22.79	23.97	
Return on capital	59.0%	64.0%	63.9%	62.6%	60.8%	58.8%	61.0%	63.3%	63.6%
Working Capital (WC)	2.29	3.27	3.27	3.43	3.60	3.78	3.97	4.17	
WC to sales	1.6%	2.1%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	
Investment in WC	-1.44	-0.98	0.00	-0.16	-0.17	-0.18	-0.19	-0.20	
Operating fixed assets (OAV)	32.27	32.17	32.55	32.91	33.26	33.59	33.92	34.23	
Depreciation on OAV	-1.10	-1.10	-1.13	-1.14	-1.15	-1.16	-1.18	-1.19	
Depreciation to OAV	3.4%	3.4%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	
Investment in OAV	-0.92	-1.00	-1.50	-1.50	-1.50	-1.50	-1.50	-1.50	
Capital employed	34.56	35.44	35.81	36.34	36.86	37.37	37.88	38.40	
EBITDA	23.30	26.10	27.76	29.14	30.60	32.13	33.74	35.43	
Taxes on EBITA	-2.54	-2.88	-3.99	-5.60	-7.36	-9.29	-9.77	-10.27	
Total investment	-2.36	-1.98	-1.50	-1.66	-1.67	-1.68	-1.69	-1.70	
Investment in OAV	-0.92	-1.00	-1.50	-1.50	-1.50	-1.50	-1.50	-1.50	
Investment in WC	-1.44	-0.98	0.00	-0.16	-0.17	-0.18	-0.19	-0.20	
Investment in Goodwill	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Free cashflows	18.39	21.24	22.27	21.88	21.57	21.16	22.28	23.46	385.51

Value operating business (due date)	336.65	342.78
Net present value explicit free Cashflows	113.60	101.59
Net present value of terminal value	223.05	241.18
Net debt	-14.66	-22.80
Value of equity	351.31	365.58
Minority interests	0.00	0.00
Value of share capital	351.31	365.58
Outstanding shares in m	37.29	37.29
Fair value per share in €	9.42	**9.80**

Cost of capital:

Riskfree rate	1.0%
Market risk premium	5.5%
Beta	1.30
Cost of equity	8.1%
Target weight	100.0%
Cost of Debt	2.5%
Target weight	0.0%
Taxshield	28.7%
WACC	**8.1%**

Return on Capital	**WACC**				
	7.1%	**7.6%**	**8.1%**	**8.6%**	**9.1%**
62.6%	11.37	10.46	9.70	9.06	8.51
63.1%	11.44	10.52	9.75	9.11	8.55
63.6%	11.51	10.58	**9.80**	9.15	8.60
64.1%	11.57	10.64	9.86	9.20	8.64
64.6%	11.64	10.69	9.91	9.25	8.68

ANNEX

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HOLD	The expected return, based on the derived target price, incl. dividend payments within the rel 10% and < + 10%.
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