

M2 Telecommunications Group Ltd

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Another kicker to earnings!

MTU will acquire the customer contracts for 15,000+ Austar mobile customers for \$2m in cash, which represents an EBITDA multiple of 1.5x. The Austar business which is consumer related, will be housed within MTU's Southern Cross Telco operations and enhance MTU relatively small consumer customer offering. We have lifted our DCF valuation and price target for MTU by 3% to \$3.80 per share.

Y/E December		2009A	2010A	2011F	2012F
Revenue	\$m	202.5	406.1	473.4	562.3
EBITDA	\$m	13.1	31.2	45.0	56.6
NPAT - reported	\$m	7.4	16.2	22.2	26.4
NPAT - adjusted*	\$m	8.2	18.5	29.1	38.3
EPS (adj)	CPS	9.7	16.7	23.7	30.8
EPS Growth	%	34.0%	72.7%	41.6%	30.1%
PER	x	33.8	19.6	14.6	11.2
EV/EBITDA	x	27.9	12.8	10.0	8.2
DPS	c	5.5	10.0	13.5	17.0
Yield	%	1.7%	3.1%	3.9%	4.9%

Source: BGF Equities / * Earnings adjusted for non-cash amortisation expense

Low risk expansion of Consumer business

While MTU's core focus remains within the SME market, the acquisition of the Austar business will represent a low risk and cost-effective expansion for MTU's subsidiary Southern Cross Telco, which is focussed on consumer and regional markets. Additionally the acquisition has been struck on a favourable multiple of 1.5x EBITDA, which represents an 18-month payback period, with recent acquisitions being struck on multiples of 2-3x EBITDA.

Commonality mitigates risk

Further mitigating any risk is that both Austar and MTU are operating on the Optus mobile network which will ensure a smooth transition for Austar customers and ease of integration for MTU. We note MTU is the officially endorsed aggregator of Optus wholesale 3G post-paid mobile services, allowing MTU to wholesale Optus mobile and data services to smaller telco providers.

FY12 EPS and valuation increase by 3%

We have assumed the Austar business to deliver FY12 revenues and EBITDA of \$10m and \$1.5m respectively, which has resulted in our forecasts FY12 EPS adj. increasing by 3% to 30.8cps (previously 30.0). Our DCF valuation and price target has also increased by 3% to \$3.80 per share. Our recommendation remains a BUY.

Interim result expectations and ACCC determination pending

MTU will release its 1H11 results on the 28th of February and we are forecasting 1H11 EPS adj. of 12.2cps (pcp: 9.7cps) and dividend of 6.0cps (pcp: 5.0). In addition we continue to wait for the ACCC to release its determination on the possible reduction in wholesale pricing for a number of Telstra supplied services. We estimate a favourable outcome for MTU could add at least 75cps to our current valuation.

Recommendation: BUY
Price: \$3.45
Price Target: \$3.80
Code: MTU

Stock Data

Market Capitalisation \$423.8m
 Issued Capital 122.9m
 Volume (monthly average) 3.1m
 12-month low \$1.36
 12-month high \$3.56

Market Data

Small Ordinaries 2867
 S&P ASX 200 4847
 All Ordinaries 4937

Valuation & Pricing Data

DCF Valuation \$3.80
 EBITDA Multiple \$3.41
 PER \$4.31

Daily Price Chart



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Forecast changes

We have upgraded our FY12 EPS adj. forecasts by 3% to 30.8cps, while reported EPS also increases by 3% to 21.2cps. Reported NPAT and EPS are adjusted for the add-back of non-cash amortisation expense in relation to acquired customer contracts.

Table 1: BGF forecast changes FY12

(\$m) – unless stated	FY11F	FY12F original	FY12F revised	% Δ
Revenues	473.4	552.3	562.3	1.8
EBITDA	45.0	55.1	56.6	2.7
Depreciation	(3.7)	(3.7)	(3.7)	
EBITA	41.3	51.4	52.9	2.9
Amort of Intangibles	(6.9)	(11.6)	(11.9)	
EBIT	34.3	39.9	41.0	2.8
Net interest exp.	(2.6)	(3.2)	(3.3)	
NPBT	31.7	36.7	37.7	2.9
NPAT	22.2	25.7	26.4	2.9
NPAT – adjusted	29.1	37.3	38.3	2.8
EPS – reported	18.1	20.6	21.2	3.0
EPS - adjusted	23.7	30.0	30.8	2.6

Source: BGF Equities / * Earnings adjusted for non-cash amortisation expense

FINANCIALS

M2 Telecommunications Group Price \$ 3.45
Market Cap \$ 423.8

Year end 30 June

Profit & Loss (\$m)	2009A	2010A	2011F	2012F
Sales Revenue	202.5	406.1	473.4	562.3
EBITDA	13.1	31.2	45.0	56.6
Depn & Amort	1.4	2.6	3.7	3.7
Amort - Identifiable Intangibles	0.8	2.4	6.9	11.9
EBIT	10.9	26.2	34.4	41.0
Net Interest Expense	-0.5	-2.0	-2.6	-3.3
NPBT	10.4	24.2	31.7	37.7
Tax expense	-3.0	-8.0	-9.5	-11.3
NPAT - pre-sign items	7.4	16.2	22.2	26.4
NPAT - adjusted	8.2	18.5	29.1	38.3
Significant items	0.0	0.0	-1.4	0.0
NPAT - reported	7.4	16.2	20.8	26.4

Cash Flow (\$m)	2009A	2010A	2011F	2012F
Operating EBITDA	13.1	31.2	45.0	56.6
- Interest & Tax Paid	3.5	10.0	12.1	14.6
+/- change in Work. Cap.	0.3	-6.2	1.0	1.2
- other	1.5	1.7	4.1	3.5
Operating Cashflow	8.3	13.3	29.7	39.8
- Capex	-0.9	-0.9	-9.0	-8.0
- other	0.0	0.0	-3.1	-3.0
- equity	-9.7	-16.3	-22.2	-22.3
Free Cashflow	-2.4	-3.8	-4.6	6.5
- Ord Dividends	-4.3	-8.3	-14.8	-18.1
- Equity /other	0.5	20.4	0.5	0.0
Net Cashflow	-6.2	8.3	-19.0	-11.5
Cash at beginning of period	6.9	6.7	15.1	2.1
+/- borrowings / other	6.0	0.1	6.0	12.0
Cash at end of period	6.7	15.1	2.1	2.6

Balance Sheet	2009A	2010A	2011F	2012F
Cash	6.7	15.1	2.1	2.6
Inventories	1.4	0.3	0.5	0.6
PP&E	5.0	3.7	11.8	18.2
Debtors	49.3	55.8	63.9	74.5
Intangibles	67.2	70.3	86.0	97.2
Other assets	11.7	14.1	14.1	14.1
Total Assets	141.3	159.3	178.3	207.1
Borrowings	16.3	16.6	22.3	34.3
Trade Creditors	55.1	54.2	63.4	75.3
Other Liabilities	21.6	11.5	7.4	3.9
Total Liabilities	92.9	82.3	93.2	113.6
NET ASSETS	48.4	77.0	85.1	93.5

Board of Directors / Substantial Shareholders

Name	Shareholding	%
Craig Farrow - Chairman	0.8	0.6%
Vaughan Bowen - CEO/MD	10.3	8.4%
Max Bowen - Non-Executive Director	0.0	0.0%
John Hynd - Non Executive Director	2.8	2.3%
Michael Simmons - Non-Executive Director	0.0	0.0%

Substantial Shareholders

Name	Shareholding	%
Hunter Hall	13.7	11.1%
Vaughan Bowen	10.3	8.4%
National Australia Bank	8.6	7.0%

Top 20 Shareholders

71.7 57.6%

Valuation ratios	2009A	2010A	2011F	2012F
EPS (cps) - underlying	8.8	14.6	18.1	21.2
EPS (cps) - adjusted	9.7	16.7	23.7	30.8
PER (x)	35.7	20.6	14.6	11.2
PER Rel - All Ind.	151%	31%	5%	-9%
PER Rel - Small Ind.	149%	29%	4%	-11%
Enterprise Value (\$m)	383.8	420.9	450.0	461.5
EV / EBITDA (x)	29.4	13.5	10.0	8.2
EV / EBIT (x)	35.3	16.1	13.1	11.3
DPS (cps)	5.5	10.0	13.5	17.0
Dividend Yield (%)	1.6%	2.9%	3.9%	4.9%
Franking (%)	100%	100%	100%	100%
CFPS (cps)	9.9	12.0	24.1	32.0
P / CFPS (x)	34.9	28.8	14.3	10.8

Profitability ratios	2009A	2010A	2011F	2012F
EBITDA Margin (%)	6.5	7.7	9.5	10.1
EBIT Margin (%)	5.4	6.4	7.3	7.3
ROE (%)	15.2	21.0	26.2	28.4
ROA (%)	8.1	18.1	19.5	20.0
ROIC (%)	21.4	29.9	31.4	32.9

Balance Sheet ratios	2009A	2010A	2011F	2012F
Net Debt (cash)	9.6	1.5	20.2	31.8
Net Gearing (%)	19.8	2.0	23.8	34.1
Interest Cover (x)	28.4	15.7	17.0	17.4
NTA per share (\$)	0.0	0.0	0.0	0.0
Price / NTA (x)	-18.8	6.7	-0.8	-3.7
EPPOWA (m)	84.2	110.9	123.1	124.6

Growth ratios	2009A	2010A	2011F	2012F
Sales revenue (\$m)	85.8%	100.6%	16.6%	18.8%
EBITDA (\$m)	47.8%	138.3%	44.4%	25.8%
EBIT (\$m)	43.6%	140.4%	31.4%	19.3%
NPAT (\$m)	43.0%	119.0%	37.6%	19.0%
EPS adj. (cps)	34.0%	72.7%	41.6%	30.1%
DPS (cps)	10.0%	81.8%	35.0%	25.9%

Interim Analysis	1H10A	2H10A	1H11F	2H11F
Revenues	187.7	218.4	220.2	253.1
EBITDA	15.3	15.9	20.7	24.3
EBITDA margin (%)	8.1%	7.3%	9.4%	9.6%
EBIT	12.6	13.6	18.8	15.5
EPS (adj)	8.7	9.7	12.2	12.2
DPS	5.0	5.0	6.0	7.5

Valuation	2012F
Normalised EBITDA multiple (x)	
EBITDA (\$m)	56.6
Target EBITDA multiple (x)	8.0
Net Debt (cash) (\$m)	20.2
Implied Valuation	432.7
Per Share	3.41

Target PE Multiple

EPS (c)	30.8
PER Target (x)	14.0
Per Share	4.31

Discounted Cash Flow

Cost of equity	13.5%	WACC	15.4%
Cost of debt	8.0%	Terminal Growth Rate	3.5%
Net Debt/ Net debt + equity	1.9%	Per Share	3.80

Disclosure: The author holds securities in M2 Telecommunications Ltd

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