1 February 2011

INTERSUISSE

M2 Telecommunications Group

(MTU)

Clear for take-off on main runway

Recommendation

Continue to Buy

Price

$3.28

Target (within 12 months)

$4.00

Price/Earnings Ratios

FY11E **15.4x**, FY12E **12.8x**

Franked Yields

FY11E **4.3%,** FY12E **5.5%**

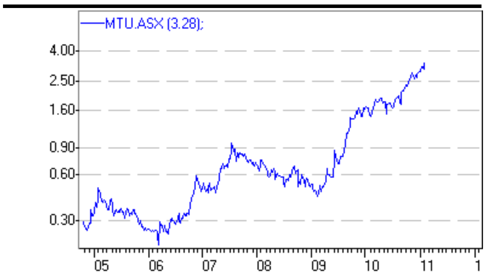
M2 has announced yet another acquisition, of the business assets of Clear Telecoms (Aust) Pty Ltd, Australia's largest privately owned provider of business telco services, with nearly 20,000 customers. On attractive terms as usual, this acquisition adds to FY12 earnings growth and future uptrend significantly.

- **M2 has an outstanding record of sound growth**
- **A leader in the SME telco field, it will enjoy margin gains from added scale, synergy and cross-sell**
- **With strong relationships with Telstra and Optus, the largest network independent provider of fixed-line, mobile and data services, with NBN a plus.**

Snapshot

Last Price	$3.28
Market Cap.	$403 million
52 Week High	$3.35
52 Week Low	$1.375
Sector	Telecommunication Services

Price Chart



M2 Telecommunications Group Ltd (MTU) is Australia's largest network independent provider of fixed-line, mobile and data telecommunications services. Established in 1999, listed in October 2004, M2 is head-quartered in Melbourne and employs over 400 people nationwide. M2 also provides fixed-line and 3G mobile services in New Zealand via 70% owned Black and White Group Limited.

See www.m2.com.au & related sites.

Analyst: Peter Russell

Investment Highlights

The acquisition announced today was in train last November when, in relation to its DRP share issue, M2 said it was in the early stages of due diligence to acquire the business assets (mainly customer contracts) of a telco reseller — a material transaction continuing M2's strategy of acquiring assets complementary to its core small and medium business market (SME) focus. The deal was not rushed and, now we know a few key details, it in no way disappoints.

In fact, at $70m of revenues, an expected FY12 EBITDA contribution in excess of $8m and underlying EPS contribution of around 5¢, at a cost of $24.5m payable in cash, this is M2's largest acquisition since June 2009 and done on the usual attractive terms. Clear's senior operational management will continue and employment has been offered to all other Clear employees. M2's MD and CEO Vaughan Bowen says Clear's customer base is not only sizeable but of a very high quality.

M2 has institutional backing. Its growth is now predictable as a leader in a very large niche. Our estimates, pre 1H11 results expected late February, are enhanced by Clear. There is plenty more upside to come.

Investment Fundamentals

Year-end June	FY08A	FY09A	FY10A	FY11E	FY12E
Revenue, $m	109	203	406	460	540
EBITDA, $m	9.1	13.3	31.2	43.5	52.8
EBIT, underlying, $m	7.8	11.9	28.5	37.6	45.8
NPAT, underlying, $m	5.4	8.1	18.5	26.3	32.1
EPS, underlying, ¢	6.7	9.4	16.3	21.3	25.6
EPS Growth, %	67.5	40.3	73.4	30.7	20.2
PE Ratio, x	49.0	34.9	17.7	15.4	12.8
Dividend, ¢	5.0	5.5	10.0	14.0	18.0
Franking, %	100	100	100	100	100
Dividend Yield, %	1.5	1.7	3.0	4.3	5.5

Source: Intersuisse estimates

Company Overview

Bundled telco services for SME's

M2's retail business offers a suite of unique bundled value-add telco services mainly for SMEs through a multi-brand strategy including Commander, People Telecom, Southern Cross Telco and M2 Telecom, each offering unique propositions through dedicated third party dealer channels.

Wholesaler to small telcos and ISP's

"M2 Wholesale" supplies wholesale telco services to small and medium sized telco service providers & Internet Service Providers (ISP's); Australia's largest independent data wholesaler, Wholesale Communications Group, and CDR's network services group, Unitel, were added in 2007 & 2008.

Much expanded business base

In April 2009, M2 completed the acquisition of People Telecom Ltd, followed by the acquisition of the telecoms business assets of Commander Communications Limited, finalised mid-June 2009. Maintaining the core focus of M2, both Commander and People Telecom target the small enterprise market. M2 has a proven track record of delivering consistent growth in both revenues and profit, year-on-year since 2003.

Summary Financial History

M2 Telecommunications	30-Jun-04	30-Jun-05	30-Jun-06	30-Jun-07	30-Jun-08	30-Jun-09	30-Jun-10
Balance Sheet							
Current Assets							
Cash	4.7	4.7	4.2	2.6	6.9	6.7	15.1
Debtors	1.9	2.9	6.7	7.5	21.4	50.1	55.8
Total Current Assets	**6.7**	**8.1**	**11.4**	**11.0**	**30.0**	**61.9**	**78.5**
Non Current Assets							
Total Fixed Assets	0.5	0.5	0.5	0.8	1.3	5.1	3.7
Goodwill		1.5	2.1	7.4	31.4	68.6	63.0
Total Non-Current Assets	**1.6**	**3.7**	**4.4**	**10.7**	**37.0**	**79.5**	**80.8**
Total Assets	**8.3**	**11.7**	**15.8**	**21.7**	**67.0**	**141.4**	**159.3**
Current Liabilities							
Creditors	2.4	3.3	5.2	7.2	25.7	55.8	54.2
Current Debt	0.0	0.1	0.1	0.1	1.9	3.1	5.1
Total Current Liabilities	**2.5**	**4.4**	**7.5**	**12.3**	**28.3**	**73.5**	**66.5**
Non Current Liabilities							
Non Current Debt	0.2	0.1	0.1	0.2	10.7	13.1	11.4
Total Non-Current Liabilitie	**0.2**	**0.1**	**0.1**	**0.2**	**11.1**	**19.3**	**15.8**
Total Liabilities	**2.7**	**4.5**	**7.6**	**12.4**	**39.4**	**92.9**	**82.3**
Shareholder's Equity							
Total Shareholders Equity	**5.6**	**7.2**	**8.2**	**9.3**	**27.6**	**48.5**	**77.0**
Interim DPS		**0.8**	**0.6**	**1.0**	**2.0**	**2.5**	**5.0**
Interim Franking			**100%**	**100%**	**100%**	**100%**	**100%**
Final DPS		**1.5**	**2.0**	**2.0**	**3.0**	**3.0**	**5.0**
Final Franking		**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Total Shares Outstanding		**59.4**	**59.4**	**60.2**	**78.9**	**108.5**	**121.5**
Profit & Loss							
Trading Revenue		**23.1**	**28.3**	**41.9**	**108.8**	**203.0**	**406.0**
Total Operating Expenses		-20.7	-29.8	-39.7	-100.1	-189.4	-375.0
Depreciation & amortisation		-0.4	-0.5	-0.6	-1.3	-2.1	-5.0
Interest Expense		-0.0	-0.0	-0.0	-0.3	-0.7	-2.2
EBITDA		**2.8**	**3.4**	**3.8**	**9.1**	**13.3**	**31.2**
EBIT		**2.4**	**2.9**	**3.2**	**7.8**	**11.9**	**28.5**
Reported NPAT pre abnormals		**1.8**	**2.2**	**2.4**	**5.4**	**8.1**	**18.5**
Reported EPS ¢ pre abnormals		**3.0**	**3.7**	**4.0**	**6.7**	**9.3**	**16.3**
Cash Flow							
Cash Flow from Operations							
Receipts from customers	14.6	23.2	30.4	46.9	97.8	187.1	399.1
Net cash flow from operations	**2.0**	**2.0**	**1.9**	**3.4**	**7.3**	**8.3**	**13.3**
Cash Flow from Investing							
Capital Expenditure (Purchase Pl	-0.4	-0.7	-0.4	-1.1	-0.9	-1.6	-1.8
Purchase of subsidiaries		-0.7	-0.6	-1.1	-9.3	-8.5	-3.8
Total Investing CashFlow	**-0.7**	**-1.5**	**-1.1**	**-2.0**	**-10.2**	**-10.7**	**-17.1**
Cash flow from Financing							
Proceeds: issue of securities	0.7	2.5				0.5	20.4
Total Financing CashFlow	**0.8**	**1.5**	**-1.3**	**-3.0**	**7.1**	**2.2**	**12.2**
Net increase in cash held	**2.0**	**2.1**	**-0.5**	**-1.6**	**4.2**	**-0.2**	**8.4**
EBITDA Margin		11.9%	10.2%	8.8%	8.1%	6.5%	7.7%
EBIT Margin		10.0%	8.6%	7.4%	7.0%	5.4%	6.4%
NPAT Margin		7.7%	6.6%	5.5%	4.7%	3.7%	4.0%
Return on Equity		**25.1%**	**26.7%**	**25.9%**	**18.7%**	**15.4%**	**21.0%**
Return on Assets		15.5%	13.8%	11.1%	8.1%	5.6%	11.1%
Net Debt to Equity, %	**-80.6%**	**-62.8%**	**-49.7%**	**-25.6%**	**20.9%**	**19.7%**	**2.0%**
Net Interest Cover		216.3	245.8	216.8	94.7	23.9	13.2

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Highlights of M2's History – From the 2010 Annual Report

December 1999 M2 established	**October 2004** M2 listed on ASX	**June 2005** Recorded NPAT of $1.8m, increase of 39%	**June 2006** Optus appointed M2 as its exclusively endorsed MVNE, and M2 Wholesale was established	**June 2006** Recorded NPAT of $2.18m, increase of 16%	**May 2007** Wholesale Communications Group acquired	**June 2007** Recorded NPAT of $2.41m, increase of 10%	**October 2007** Orion Telecommunications acquired

February 2008 Unitel Australia acquired **June 2008** Recorded NPAT of $5.16m, increase of 114%	**April 2009** People Telecom acquired **June 2009** Telecoms business assets of Commander acquired	**December 2009** M2 celebrated its 10th anniversary	**February 2010** 11th consecutive dividend declared **February 2010** Dividend Reinvestment Plan introduced	**March 2010** M2 added to the S&P/ASX All Ordinaries **April 2010** Optus extends exclusive MVNE endorsement of M2 to 2013	**May 2010** Share Placement completed, raising $20m **May 2010** Business assets of Clever Communications acquired	**June 2010** **Recorded NPAT of $16.16m, increase of 119%**

Intersuisse Reports — reflect M2's Outstanding Growth Story

24 July 2006	31¢	Spec Buy	Just another Ugly Duckling - or possibly a Baby Swan?
10 May 2007	62¢	Buy	Acquires Wholesale Communications Group P/L
11 September 2007	78.5¢	Buy	With Orion coming into orbit, M2's stars are in alignment
4 February 2008	78.5¢	Buy	Unitel acquisition sets up M2 to be 'best of breed' junior wholesale telco & SME supplier
18 March 2008	62.5¢	Buy	Strategic acquisitions build major growth platform; 1H08 result shows M2's mettle
26 August 2008	62¢	Buy	FY08 was another record and strategic acquisitions have built a major growth platform
8 December 2008	50¢	Buy	To buy People Telecom
14 April 2009	54¢	Buy	M2 concludes successful acquisition of People Telecom
27 August 2009	99¢	Strong Buy – all set for the next growth phase	Another record year & two big acquisitions lift revenues to over $1m a day, everyday
1 March 2010	$1.68	Strong Buy - well set for continuing revenue and margin gains	Another record result shows M2 integrating and building on its two big acquisitions
27 July 2010	$1.91	Strong Buy	Leading SME telco flags 40% FY11 growth after major acquisitions
1 February 2011	$3.28	Buy	Clear for take-off on main runway

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Since our July 2010 report, M2 has

- Completed the Bell Network acquisition
- Entered an alliance with FlexiGroup Limited (ASX: FXL) whereby FlexiGroup will provide customers of M2's Commander business with competitive finance solutions for phone systems and other office equipment.
- Acquired the telecommunications business assets of NZ-based Black & White Group Limited, in exchange for an issue of shares in the profitable M2 NZ Limited. The Black and White vendors, notably founder and MD Jonathan Eele, will hold 30% of the enlarged company and Mr Eele become MD and CEO of M2 NZ.
- Made the final payment - $1.06m – to acquire the Clever Communications assets, for a total of $4.81m.

Cornish Group Investments recently built its stake up to 7.04%, while the Hunter Hall Investment group reduced from 12.27% to 11.12%. Vaughan Bowen's interests are 8.99%. National Australia Bank is a holder of 7.08%.

We note that EBIT and NPAT are impacted by the non-cash amortisation of the value attributed to customer contracts acquired. This reduced reported NPAT by $0.75m in FY09 and $2.38m in FY10. Our estimates and prior year figures show normalised earnings struck before such amortisation; M2 has low churn and rising revenues.

Highlights of the Clear Telecoms (Aust) Pty Ltd acquisition – M2's release

The Clear assets acquired by M2 include all customer contracts, operating systems, brands and all other related intellectual property. Clear is Australia's largest privately owned provider of business telecommunications services, with nearly 20,000 small and medium business customers Australia-wide, generating annual recurring revenues of ~$70m. The deal is of a similar size to M2's purchase of the telecoms assets of Commander Communications in June 2009 and larger than the People Telecom acquisition. The acquisition brings M2's revenues over $500m, further strengthening its position as the pre-eminent challenger in the SMB telecommunications market.

The net cash consideration of $24.5m is payable in three tranches, one immediate and others in September 2011 and March 2012. The amounts of the later tranches are subject to certain minimum performance milestones, and a variable bonus consideration may also be payable if milestones are exceeded. The consideration is funded by a draw-down on M2's available debt facilities.

M2 expects the Clear assets to contribute in excess of $8 million in EBITDA in FY12. Based on this, the acquisition cost equates to approximately three times EBITDA. The underlying* earnings per share (EPS) contribution of the Clear assets in FY12 is expected to be ~5c, representing an increase of more than 20% on M2's FY11 underlying* EPS guidance released in July 2010.

M2's MD and CEO Vaughan Bowen said, "The addition of the Clear business to the M2 Group is another extremely positive step in further expanding our presence in the small and medium business telco market. The Clear customer base is not only sizable but is of a very high quality. We see considerable opportunity to add further value to the existing customers and in doing so expand both Clear's revenues and earnings contribution over the coming years".

The Industry Position of M2

The group is amongst the largest customers of both Telstra and Optus. The nationwide exclusive dealership network of Commander operates alongside the national channels which deliver the service-oriented People Telecom offering, M2 Telecom, Southern Cross and Simply Mobiles (online).

M2 has a full product suite and national coverage. Its business is built around the cost base of a (lower margin) reseller model and it is "infrastructure light" and will have no "stranded assets" post-NBN. Despite being a leader in its niche SME market, M2 has an overall telecoms market share of barely 2%. Its focus differs from that of the major telcos, which aim particularly at large corporations, larger SMEs, government and public sector clients and residential customers.

INTERSUISSE

The Impact of Clear, and Recommendation

The Clear acquisition is significant. We expect M2 to continue to pursue bolt-on and complementary opportunities, while pursuing organic growth and integration benefits of synergy, cross-sell and scale. This focused strategy, M2's low debt and sound track record of annual growth in revenue, profits and dividends – make it an easy-to-recommend stock.

Vaughan Bowen is aged 37 (Wikipedia). While he and the M2 team – several from before the ASX-listing, some from acquisitions, have come a long way already, this saga could have a great deal further to go. Clear for take-off on the main runway, take your seats!

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