INTERSUISSE INVESTMENT RESEARCH

M2 Telecommunications Group MTU 8 December 2008

M2 agrees to buy People Telecom by Scheme of Arrangement – A win-win

Recommendation: Buy

Investment Rationale

M2 marked its seventh record year in revenues, profits and dividends with several acquisitions including Orion and Unitel, to make it the largest non-infrastructure-owning telco. M2 wholesales to over 300 mobile and other resellers and ISPs, as well as directly servicing SMEs nationally. Its full range suite includes 3G mobiles (it is the 'gateway' for wholesaling Optus 3G mobile services), ADSL 2+ data transmission and Local Access Resale (the 'last mile' delivery of Telstra landline access). The FY08 acquisitions strengthened M2's back-of-house capabilities, IT and billing systems, added specific strengths and built the revenue base. M2 issued shares for Orion and took a $10m 5-year debt facility for Unitel. It ended FY08 with $27.6m net assets and $3.3m net debt. Revenues rose from $44m to $109m with EBIT up from $3.2m to $7.9m. The revenue rate is now some $160m pa. M2's pre-eminence as a wholesaler was shown in its May 2008 deal to supply People Telecom (PEO) with Optus 3G mobile services, valued at a minimum of $9m over two years.

Event

M2 is now moving to the next level with the acquisition of People Telecom by an agreed Scheme of Arrangement. This will add scale, complementary capabilities and marketing channels, building revenues over $250m annualized.

M2 will issue ~26.6m MTU shares (0.0916 MTU shares per PEO share) with a cash payment of $2m (0.6886¢ per PEO share). Further consideration up to $1m (0.344¢ per PEO share) is payable in M2 shares or cash (at M2's election) if PEO has net cash assets above a mutually agreed level a week before the meeting of PEO to agree the scheme, such payment reducing dollar for dollar that net cash is below that level. Directors of PEO have committed to support the Scheme subject to no higher offer for PEO shareholders emerging, with mutual exclusivity and break fees. Completion is expected in early April 2009.

Impact

Pre- announcement on 5 December, M2 closed at 57¢, implying market capitalization of $45m; PEO closed at 2.5¢, a capitalization of $7.3m.. Based on MTU's volume weighted average price (VWAP) of 52¢ for the 30 trading days ending 3 December, the deal values PEO shares at a minimum of 5.46¢ and up to 5.81¢. This is a premium over PEO's 30-day VWAP of from 118% to 132%.

Given the history of PEO—losses of $36.5m over the last ten years, with one profit of $2.0m in FY07 and a loss of $0.6m in FY08—such an outcome can be seen as an excellent win, particularly in the present economic conditions.

It can also be seen as a useful win for M2, which expects the acquisition to be 15% to 20% EPS accretive on an annualised basis. We expect M2 to quickly cut out corporate overheads of PEO while retaining virtually all operating staff. Consolidated revenues annualised at above $250m will add scale and strength to accelerate earnings, notably in the medium enterprise market.

With the PEO shareholders' stake in MTU being about 25% on completion, in addition to their $2-3m cash payments they will earn significant dividends from the strengthened group, a pleasure to which they are not accustomed. M2 will be able to take advantage of PEO's back-of-house capabilities, its strong NSW presence and hub, some key talent and technologies and the People brand. With these mutual benefits, greater scale, buying power and complementarity, we see the deal as an excellent solution for PEO and a strong win-win for both.

Recommendation Impact

While we expect M2 to exceed our August estimates shown in the table, the benefits will come in FY09. We strongly reaffirm our Buy recommendation for M2, expecting its EPS dilution to be more than offset by added income / growth.

Snapshot

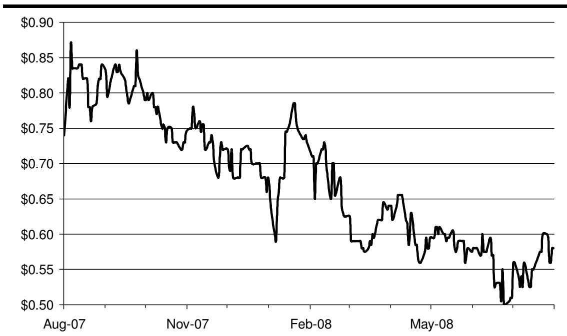
Last Price	$0.50
Market Cap.	$40 million
52 Week High	$0.82
52 Week Low	$0.465
Sector	Telecommunication Services

Investment Fundamentals

Year-end Jun	FY07A	FY08A	FY09E	FY10E
NPAT ($m)	2.4	5.4	7.6	10.2
EPS (c)	4.0	6.7	9.6	12.7
EPS Growth (%)	8.1	67.5	43.3	35.4
PE Ratio (x)	12.5	7.5	5.2	3.9
DPS (c)	3.0	5.0	6.7	8.8
Franking (%)	100	100	100	100
Dividend Yield (%)	6.0	10.0	13.4	17.6

Source: Intersuisse estimates (excluding PEO benefits)

Price Chart



Business Description

Profitable telco provider M2 (MTU) provides a full suite of network independent fixed line, mobile and data telecommunications services Australia wide and in NZ. It has a unique bundled offering targeted mainly at the Small and Medium Enterprise (SME) market and distributed through a network of dealerships and agencies. More significant growth will come from the leadership position of its wholesale services division, established on its appointment in May 2006 as the exclusively endorsed aggregator / enabler (wholesaler) of Optus mobile services to other telco service providers and ISP's. Strategic acquisitions have now rounded out complete suites of services for both wholesale telco customers (with Unitel) and SMEs (with Orion).

Analyst: Peter Russell

(See Page 2 for Disclaimer and Disclosures)

Important Information

Confidential

This document is for the confidential use of the recipients only and is not to be reproduced without the authority of Intersuisse Limited.

Disclaimer

The persons involved in or responsible for the preparation and publication of this report believe that the information herein has been obtained from reliable sources and that any estimates, opinions, conclusions or recommendations are reasonably held at the time of compilation. No warranty is made as to the accuracy of the information in this document and, to the maximum extent permitted by law, Intersuisse Limited and its related entities, their respective directors and officers ("Intersuisse") disclaim all liability for any loss or damage which may be suffered by any recipient through relying on anything contained or omitted from this document.

General Advice

The content is of a general nature and is based on a consideration of the securities alone, and as such is conditional and must not be relied upon without advice from a securities adviser as to the appropriateness to you given your individual investment objectives, financial situation and particular needs. Whilst this document is based on information and assessments that are current at the date of publication, Intersuisse has no obligation to provide revised assessments in the event of changed circumstances.

Disclosure

Intersuisse, its directors and associates disclose a relevant interest in securities mentioned in this document. Intersuisse receives commission from dealing in securities.

Analyst Certification

The analyst responsible for this research report certifies that all of the views expressed reflect his personal views about the securities or the issuer; and that no part of his remuneration was, is, or will be, related to the recommendations or views expressed by him in the report. The author has an interest in securities mentioned in this document.

Prepared by Peter Russell