

M2 Telecommunications Group

MTU

18 March 2008

Strategic acquisitions build major growth platform; 1H08 result shows M2's mettle

Recommendation: BUY

Investment Rationale

MTU is on its way to a sixth record year in revenues, profits and dividends since listing. MTU has a clear focus on profitability and a history of careful and strategic acquisitions. It is now in a position to offer the full range of telco services to small and medium businesses, nationwide buying groups, associations and mid-tier corporates, and also to small and mid-sized telecommunications service providers. With recent acquisitions Orion Telecommunications (see Intersuisse report 11.9.07) and Unitel Australia (report 4.2.08), the full range suite of MTU services includes

- 3G mobiles – MTU is the 'gateway' for Optus 3G mobile services to wholesalers
- ADSL 2+ data transmissions – the current generation of broadband services
- Local Access Resale – the 'last mile' delivery of Telstra landline access
- Together with MTU's web sales sites, 'Simply Mobiles' online mobile phone retailing and Green Mobiles – mobile phone services using the Optus 3G network.

M2 has proven performance and the platform for substantial growth. Buy!

Results for 1H08, to 31 December 2007

In 1H08 MTU built NPAT 160% from \$0.75m to \$1.95m. Revenues rose 104% from \$19.8m to \$40.7m. EBIT was up 187% from \$0.96m to \$2.75m.

Operating cash flow increased from \$1.82m to \$4.26m. Net assets grew from \$9.3m to \$25.4m with 19m shares issued for Orion adding \$15.1m to shareholders funds. With debt flat at \$0.3m, cash rose from \$2.6m in June to \$5.5m in December 2007.

EPS rose from 1.26¢ to 2.76¢. Interim franked dividend was doubled from 1¢ to 2¢.

M2 Wholesale grew strongly, with \$5.9m arising from MTU's appointment as Optus' wholesale aggregator and \$5.6m from acquisition of Wholesale Communications Group. M2 Telecom (SME retail) also grew, organically through the external agent network and with three months' contribution from Orion. EBIT margin rose to 6.7% from 4.8% in the pcp, with careful cost management and volumes improving buying. A \$274,000 non-cash charge relating to share options reduced EBIT from \$3.0m.

MTU also integrated the Tenex business customer database acquisition and grew operations in new Zealand. MTU was on track to achieve Board forecasts for FY08.

Impact of Recent Developments

Orion was Tasmanian-based and traded as Southern Cross Telco with over 25,000 customers and \$30m revenues. Its team and complementary IP systems added considerable back-of-house strength to scale up for the next growth phase of M2's small enterprise targeted business unit. Unitel Australia P/L is a leading supplier of wholesale telecommunications services to small and medium telecommunications service providers Australia-wide. Its acquisition in February put in place MTU's fixed line and local loop access strategy. M2 paid \$10m up front and will pay up to \$2.5m on performance over 36 months. MTU arranged a debt facility for this acquisition. Unitel has delivered wholesale network services since 1999 and with strong recurring revenues is forecast to be substantially earnings accretive. EPS is expected to rise by 2.9¢ annualised, on approx. \$37m revenue, taking group revenues over \$140m.

We expect strong growth in EBITDA as the recent acquisitions add to earnings and cash flow, such that interest will be over 10 times covered and the new debt will be quite swiftly paid down while meeting low capex needs and a 70% dividend payout.

MTU found no gremlins in Orion and Unitel also had thorough due diligence. Unitel notably expands MTU's wholesale customer base and confers unique IP in the supply of Local Access Resale ("LAR") services - a substantial advantage in passing full Telstra support - on faults, installations and transfers of lines – downstream to wholesale customers and their clients. Cross-sell opportunities are substantial and the bulking-up of MTU's revenues offers better buying opportunities across the group. Unitel's customers have negligible overlap with MTU's; and its 60% NSW focus and eight Sydney-based staff should mesh well into an MTU Sydney office.

Recommendation Impact

MTU's track record is endorsed by its strong 1H08 growth. Its much enlarged base and platform for growth recommend it strongly as a Buy, particularly at current prices.

Snapshot

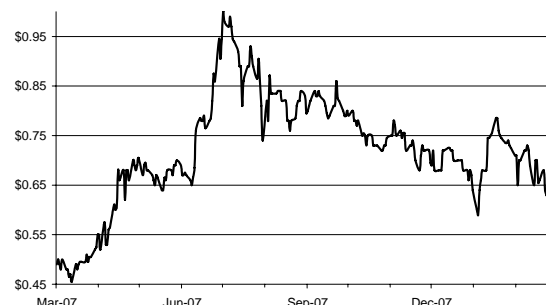
Last Price	\$0.625
Market Cap.	\$49 million
52 Week High	\$1.00
52 Week Low	\$0.455
Sector	Telecommunication Services

Investment Fundamentals

Year-end Jun	FY06A	FY07A	FY08E	FY09E
NPAT (\$m)	2.2	2.4	5.3	7.6
EPS (c)	3.7	4.0	6.7	9.4
EPS Growth (%)	16.2	8.1	67.5	40.3
PE Ratio (x)	16.9	15.6	9.3	6.6
DPS (c)	2.6	3.0	4.75	6.6
Franking (%)	100	100	100	100
Dividend Yield (%)	4.2	4.8	7.6	10.6

Source: Intersuisse estimates

Price Chart



Business Description

MTU is a profitable provider of 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. MTU also operates a 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).

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