

M2 Telecommunications Group

MTU

14 April 2009

M2 concludes successful acquisition of People Telecom

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. In our review of 8 December 2008 (Buy, 50¢) we outlined M2's agreement to acquire 100% of People Telecom Limited (PEO) by way of Scheme of Arrangement. We noted that this will add scale, complementary capabilities and marketing channels, building revenues over \$250m annualised.

Event – Acquisition of People Telecom Limited

Today M2's successful acquisition of People Telecom becomes effective. The Scheme of Arrangement was supported by ~90% of PEO shareholders on 6 April and has been approved by the Federal Court.

PEO had advised that at end March, as set out in the Scheme Implementation Agreement, its net cash holding exceeded \$4.7m and so the full \$1m Additional Consideration is; M2 elected to pay this in M2 shares. PEO shareholders thus receive 0.0916 M2 Shares plus 0.6886¢ cash per PEO share at the Record Date plus 0.0068 M2 Shares as Additional Consideration. M2 issued capital rises by 28,583,504 shares to 107.5m shares. The cash payment is \$2m.

Event – Record 1H09 Result to 31 December 2008

M2 delivered record revenue, profit and EPS, declaring its 9th dividend, at 2.5¢.

	1H 2009	1H 2008	Variance
Revenue (\$m)	87.28	40.75	Up 114%
EBITDA (\$m)	6.14	3.42	Up 78%
EBIT (\$m)	5.15	2.86	Up 80%
NPAT (\$m)	3.19	1.95	Up 63%
EPS (cents)	4.0	3.0	Up 33%
Dividend (cents)	2.5	2.0	Up 25%
Franking status	Fully franked	Fully franked	

M2 ended 1H09 with a revenue run rate of \$160m pa; PEO should add \$80m+. Cash flow was strong at \$4.7m (pcp \$4.3m). Borrowings reduced \$1m to \$9.3m with net debt \$2.1m, interest 12.5x covered by EBIT. FY09 NPAT guidance was re-affirmed at \$7.2 to \$8.0m, 48% up on FY08.

Impact

The cost of the acquisition of PEO is \$17.4m at M2's 54¢, or \$12.7m net of the cash in PEO. PEO shareholders in total will hold 26.6% of M2.

We saw the deal as a 'win-win' for both parties, and valuable M2, which expects it to be 15% to 20% EPS accretive on an annualised basis. M2 plans to quickly cut out corporate overheads of PEO while retaining virtually all operating staff. Consolidated revenues above \$250m will add scale and strength to accelerate earnings, notably in the medium enterprise market. M2 gains PEO's back-of-house capabilities, its strong NSW presence and hub, some key talent and technologies and the People brand. NBN impact should be small but positive.

Recommendation Impact

We have allowed for a PEO contribution of ~\$0.2m in FY09 and \$2.0m in FY10, below M2's target of it being >15% EPS accretive – which we have no doubt will be achieved in time. We clearly reaffirm our Buy recommendation.

Snapshot

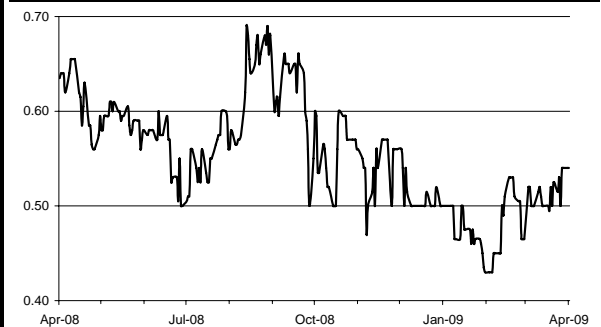
Last Price	\$0.54
Market Cap.	\$58 million
52 Week High	\$0.69
52 Week Low	\$0.43
Sector	Telecommunication Services

Investment Fundamentals

Year-end Jun	FY07A	FY08A	FY09E	FY10E
NPAT (\$m)	2.4	5.4	7.8	12.2
EPS (c)	4.0	6.7	9.1	11.2
EPS Growth (%)	8.1	67.5	43.3	35.4
PE Ratio (x)	13.5	8.1	7.6	4.8
DPS (c)	3.0	5.0	6.4	7.8
Franking (%)	100	100	100	100
Dividend Yield (%)	5.6	9.3	11.8	14.4

Source: Intersuisse estimates

Price Chart



Business Description

Profitable telco provider M2 Telecommunications Group (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 gave MTU complete suites of services for both wholesale telco customers (with Unitel) and SMEs (with Orion), now extended with people Telecom.

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