

M2 Telecommunications Group

MTU

4 February 2008

Unitel acquisition sets up M2 to be 'best of breed' junior wholesale telco & SME supplier

Recommendation: Buy

Investment Rationale

MTU is on its way to a sixth record year in revenues, profits and dividends since listing, pretty unique for a small telco. M2's focus on profitability is home grown but it has added to its success by careful acquisitions. M2 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 for small / mid-sized telecommunications service providers, with online mobile phone retailing and Green Mobiles – mobile phone services powered by the Optus 3G network. M2 has net cash and is committed to build both its strength and dividends. Buy.

FY07 results

We last reviewed MTU on 11 September 2007, as a 'Buy' at 78.5¢ as its acquisition of Orion Telecommunications Limited (OTL) neared completion. A very strategic deal, Orion was a full service telco service provider based in Hobart, trading as Southern Cross Telco with over 25,000 customers and \$30m revenues. Its Tasmanian-based team and complementary IP systems added considerable back-of-house strength to provide a scaled base of operations to support the next growth phase for M2's small enterprise targeted business unit

Now MTU has announced another key strategic acquisition, putting in place its fixed line and local loop access strategy to enable the offering of a full suite of telco products for its wholesale telecommunications unit.

MTU is to acquire Unitel Australia Pty Ltd ("Unitel"), the wholesale network services business of Commander Communications Limited (CDR). Unitel (formerly "RSL Com Partners") is a leading supplier of wholesale telecommunications services to small and medium sized telecommunications service providers Australia-wide.

M2 will pay \$10m (pre adjustments) up front and up to \$2.5m, based on performance, over 36 months, subject to agreed performance milestones. The acquisition will be funded by cash reserves and bank debt.

As an established provider of fixed line (including local access), mobile and data services, Unitel has been delivering wholesale network services since 1999, with a track record of strong recurring revenues and positive earnings.

The Unitel acquisition is forecast to be substantially earnings accretive for MTU. MTU's EPS is expected to rise by nearly 50%, or 2.9¢ annualised, on approx. \$37m additional annual revenue, taking group revenues over \$140m.

Impact

The acquisition of the Unitel network services business is a highly strategic step for MTU's fast growing network wholesaling business ("M2 Wholesale"), providing a sizable expansion to its wholesale customer base and access to certain unique intellectual property used by Unitel in the supply of Local Access Resale ("LAR") services and other core telecommunications network services. This gives MTU a substantial advantage in passing full Telstra support - on faults, installations and moves of lines – downstream to its wholesale customers and their clients.

MTU will combine this full service Telstra fixed line access with its unique Optus 3G mobile, wireless broadband and ADSL2+ data services to offer a complete suite of products to wholesale customers. The cross-sell opportunities between Unitel's and MTU's customers are substantial; the bulking-up of MTU's revenues offers better buying opportunities across the group. With no current debt, the deal can be readily cash and debt-funded; Unitel's customers have negligible overlap with MTU's; and its 60% NSW focus and eight Sydney-based staff are expected to mesh well with MTU currently opening a Sydney office. With MTU's experience, integration looks natural. Pending the half-year results we made only partial additions to our earlier estimates.

Recommendation Impact

MTU's track record and new platform for growth recommend it strongly as a Buy. We expect the 1H08 results in the last week of February to provide further evidence of the integration of recent acquisitions and prospects for profitable growth.

Snapshot

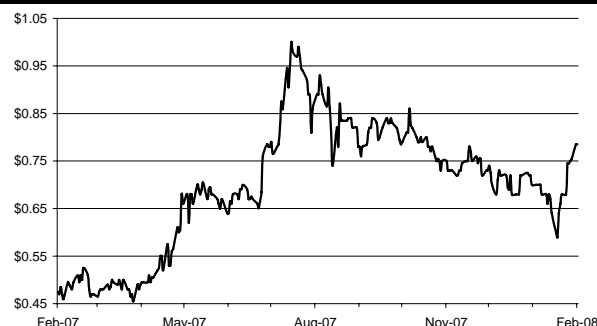
Last Price	\$0.785
Market Cap.	\$62 million
52 Week High	\$1.00
52 Week Low	\$0.435
Sector	Telecommunication Services

Investment Fundamentals

Year-end Jun	FY06A	FY07A	FY08E	FY09E
NPAT (\$m)	2.2	2.4	5.6	7.9
EPS (c)	3.7	4.0	7.1	10.0
EPS Growth (%)	16.2	8.1	77.5	40.8
PE Ratio (x)	21.2	19.6	11.1	7.9
DPS (c)	2.6	3.0	4.9	7.0
Franking (%)	100	100	100	100
Dividend Yield (%)	3.3	3.8	6.2	8.9

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 and SMEs.

Analyst: Peter Russell

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