

M2 Telecommunications Group

MTU

1 March 2010

Another record result shows M2 integrating and building on its two big acquisitions

Recommendation: Strong Buy - well set for continuing revenue and margin gains

Investment Rationale

MTU's goal is to be the pre-eminent provider of telecoms services to Australian small and medium business. Its growth since listing in October 2004 has proven this is no idle dream. The global financial crisis passed MTU by, and in FY09 it acquired both People Telecom Limited (PEO) and the small and medium business (SMB) assets and related IP of Commander Communications Limited (CDR) late in the period. It also achieved its seventh record year in revenues, profits and dividends, confirming its attraction for serious investors.

FY10 was both the biggest opportunity and challenge for MTU. It grew to well over 400 staff, with several sets of cultures, management, systems and offices to bed down, coordinate and hone to efficiency. A key focus was to adapt to run the much larger business and build efficiencies in its nationwide complementary SME, retail and wholesale services.

MTU now rates as seventh largest Australian Telco by revenue. Telstra, Optus, Vodafone Hutchison and AAPT, the top four, are followed by TPG Telecom (TPM) (TPG & Soul) and iiNet (IIN) with their own infrastructure, next MTU, Primus and Macquarie Telecom, then some 350 smaller resellers and ISPs. The National Broadband Network (NBN) aims to add infrastructure, seeking resellers.

Events – A strong record interim result shows integration success

M2 has already in the first half overcome the challenge and made an excellent start on the integration and gearing up of its major acquisitions. Numbers are somewhat ahead of our expectations and will improve further in 2H10, despite some further one-off costs, ready for a significant boost, as expected, in FY11.

\$m	1H10	1H09	% up	\$m	1H10 (U/L)	1H09	% up
Revenue	187.7	87.3	+115%	NPAT	8.19 (9.55)	3.19	+156% / +199%
EBITDA	15.35	6.14	+150%	EPS, ¢	7.5¢ (8.7¢)	4.0¢	+86% / +118%
EBIT	12.68	5.15	+146%	Div, ¢	5.0¢	2.5¢	+100%

The table shows revenue well on target, margin benefits more than expected. Underlying figures before one-off integration costs; H2 will again outperform.

The interim franked dividend is doubled to 5¢, ex-date 16 March.

FY10 guidance is \$380-400m revenue, \$29-31m EBITDA, \$14.5-15.5m NPAT (\$17.1-18.1m underlying) and 13.3-14.3¢ EPS (15.4-16.4¢ underlying).

The group is amongst the largest customers of both Telstra and Optus. It has excellent relationships with both. Commander's long-term landline-focused Telstra connections beef up those of MTU and balance the latter's mobile wholesaler role with Optus. The nationwide exclusive dealership network of Commander is a great asset alongside the national channels which deliver the service-oriented People Telecom offering, M2 Telecom, Southern Cross and Simply Mobiles (via online). MTU has a full product range and well-established nationwide coverage. It has a clear strategy to work it and build it. We have left our earnings at our 27 August 2009 level, pending an uplift, likely up to 10%.

Impact and Prospects

MTU has a market share of around 1%. Its focus on Small & Medium Enterprises (SME) targets a sector mainly serviced by Telstra by default, as most telcos aim at the larger corporations, big SMEs and residential. As MTU's expanded machine slips into higher gear, with enhanced buying and other efficiencies, large dedicated sales channels and well-known brands we expect strong growth in revenues and margins. A 33% net debt to equity and over 12 times interest cover allows MTU to return to acquisition after a self-imposed six-month pause to digest the PEO and CDR acquisitions. We expect M2 to exceed our figures.

Recommendation Impact

An easy to recommend Buy, particularly for sound growth in a volatile market.

Snapshot

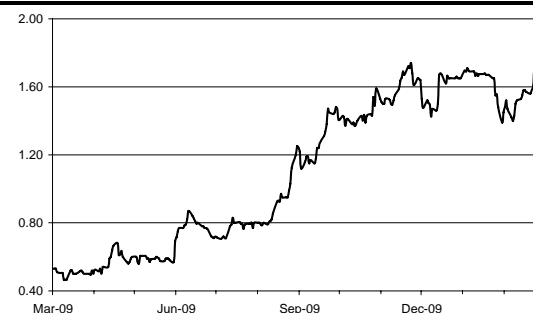
Last Price	\$1.68
Market Cap.	\$185 million
52 Week High	\$1.83
52 Week Low	\$0.455
Sector	Telecommunication Services

Investment Fundamentals

Year-end Jun	FY08A	FY09A	FY10E	FY11E
Revenue (\$m)	109	203	385	481
EBITDA (\$m)	9.1	13.3	30.0	40.5
EBIT (\$m)	7.8	11.6	23.9	34.9
NPAT (\$m)	5.4	7.9	15.5	23.4
EPS (¢)	6.7	9.4	14.0	21.0
EPS Growth (%)	67.5	40.3	48.9	50.0
PE Ratio (x)	25.1	17.9	12.0	8.0
Dividend (¢)	5.0	5.5	10.0	15.0
Franking (%)	100	100	100	100
Dividend Yield (%)	3.0	3.3	6.0	8.9

Source: Intersuisse estimates

Price Chart



Business Description

M2 Telecommunications Group Limited (MTU) is Australia's largest network independent provider of fixed-line, mobile & data telecommunications services. MTU also provides fixed-line & 3G mobile services in New Zealand.

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. "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. See www.m2.com.au and related company sites, such as: • www.commander.com.au • www.peopletelcom.com.au

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