

# M2 Telecommunications Group



## Bolt-on adds 5% to FY11 earnings

M2 Telecommunications (MTU) has acquired the small and medium (SMB) business assets and customer contracts of Bell Networks for \$4m in cash. The transaction represents the second 'bolt-on' acquisition for MTU in as many months after acquiring the SMB assets of Clever Communications in May.

Price: A\$1.79

Code: MTU

### Key Financial Information

Y/E June		2008A	2009A	2010F	2011F	2012F
Revenue	\$m	109.0	202.5	388.8	431.9	460.0
EBITDA	\$m	8.8	13.1	32.5	42.7	46.9
Reported NPAT	\$m	5.2	7.5	17.6	25.3	28.6
Normalised NPAT	\$m	5.3	8.3	20.3	28.3	31.6
EPS (adj)	CPS	7.2	9.4	18.0	23.0	25.8
EPS Growth	%	82.4	30.5	90.5	28.1	11.8
PER	x	24.7	18.9	10.0	7.7	6.9
EV/EBITDA	x	16.3	15.5	6.8	5.0	4.3
DPS	c	5.0	5.5	11.0	14.5	16.5
Yield	%	2.8	3.1	6.2	8.1	9.2

### Stock Data

Market Capitalisation	\$216m
Issued Capital	121.5
Volume (monthly average)	2.8m
12-month low	\$0.70
12-month high	\$1.97

### Market Data

Small Ordinaries	2344
S&P ASX 200	4505
All Ordinaries	4517

### Valuation & Pricing Data

DCF Valuation	\$2.40
EBITDA Multiple	\$2.08
PE Multiple	\$2.43
<b>12 Month price Target</b>	<b>\$2.50</b>

### Share Price Drivers

Results	↑
Acquisitions	↑
Dividends	↑
NBN	↑↓

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### Bell Networks is an established telco reseller

Bell Networks is a reseller of telecommunications services to the SMB market and an existing wholesale customer of M2 Wholesale. The acquisition of Bell Networks by MTU will add annualised revenues of approximately \$6m and EBITDA of \$2m.

### Acquisition 5.1% EPS accretive

MTU will pay up to \$4m in cash for the SMB assets and customer contracts of Bell Networks which represents a purchase price of 2x EBITDA. With the acquisition effective 1 August 2010, we have upgraded our FY11 and FY12 EPS forecasts by 5.1% and 4.8% respectively to 23.0cps and 25.8cps.

### Acquisition war chest being fired

Having raised \$20m in May at \$1.80 per share, the acquisition of Bell Networks is consistent with MTU's acquisition strategy of utilising its established distribution and infrastructure to make highly accretive 'bolt-on' acquisitions. In May MTU acquired the SMB assets and customer contracts of Clever Communications for up to \$5.0m which represented an effective purchase multiple of 2.2x EBITDA.

### Valuation upgraded by 4.2% to \$2.50 per share

We rate MTU as an attractive investment trading on a FY10 PER of 10.0x and FY11 PER of 7.7x. Our DCF valuation of \$2.50 per share implies a 42% premium to the current market price. In addition to the 5.0c interim dividend, we are expecting a 6.0c final dividend taking the full year dividend to 11.0cps. This implies a yield of 6.2% and should provide support to the stock at current levels.

# FINANCIALS SUMMARY

M2 Telecommunications Group	Price	\$ 1.79							
	Market Cap	\$ 216.9							
					Year end 30 June				
<b>Profit &amp; Loss (\$m)</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>	<b>Valuation ratios</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
Sales Revenue	202.5	388.8	431.9	460.0	EPS (cps)	8.6	15.6	20.6	23.3
EBITDA	13.1	32.5	42.7	46.9	EPS (cps) - pre-amort	9.4	18.0	23.0	25.8
Depn & Amort	1.3	2.6	2.8	3.1	PER (x)	18.9	9.9	7.7	6.9
Amort - Identifiable Intangibles	0.8	2.7	3.0	3.0	PER Rel - All Ind.	33%	-32%	-34%	-37%
EBIT	11.0	27.1	36.8	40.8	PER Rel - Small Ind.	26%	-26%	-30%	-33%
Net Interest Expense	-0.5	-2.0	-0.7	0.1	Enterprise Value (\$m)	203.2	221.9	212.8	202.1
NPBT	10.5	25.1	36.1	40.9	EV / EBITDA (x)	15.5	6.8	5.0	4.3
Tax expense	-3.0	-7.5	-10.8	-12.2	EV / EBIT (x)	18.5	8.2	5.8	4.9
NPAT - reported	7.5	17.6	25.3	28.6	DPS (cps)	5.5	11.0	14.5	16.5
NPAT - Pre Amort Intangibles	8.3	20.3	28.3	31.6	Dividend Yield (%)	3.1%	6.2%	8.1%	9.2%
+/- Significant Items	0.0	0.0	0.0	0.0	Franking (%)	100%	100%	100%	100%
Underlying NPAT - Pre-Amort	8.3	20.3	28.3	31.6	CFPS (cps)	10.4	12.6	28.9	26.1
					P / CFPS (x)	17.2	14.2	6.2	6.8
<b>Cash Flow (\$m)</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>	<b>Profitability ratios</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
Operating EBITDA	13.1	32.5	42.7	46.9	EBITDA Margin (%)	6.5	8.4	9.9	10.2
- Interest & Tax Paid	3.5	9.6	11.5	12.2	EBIT Margin (%)	5.4	7.0	8.5	8.9
+/- change in Work. Cap.	-1.0	3.3	4.9	0.7	ROE (%)	15.4	23.5	30.0	30.5
- other	-0.5	12.0	0.6	3.4	ROA (%)	8.1	18.7	24.3	27.0
Operating Cashflow	9.1	14.2	35.5	32.0	ROIC (%)	21.9	31.9	33.5	35.1
- Capex	-0.9	-3.0	-3.0	-2.5					
- other	0.0	-15.3	-7.6	0.0	<b>Balance Sheet ratios</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
- equity	-9.7	0.0	0.0	0.0	Net Debt (cash)	9.6	5.0	cash	cash
Free Cashflow	-1.6	-4.1	24.9	29.5	Net Gearing (%)	19.7	6.7	cash	cash
- Ord Dividends	-4.3	-12.7	-15.8	-18.8	Interest Cover (x)	28.4	15.9	60.7	cash
- Equity /other	0.5	21.3	0.0	0.0	NTA per share (\$)	0.0	0.0	0.0	0.0
Net Cashflow	-5.4	4.6	9.1	10.7	Price / NTA (x)	-21.8	-6.8	-0.9	12.7
Cash at beginning of period	6.9	6.7	5.3	4.1	EFPOWA (m)	87.4	112.8	122.8	122.8
+/- borrowings / other	6.0	-6.0	-10.3	0.0					
Cash at end of period	7.5	5.3	4.1	14.8	<b>Growth ratios</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
					Sales revenue (\$m)	85.8%	92.0%	11.1%	6.5%
<b>Balance Sheet</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>	EBITDA (\$m)	47.8%	148.5%	31.3%	9.9%
Cash	6.7	5.3	4.1	14.8	EBIT (\$m)	44.9%	147.2%	35.6%	11.0%
Inventories	2.6	1.6	1.8	2.0	NPAT (\$m)	45.0%	134.9%	43.9%	13.3%
PP&E	5.1	6.7	7.8	8.0	EPS adj. (cps)	30.5%	90.5%	28.1%	11.8%
Debtors	50.1	48.6	49.7	52.9	DPS (cps)	10.0%	100.0%	31.8%	13.8%
Intangibles	70.3	81.9	85.5	81.7					
Other assets	6.7	6.5	6.5	6.5	<b>Interim Analysis</b>	<b>2H09A</b>	<b>1H10F</b>	<b>2H10F</b>	<b>1H11F</b>
Total Assets	141.4	150.5	155.4	165.8	Revenues	115.4	187.7	201.1	202.7
Borrowings	16.3	10.3	0.0	0.0	EBITDA	7.1	15.3	17.2	19.0
Trade Creditors	55.8	56.4	62.6	66.7	EBITDA margin (%)	6.1%	8.1%	8.6%	9.4%
Other Liabilities	20.8	8.8	8.2	4.8	EBIT	6.0	12.6	14.5	17.6
Total Liabilities	92.9	75.4	70.8	71.5	EPS (adj)	5.7	8.7	9.7	12.2
NET ASSETS	48.5	75.1	84.6	94.4	DPS	5.0	5.0	6.0	6.5
<b>Board of Directors / Substantial Shareholders</b>					<b>Valuation</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
Name	Shareholding	%			Normalised EBITDA multiple (x)				
Craig Farrow - Chairman	1.0	0.8%			EBITDA (\$m)	13.1	32.5	42.7	46.9
Vaughan Bowen - CEO/MD	10.9	8.9%			Target EBITDA multiple (x)	8.1	8.0	7.0	6.3
Max Bowen - Non-Executive Director	0.0	0.0%			Net Debt (cash) (\$m)	9.6	5.0	-4.1	-14.8
Dennis Basheer - Non Executive Director	5.0	4.1%			Implied Valuation	96.3	254.9	302.7	310.3
John Hynd - Non Executive Director	2.8	2.3%			<b>Per Share</b>	<b>0.85</b>	<b>2.08</b>	<b>2.46</b>	<b>2.53</b>
Michael Simmons - Non-Executive Director	0.0	0.0%			<b>Target PE Multiple</b>				
					EPS (c)	9.4	18.0	23.0	25.8
<b>Substantial Shareholders</b>	<b>Shareholding</b>	<b>%</b>			PER Target (x)	15.0	13.5	11.0	10.3
Hunter Hall	13.2	11.7%			<b>Per Share</b>	<b>1.42</b>	<b>2.43</b>	<b>2.54</b>	<b>2.65</b>
Vaughan Bowen	10.9	9.7%							
National Australia Bank	8.6	7.6%			<b>Discounted Cash Flow</b>				
					Cost of equity	14.9% WACC			14.3%
<b>Top 20 Shareholders (pre-\$20m placement)</b>	<b>60.0</b>	<b>48.8%</b>			Cost of debt	7.5% Terminal Growth Rate			3.0%
					Net Debt/ Net debt + equity	6.3% Per Share			2.50



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## RESEARCH

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**Stock Recommendations:**

STRONG BUY – Minimum expected upside is 40% over 12-months.

BUY - Minimum expected upside is 20% over 12 months.

HOLD – Minimum expected upside is 5% over 12 months.

REDUCE - Expected upside is below 5% over 12 months.

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