M2 TELECOMMUNICATIONS GROUP

PATERSONS
THE AUSTRALIAN STOCKBROKER

RESEARCH NOTE

Seasoned Acquirer

Initiation of Coverage

- **MTU is Australia's largest network-independent provider of fixed line, mobile, mobile broadband and data services. Operating as a reseller, MTU primarily utilises Telstra's and Optus' networks to provide retail (targeting SMB's) and wholesale (small ISP's) services.**

- **The ACCC's interim access determinations (IADs) for the price of fixed line telecommunications services provide significant cost savings for MTU. Lower access pricing, contributions from acquisitions and organic growth underlie our forecasts for 53.6% and 38.9% EPS growth in FY11 and FY12 respectively. We rate the stock a BUY with a target price of $4.35.**

- **NPAT up 40.2% in the 1H11, FY11 guidance upgraded.** MTU reported 1H11 EBITDA of $20.1m (up 31.4%) and NPAT of $11.5m (up 40.2%). Management guidance for FY11 EBITDA was recently upgraded to EBITDA of between $48.5 - $50.0m. The upgrade came as a result of lower access prices and the recent acquisitions of Clear Telecoms (Clear) and the mobile assets of Austar United Mobility Pty Ltd (AUSTAR). We forecast FY11 EBITDA of $49.1m which implies growth of 56.0%.

- **ACCC's IADs a significant win for resellers.** The most notable determination is a fall in the wholesale line rental rate on business lines from $26.93 to $22.10 per line per month. A significant portion of MTU's costs of sales are access charges paid to Telstra. Annual savings from the determinations imply between $10.0m and $15.0m EBITDA benefit.

- **Seasoned acquirer.** MTU has undertaken numerous strategic acquisitions since 2007. Key acquired brands include Commander, People Telecom, Southern Cross Telco and Clear Telecoms. With significant integration expertise and a highly fragmented telecommunications market, we believe MTU will continue to acquire business assets tailored towards SMB's.

Year End June 30	2009A	2010A	2011F	2012F	2013F
Reported NPAT ($m)	7.4	16.2	27.5	38.5	46.3
Recurrent NPAT ($m)	7.4	16.2	27.5	38.5	46.3
Recurrent EPS (cents)	8.6	14.4	22.1	30.8	37.0
EPS Growth (%)	24.2	66.9	53.6	38.9	20.4
PER (x)	41.2	24.7	16.1	11.6	9.6
PEG	1.7	0.4	0.3	0.3	0.5
EBITDA ($m)	13.2	31.4	49.1	67.1	75.5
EV/EBITDA (x)	23.8	12.7	9.6	6.8	5.7
Free Cashflow	7.4	12.4	27.5	42.4	51.9
FCFPS (cents)	8.7	11.1	22.1	33.9	41.5
PFCF (x)	41.2	32.1	16.1	10.5	8.6
DPS (cents)	5.5	10.0	15.7	21.8	26.3
Yield (%)	1.5	2.8	4.4	6.1	7.4
Franking (%)	100.0	100.0	100.0	100.0	100.0

8 April 2011

12mth Rating		**BUY**
Price	A$	3.56
Target Price	A$	4.35
12m Total Return	%	26.6
RIC: **MTU.AX**		BBG: **MTU AU**
Shares o/s	m	123.2
Free Float	%	91.0
Market Cap.	A$m	438.4
Net Debt (Cash)	A$m	26.1
Net Debt/Equity	%	31.0
3m Av. D. T'over	A$m	0.87
52wk High/Low	A$	3.83/1.52
2yr adj. beta		1.25

Valuation:

Methodology		Blended
Value per share	A$	4.35

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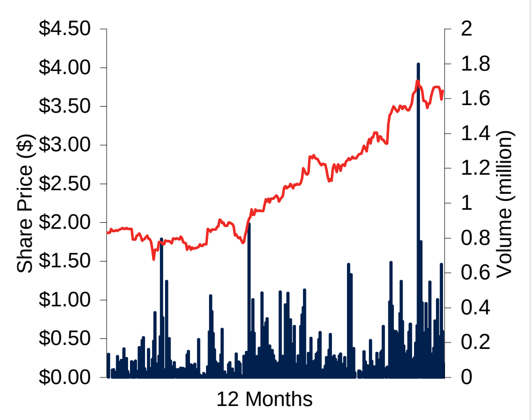
12 Month Share Price Performance



Performance %	1mth	3mth	12mth
Absolute	-1.4	25.6	94.1
Rel. S&P/ASX 300	-2.6	25.2	108.1

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Investment Summary

Network-independent provider of telecommunication services

MTU is Australia's largest network-independent provider of fixed line, mobile, mobile broadband and data services. Operating as a reseller, MTU primarily utilises Telstra's and Optus' networks to provide retail (targeting SMB's) and wholesale (small ISP's) services.

SMB focus

MTU's Retail division comprises multiple brands offering a wide range of telecommunications services tailored towards SMB's. The sales process is supported by a national network of dealerships (Commander and People Telecom dealerships) and internal sales teams. Alternatively, MTU's Wholesale division comprises a full service wholesale offering to reseller telecommunication companies and specialised internet service providers who in turn offer services to their respective customer bases.

Strong earnings history and outlook

MTU has delivered nine consecutive years of earnings and dividend growth. During FY06 to FY10, MTU has achieved EBITDA growth at a compound annual growth rate (CAGR) of 56.0%. We forecast EBITDA growth of 56.1% in FY11 and 36.7% in FY12.

ACCC determinations a significant win for resellers

The ACCC recently issued interim access determinations (IADs) for the pricing of fixed line telecommunication services between Telstra and resellers. The most notable determination for MTU is a fall in the wholesale line rental rate on business lines from $26.93 to $22.10 per line per month.

The IADs provide significant cost savings for MTU. Annual savings from the IADs imply between $10.0m and $15.0m EBITDA benefit.

Clear Telecoms a large, complementary asset

The acquisition of Clear Telecoms (Clear) in February 2011 is MTU's most significant transaction since the Commander acquisition in June 2009. Clear was Australia's largest privately owned provider of business telecommunications services, with nearly 20,000 SMB customers. Consideration was $24.5m (funded by a draw down of debt). On an annualised basis, Clear is expected to generate revenue of approximately $70.0m and EBITDA of $8.0m.

Well placed to continue growing in pre and post NBN environment

We believe MTU will continue to act as a re-seller / wholesale provider of telecommunication services under the National Broadband Network (NBN). As opposed to acquiring services from Telstra, MTU may elect to acquire services from NBNCo. Alternatively, MTU may elect to acquire services from an aggregator such as Telstra or Optus.

Hence little change to MTU's business model is anticipated, however pricing will be a key consideration. While explicit pricing for SMB's has not been provided by NBNCo, we do not expect much change from pricing levels set by the ACCC.

Attractively priced, strategically well positioned, conservatively geared

We value MTU at $4.35 which is derived by equal weighting our relative multiple valuation ($3.84) and our DCF valuation ($4.86). MTU offers investors exposure to the SMB telecommunications sector with a 3 year compound average EPS growth rate of 37.0%. A conservative balance sheet provides room for more acquisitions going forward.

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1H11 Financials

MTU reported 1H11 revenue of $215.7m and EBITDA of $20.1m (up 14.9% and 31.4% on the prior corresponding period).

Figure 1: Financial Performance

$m	1H10	1H11	% Change
Revenue	187.7	215.7	14.9
EBITDA	**15.3**	**20.1**	**31.4**
EBIT	12.7	17.4	37.0
NPAT	**8.2**	**11.5**	**40.2**
EPS (cents)	7.5	9.3	24.0

$m	1H10	1H11
Operating Cashflow	**5.6**	**24.1**
Capital Expenditure	(0.5)	(0.8)
Free Cashflow	**5.1**	**23.4**
Net Change in Cash	**(1.0)**	**4.5**

Source: M2 Telecom., Patersons Securities

Figure 2: Balance Sheet

$m	1H10	1H11
Cash	5.7	19.5
Receivables	54.7	57.2
Intangibles	66.3	76.9
Total Assets	**143.0**	**172.0**
Creditors	53.8	65.7
Gross Debt	23.7	14.0
Shareholder Equity	**54.3**	**84.1**
Net Debt (Cash)	18.0	(5.5)
NTA ($/share)	(0.11)	0.06

Source: M2 Telecom., Patersons Securities

Organic growth in MTU's core businesses contributed circa 70% of the revenue growth. The remaining growth was derived from the Clever, Bell and Black & White (NZ) acquisitions. The Retail division grew revenue by 4.1% to $119.6m while the Wholesale division grew revenue by 32.1% to $96.1m.

During the period, MTU successfully integrated the assets of Clever, Bell Networks and Black & White (NZ) into the Group and expanded the dealer channels of Commander and People Telecom.

At the Group level, EBITDA margins improved to 9.3% from 8.2%. Expansion of margins was delivered from improving business efficiencies (e.g. synergies from integrating acquisitions) and as a result of improved wholesale buying economies.

While segmental EBITDA is not reported by the Company, the Retail division contributed 70.2% of earnings before corporate costs to the Group (Retail $8.9m vs Wholesale $3.8m). Group NPAT was $11.5m, implying 40.2% growth. Despite dilution from the May 2010 capital raising, EPS growth was 24.0%.

A fully franked interim dividend of 7.0cps was declared (up from 5.0cps in 1H10). This was in accordance with MTU's intention to pay out circa 70.0% of NPAT.

Operating cash flows improved to $24.1m from $5.6m. An $11.8m increase in payables had a significant impact on the stronger cash flow. With minimal change in capital expenditure levels, 1H11 free cash flow improved to $23.4m.

After considering $6.3m of acquisitions and investments, $5.5m of deferred consideration, $7.1m of dividends paid, equity and debt movements, net cash generated was $4.5m.

MTU's cash balance was $19.5m as at 31 December 2010 while gross debt was $14.0m. However, acquisitions to the value of $31.5m have been finalised after the balance date. As such a clearer view of net debt is provided by our FY11 forecast of $26.1m.

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FY11 Outlook

Management recently upgraded guidance for FY11 to: revenue of $450m - $470m; EBITDA of $48.5 - $50.0m; and NPAT of $26.5 - $28.0m. The upgrade came as a result of material improvements in MTU's wholesale purchasing arrangements for certain services (ACCC determinations discussed on page 10) and due the recent acquisitions of Clear Telecoms and the mobile assets of Austar United Mobility Pty Ltd.

Growth going forward will be driven from MTU's extensive dealer channels (over 500 sales people in Commander and People Telecom dealerships) and improving business efficiencies. MTU's increasing scale will also aid wholesale buying economies where MTU may negotiate a better price from carriers.

In particular, MTU anticipates further leverage from its Australia-wide dealer channel. In recent times, MTU has worked to expand these dealer channels with an 'intensive development program introduced to further equip dealer channels to procure more customers, including structured sales training, lead generation etc'.

Our forecasts for FY11 through FY13 are as follows:

Figure 3: Forecast Profit & Loss

	2010A	2011F	2012F	2013F
Total Income	**406.1**	**465.0**	**549.8**	**583.8**
EBITDA	**31.4**	**49.1**	**67.1**	**75.5**
Depreciation	(1.5)	(2.3)	(3.5)	(4.1)
Amortisation	(3.5)	(4.5)	(5.5)	(2.2)
EBIT	**26.5**	**42.4**	**58.1**	**69.2**
Interest	(2.0)	(2.2)	(2.0)	(1.6)
Operating Profit	24.5	40.2	56.1	67.6
Tax expense	**(8.0)**	**(12.7)**	**(17.7)**	**(21.3)**
Minority Interest	0.0	0.0	0.0	0.0
NPAT	16.5	27.5	38.5	46.3
Normalised NPAT	**18.5**	**30.6**	**42.2**	**47.8**

Source: Patersons Securities

With full year contributions from Clever and Bell Networks and part year contributions from AUSTAR, Clear and Edirect, we forecast FY11 revenue of $465.0m (14.5% growth) and EBITDA of $49.1m (56.1% growth). EBITDA margins are expected to improve to 10.6% (from 7.7%) as a result of improving cost efficiencies within the Group and significantly lower access prices.

We forecast FY11 EPS and DPS to be 22.1 cps and 15.7 cps respectively. Our expectation for dividend payout is in line with the historic 70% payout of NPAT.

Improvement in MTU's operating cash flow is expected, FY11 $35.5m versus FY10 $13.3m. Our expectation for capital expenditure in FY11 is $8.0m which is largely expenditure on a new business support system. After considering the AUSTAR, Clear and Edirect acquisitions, we forecast a net cash outflow of $6.3m. Net debt at 30 June 2011 is expected to be $26.1m.

Additional complementary acquisition targets will no doubt be looked at by MTU. As with prior acquisitions, we expect targets would be businesses with SMB assets or wholesale offerings.

In the short term, risks relate to the integration of the AUSTAR, Clear and Edirect acquisitions and the implementation of the new business support system (will allow for the current 5+ billing systems to be rolled into one platform). Offsetting factors to these risks are; MTU has a good history of successfully integrating both large and small businesses; and MTU has contracted a UK based firm who specialises in billing system builds (successfully rolled out over 40 telecommunications platforms around the world). MTU has set up a special internal team to roll out the system so day to day processes are not inhibited.

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Valuation

MTU's core business is reselling and wholesaling telecommunication services. We have included other listed Australian telecommunications providers in MTU's peer group. This is summarised below:

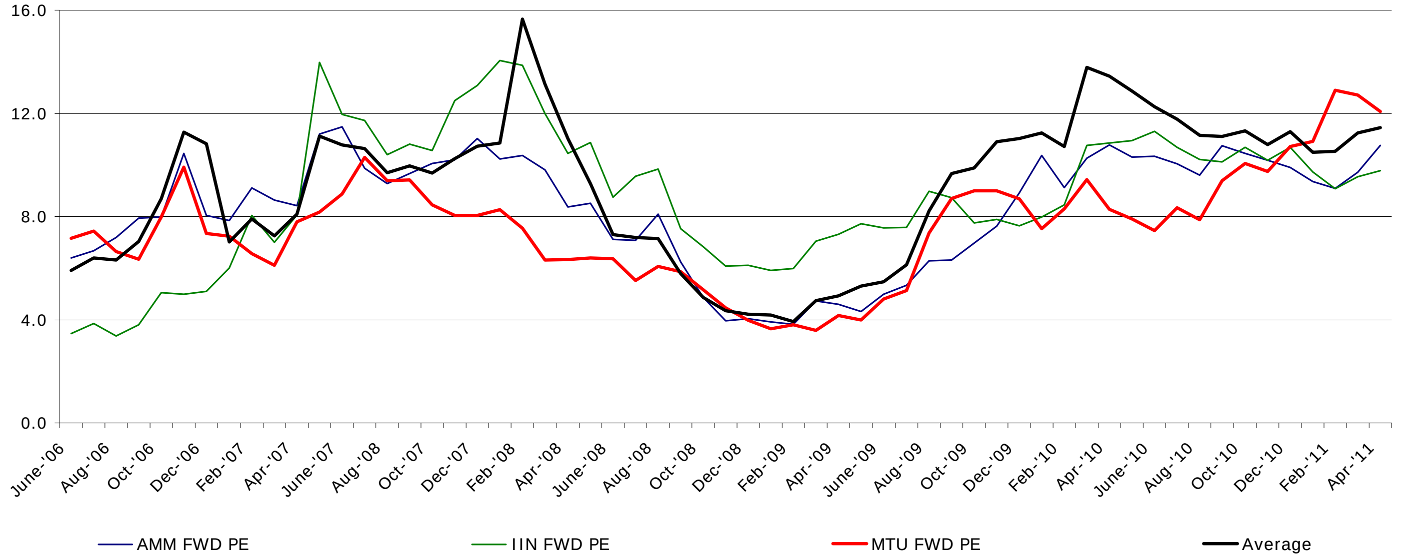
Figure 4: Peer group relative multiples

Code	Company	Market Cap. $m	3 year EPS CAGR %	EV/EBITDA (x) FY11	EV/EBITDA (x) FY12	EV/EBITDA (x) Hist Ave	PE (x) FY11	PE (x) FY12	PE (x) Hist Ave
TPM	TPG Telecom	1,349	23.5	6.9	6.1	7.3	17.9	11.6	14.1
IIN	iiNet Ltd	417	8.9	4.7	4.3	4.3	10.6	9.7	10.2
AMM	Amcom Telecom.	269	12.4	9.7	8.3	6.6	12.5	10.8	12.9
MAQ	Macquarie Telecom.	239	40.7	5.3	4.4	na	13.7	11.8	na
	Average		**21.4**	**6.7**	**5.8**	**6.1**	**13.7**	**11.0**	**12.4**
MTU	M2 Telecom.	443	37.0	9.2	6.8	4.2	16.3	11.7	7.6

Source: Patersons Securities, Bloomberg consensus estimates

MTU is currently trading on 11.7 times our forecast FY12 PE. This is above the current peer group average and is above MTU's historical average.

Figure 5: Peer group historic forward EV/EBITDA, June 2006 to current



Source: Patersons Securities, Bloomberg consensus estimates

We estimate MTU has historically traded at an average multiple of around 7.6 times PE since June 2005. MTU is therefore currently trading at a significant premium to historic levels. We believe reasons for this include MTU's improving organic growth outlook, recent accretive acquisitions and positive sentiment from the ACCC determinations. We forecast MTU to generate a 3 year EPS CAGR of 37.0% which is clearly above the current sector average.

We have used 12.5 times PE as our target multiple for MTU. Applying this to our $0.31 FY12 EPS forecast equates to a target value of $3.84 per share.

We value MTU at $4.86 on a Discounted Cash Flow basis. The DCF considers MTU's long term growth prospects using a long term growth rate of 3.0% and a weighted average cost of capital 11.2%.

Equal weighting the relative multiple valuation and the DCF valuation results in our 12-month price target of $4.35.

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Company Overview

M2 Telecommunications Group Ltd (MTU) is Australia's largest network-independent provider of retail and wholesale fixed line, mobile, mobile broadband and data services. MTU was founded in 1999 and listed on the ASX in 2004. The Company is headquartered in Melbourne with offices in Adelaide, Brisbane, Hobart, Perth, Sydney and Wollongong.

Via both organic and acquisitive growth, MTU has recorded nine consecutive years of growth in earnings and dividends per share.

MTU's goal is to be the 'pre-eminent provider of telecoms services to Australian small and medium businesses (SMBs), reseller telcos and Internet Service Providers (ISPs)'.

As opposed to the traditional business model for telecommunication companies, MTU owns minimal infrastructure and hence requires low ongoing capital expenditure. The Company instead utilises the networks of larger market participants. Telstra's networks are used for phone and data services with Optus' networks providing the basis for mobile services.

MTU operates retail (small and medium sized businesses), wholesale (small and medium sized telecommunications service providers) and secondary (other selected consumer segments and mid sized corporates) offerings.

MTU's business model is structured under the Retail and Wholesale divisions. Within the 1H11, Retail contributed revenue of $119.6m (55.4% of total revenue) and earnings before corporate costs of $8.9m (70.2% of total). Wholesale contributed revenue of $96.1m and earnings before corporate costs of $3.8m.

In terms of product splits, fixed line services form a large proportion of MTU's total revenue (approximately 70.0%). Mobile services contribute approximately 20.0% of total revenue with data services contributing the balance.

The key brands encompassed within MTU are briefly described below.

Figure 6: MTU's key brands

Source: M2 Telecom.

MTU's scale and distribution capability is a clear competitive advantage. With increasing scale, we believe MTU has opportunity to negotiate better prices from carriers going forward. This coupled with MTU operating one of, if not Australia's largest dealer network away from Telstra, places the Company in good stead to generate new business and retain current customers.

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Retail Division

MTU's retail division comprises multiple brands offering a wide range of telecommunications services tailored towards SMB's. Services offered include voice (single fixed line business phones through to Multiline phone services), mobile plans (cap, fleet, Blackberry, mobile broadband etc) and internet (ADSL, mobile and business grade data).

The sales process is supported by a national network of dealerships (Commander and People Telecom dealerships) and internal sales teams. The majority of customers are signed onto contract with average tenures between 18 and 24 months (phone system contracts tend to be 24+ months). As such a large proportion of MTU's revenue is recurring.

Division revenue in FY10 was $251.5m while annualised revenue is now approximately $280.0m on our estimates. This compares favourably to FY09 revenue of $112.2m and FY08 revenue of $51.9m.

Recent data on revenue splits by product have not been provided by MTU, however, we don't expect the current split to be too different from the 1H10 figures. Within this period, fixed line services contributed approximately 72.0% of revenue with mobile contributing 16.0% and data contributing the balance.

We expect mobile and data to increase their contributions relative to fixed line over time. However, we believe fixed line services will continue to be the mainstay product for SMB's into the medium term with fixed to mobile substitution being more relevant to retail consumers (households and to some extent home offices etc).

Organic growth within MTU's key brands has been a contributor to the strong Group growth in the past, however the bulk of growth may be construed as a result of numerous acquisitions. MTU has undertaken numerous strategic acquisitions since 2007 the most recent being the acquisition of Clear. Details of MTU's recent acquisitions are included in Appendix 1.

The acquisition of Clear in February 2011 is MTU's largest transaction since the Commander acquisition in June 2009. Clear was Australia's largest privately owned provider of business telecommunications services, with nearly 20,000 SMB customers.

The assets acquired include all customer contracts, operating systems, brands and all other related intellectual property.

Consideration was $24.5m (funded by a draw down of debt) payable in three tranches, the first immediately, with the remaining tranches payable in September 2011 and March 2012. The amount of the remaining tranches is subject to certain minimum performance milestones being achieved. A variable bonus consideration may also be payable in the event that specific milestones are achieved.

On an annualised basis, Clear is expected to generate revenue of approximately $70.0m. In FY12, MTU anticipate Clear to contribute EBITDA of $8.0m. The implied multiple paid was therefore circa 3.0x FY12 EBITDA.

After considering the Clear acquisition, we expect the Retail division to contribute circa 75.0% to Group earnings.

Growth in the division will be driven by the Commander and People Telecom brands. Commander targets businesses that are in a state of change (upgrading systems, moving locations etc). People Telecom operates a 'disrupter' model challenging businesses current systems and offering improved and personalised services.

Telstra is the clear market leader in the SMB market with 80+% market share. We believe MTU will look to improve on its 4 - 5% SMB market share by targeting the smaller end of the market (5 - 50 people businesses) where Telstra is less likely to be aggressively competing (current concentration in retail broadband and mobile).

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Wholesale Division

MTU's Wholesale division (branded under M2 Wholesale) comprises of a full service wholesale offering to reseller telecommunication companies and specialised internet service providers. Core products include fixed line, 3G mobile, mobile broadband, ADSL (1-2+) and business grade data.

M2 Wholesale allows customers to incorporate mobile, voice and data services into their existing product offerings. The Company may then in turn offer those services through their existing sales channels under their own brand name.

The sales process is supported by an internal sales and account management team. Wholesale customers are normally signed onto a 12 month contract with specified supply terms.

Division revenue in FY10 was $154.7m while annualised revenue is now approximately $185.0m on our estimates. This compares favourably to FY09 revenue $90.3m and FY08 revenue of $57.4m.

Recent data on revenue splits by product have not been provided by MTU, however, we don't expect the current split to be too different from the 1H10 figures. Within this period, fixed line services contributed approximately 62.0% of revenue with mobile contributing 29.0% and data contributing the balance.

The driver behind the change of these statistics is dependent on MTU's wholesale customers and what their respective client bases are requesting. Organic growth within the Wholesale division is determined by signing on new customers and from current customers requesting additional services on the back of their organic growth.

The division was established in 2006, after MTU signed an exclusive endorsement to be the wholesale aggregator of Optus third generation (3G) mobile services. As the first and exclusively endorsed Optus Mobile Virtual network Enabler (MVNE), M2 Wholesale can provide 'a smooth and expedient access path to full MVNO enablement'.

Growth within the Wholesale division has been aided by the acquisitions of Wholesale Communications Group in May 2007 and Unitel in February 2008. Wholesale Communications was 'Australia's largest independent data wholesaling business' at the time of acquisition.

In April 2010, the agreement with Optus was extended for a further three and a half years to September 2013. Incorporated within the agreement were 'various new commercial terms which MTU expects will provide it with increased competitiveness and flexibility within its 3G mobile voice and data offerings, for delivery to is core SMB and wholesale markets'.

MTU currently provides wholesale services to approximately 220 customers. The wholesale business may be seen to support businesses that in turn compete directly with MTU, however the division provides scale to MTU's purchase contracts with carriers. A lower cost base of using the major carrier's networks is achieved and thus margin increases can be achieved within the retail division.

An indirect benefit of the reselling model is that over time, MTU gets to know their customers well (in terms of how the business is managed, how many SMB clients they support, their payment schedules etc). In turn, MTU can work to acquire these businesses and hence their SMB customers.

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Key Industry Considerations

In 2010, the Australian telecommunications market was estimated to have generated revenue of $39.0bn. Within the broader market, there are a few major network owners (Telstra, Optus, Vodafone), many partial network owners (AAPT, iiNet, Amcom, TPG etc) and a few hundred resellers. The SMB segment represents approximately $6.0bn or 15% of the market.

The reseller market is highly fragmented, within this market MTU wholesales services to 220+ resellers. MTU estimate that Telstra holds about 80% of the SMB market. Using the above metrics, MTU holds 4 - 5% of the SMB market. MTU's opportunity into the long term is to grow market share at the expense of Telstra.

ACCC: Enforcing trade practices and consumer protection

The ACCC is an independent statutory authority enforcing Australia's national trade practices and consumer protection laws. Within these responsibilities, the ACCC enforces telecommunication access determinations (specifies price and non-price terms for access to Telstra's copper network).

The ACCC recently issued interim access determinations (IADs) for the pricing of fixed line telecommunication services between Telstra and resellers. Notable determinations were: a fall in the wholesale line rental rate on business lines from $26.93 to $22.10 per line per month; and a fall in local carriage costs from 17.0c to 9.1c.

The determinations will be backdated to 1 January 2011 and are applicable until 31 December 2011 unless the final access determination is announced.

National Broadband Network: A level playing field?

The National Broadband Network is postured to be a national wholesale-only open access broadband network. All users will enjoy open access at equivalent prices and therefore provides a potential 'level playing field'. In reality, the specific definition of these terms remains a little opaque as to NBNCo's roles and responsibilities.

Services offered over the network by telecommunication providers will need to be superior and / or differentiated from competitors with a perception of value add via improved technologies, bundling of offerings, better customer service etc.

As opposed to acquiring services from Telstra, MTU may elect to acquire services from NBNCo. Alternatively, MTU may elect to acquire services from an aggregator such as Telstra or Optus.

Consolidation: Continuing industry rationalisation

The telecommunications industry has seen significant consolidation in recent years across fibre network, retail broadband and wholesale operators. Some of the notable transactions are mentioned below.

Fibre networks operators Powertel (April 2007; $357m) and Pipe Networks (April 2010; $373m) have been acquired by Telecom NZ and TPG Telecom respectively. Retail broadband operators Soul (February 2008; $230m), Westnet (May 2008; $81m), Netspace (April 2010; $40m) and AAPT Consumer (August 2010; $60m) have been acquired by TPG Group (Soul) and iiNet (Westnet, Netspace, AAPT Consumer).

Wholesale operators People Telecom (December 2008; $14m), Commander (June 2009; $19m) and Clear Telecoms (February 2011; $24.5m), among others, have been acquired by MTU.

In the lead up to the NBN, we expect industry consolidation to continue, if not accelerate as larger players look to consolidate market share. We believe having adequate scale will be a key feature under the NBN. Wholesale operators may well be beneficiaries if smaller providers find in uneconomic to access NBN services directly.

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Key Risks

Government policies and legislation: National Broadband Network

While MTU is exposed to changes of Federal and State Government policies and legislation such as taxation, the specific Government policy risk currently relates to the National Broadband Network. The NBN implies significant changes to the regulatory landscape of the telecommunications sector.

The NBN intends to create a commoditised network that lowers barriers to entry and gives providers access to markets and geographies that were previously not easily accessible. The uncertainty is around costs to access the NBN and the effect this will have on MTU's retail and wholesale operations.

Technology changes

New products and services may be introduced by other telecommunications companies which may be superior to MTU's products and services. If MTU is unable to offer these new products and services, their own offerings may become obsolete which could impact adversely of the Group's ability to compete in the market.

Fixed vs mobile / internet substitution

The evolution of mobile technology (e.g. the introduction of 4G technology), VoIP and other IP-based communication platforms provides users with a number of avenues to undertake their telecommunication needs.

However, we believe fixed line services will continue to be a mainstay product for SMB's into the medium term with reliability / quality of service being an integral consideration for these entities. Substitution is more relevant to retail consumers (households and to some extent home offices etc).

Contract renewal

While MTU has a good history with client renewal rates, in the event a number of clients do not renew their respective contracts, this may have a material impact on the revenue and earnings of the Group especially seeing that a major benefit to MTU's current business model is the recurring revenue base.

Competition in the SMB market

Leading into the NBN, the SMB market may become more competitive. To date MTU has shown it can maintain its customer base as a result of in depth support and leading customer service. Aggressive marketing by competitors such as Telstra or Optus could lead to margin compression. We believe increasing scale (hence buying power) and the extraction of synergies from acquisitions are avenues for MTU to maintain margins over the longer term.

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Board of Directors

Craig Farrow - Chairman

Mr Farrow is a founding partner of Brentnalls SA, Chartered Accountants. He is Chairman of Tonkin Consulting Engineers, and a national director of the Institute of Chartered Accountants in Australia, Chair of their Governance Committee, and a Director of General Practice SA. In addition, Mr Farrow is a director and Board adviser to several private consulting and trading enterprises across the agribusiness, software and manufacturing sectors.

Vaughan Bowen - Managing Director

Mr V. Bowen co-founded MTU in late 1999. He was appointed Managing Director/CEO following incorporation, and has successfully steered MTU from a start-up technology enterprise to its current position as a fast growing and profitable national telecommunications company. In over 10 years of leading the Company, Mr Bowen's innovative approach to branding, sales, alliance marketing and his proven ability to successfully execute complementary acquisitions has provided MTU with a considerable competitive advantage and a respected position in the telecommunications industry. He is a member of the Australian Institute of Company Directors and was named as a finalist in the Entrepreneur of the Year Southern Region in 2004 and 2009.

Max Bowen - Non Executive Director

Mr M. Bowen provides the Board with valuable experience gained in a management and business career spanning more than four decades. Founding Chairman of MTU, Mr Bowen spent over 20 years developing commercial property throughout Sydney and overseas. Over the last 10 years, Mr Bowen has acted in a senior advisory capacity to corporations and public utilities, including PricewaterhouseCoopers, Optus, Sydney Olympic Village, Sydney Harbour Foreshore Authority and Federal Airports Corporation.

John Hynd - Non Executive Director

Mr Hynd is founding partner of Hynd & Co, a commercial law firm in Adelaide. He has over 30 years experience in commercial transactions, corporate advice, corporate governance, insolvency and property development. A fellow of the Australian Taxation Institute, member of the Advisors Group with Family Business Australia and a former member of the Law Council of the Law Society, Mr Hynd's broad business experience provides MTU with valuable assistance with mergers and acquisitions and strategic planning.

Michael Simmons - Non Executive Director

Mr Simmons brings to the Board considerable experience in the telecommunications sector, having previously held the position of Chief Executive Officer SP Telemedia Limited (now known as TPG Telecom Limited) since its listing in 2001. Prior to listing, the SPT Group was a wholly owned subsidiary of the Washington H.Soul Pattinson Limited controlled NBN Television Group. He served in executive roles for nearly 26 years within the SPT/NBN Group of Companies, including as Chief Financial Officer and Chief Executive Officer. During 2008 following the acquisition of TPG Telecom Pty Ltd, Mr Simmons left the SPT Group to become the Managing Director of TERRiA, a telecommunications consortium of infrastructure based telecommunications carriers, formed to bid for the contract to build the National Broadband Network (NBN).

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Appendix I: Recent Acquisition History

Figure 7: MTU's recent acquisition summary

Business	Date acquired / Consideration	Comment
People Telecom	April 2009 / $19.4m	SMB assets. In FY10 People generated revenue of $77.8m and NPAT of $4.1m.
Commander	June 2009 / $24.4m	SMB assets as well as the Commander "OneStream" Data Network Business. In FY10 Commander generated revenue of $118.0m and NPAT of $5.2m.
Clever Communications	May 2010 / $5.0m	SMB assets. A full year contribution from Clever Communications would have added approximately $8.0m revenue and $2.3m EBITDA. The implied multiple paid was therefore circa 2.2x EBITDA.
Bell Networks	August 2010 / $4.0m	SMB assets. A full year contribution from Bell Networks would have added approximately $13.0m revenue and $2.0m EBITDA. The implied multiple paid was therefore circa 2.0x EBITDA.
Black & White Group	November 2010 / 30% shareholding in M2NZ (M2 retains 70% ownership)	Customer contracts, all operating systems and IP (including brand). The rationale behind the acquisition is to grow the M2 New Zealand business. While small in comparison to the Group, M2NZ is a profitable subsidiary with annual revenues of approximately $5.0m. The addition of Black & White as well as two key personnel appointments look to bolster both scale and management depth of M2NZ.
Clear Telecoms	February 2011 / $24.5m (payable in three tranches: immediately; September 2011 and March 2012. Subject to certain minimum performance milestones with bonus payments if milestones exceeded).	SMB assets. On an annualised basis, Clear is expected to generate revenue of approximately $70.0m and EBITDA of $8.0m. The implied multiple paid was therefore circa 3.0x EBITDA.
AUSTAR (Austar United Mobility Pty Ltd)	February 2011 / $2.0m	Mobile assets. As a respected regional Australian brand, AUSTAR represents an opportunity for MTU to expand Southern Cross Telco (MTU's regional consumer brand) with a complementary customer base. At the time of acquisition, a full year contribution would have added approximately $10.0m revenue and $1.3m EBITDA. The implied multiple paid was therefore circa 1.5x EBITDA.
Edirect Pty Ltd	April 2011 / $5.0m	Mobile assets. MTU is confident that the business will generate EBITDA of $2.0m in FY13 after a significant restructuring process. The implied multiple paid was therefore circa 2.5x EBITDA.

Source: Patersons Securities, M2 Telecommunications

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M2 Telecommunications Group **$3.56**

Company Background

MTU was established in 1999 and listed on the ASX in April 2004. Via oranic growth and numerous acquisitions, MTU has established itself as Australia's largest reseller of telecommunications services.

MTU offers a wide range of services encompassing fixed-line, mobile, mobile broadband and complex data services. Services are predominantly offered to small and medium sized businesses and small telco customers in Australia and New Zealand.

Year End June 30

Profit & Loss ($m)	2010A	2011F	2012F	2013F
Total Income	**406.1**	**465.0**	**549.8**	**583.8**
EBITDA	**31.4**	**49.1**	**67.1**	**75.5**
Depreciation	-1.5	-2.3	-3.5	-4.1
Amortisation	-3.5	-4.5	-5.5	-2.2
EBIT	**26.5**	**42.4**	**58.1**	**69.2**
Interest	-2.0	-2.2	-2.0	-1.6
Operating Profit	**24.5**	**40.2**	**56.1**	**67.6**
Tax expense	-8.0	-12.7	-17.7	-21.3
Minority Interest	0.0	0.0	0.0	0.0
NPAT	**16.5**	**27.5**	**38.5**	**46.3**
Normalised NPAT	**18.5**	**30.6**	**42.2**	**47.8**

Ratios	2010A	2011F	2012F	2013F
Profitability				
Revenue Growth (%)	100.6	14.5	18.2	6.2
EBITDA Margin (%)	7.7	10.6	12.2	12.9
EBIT Margin (%)	6.5	9.1	10.6	11.9
Effective Tax Rate (%)	32.7	31.5	31.5	31.5
ROE (%)	26.2	32.7	38.4	39.5
ROA (%)	10.9	15.2	18.2	20.5
Payout Ratio (%)	69.4	70.0	70.0	70.0
EV/EBITA (x)	14.7	9.9	7.0	6.0
Balance Sheet				
Net Debt (Cash) ($m)	1.5	26.1	9.8	-13.0
Net Debt/Equity (%)	2.0	28.5	9.1	na
Interest Cover (x)	13.3	19.6	29.3	42.6
NTA ($/share)	0.06	-0.10	0.08	0.24
Price/NTA (x)	61.0	-36.1	42.8	14.9
EFPOWA (m)	112.1	124.4	125.0	125.0

Cash Flow ($m)	2010A	2011F	2012F	2013F
EBITDA	**31.4**	**49.1**	**67.1**	**75.5**
Net interest	-2.0	-2.2	-2.0	-1.6
Income tax paid	-5.9	-10.3	-15.2	-19.5
Working capital change	-6.2	-1.1	1.0	1.5
Other	-4.1	0.0	0.0	0.0
Operating Cashflow	**13.3**	**35.5**	**50.9**	**55.9**
Capital expenditure	-0.9	-8.0	-8.5	-4.0
Free Cashflow	**12.4**	**27.5**	**42.4**	**51.9**
Acquisitions & Invest.	-3.8	-32.9	-4.9	0.0
Disposals	0.0	0.0	0.0	0.0
Increase (Repay) Debt	0.1	18.2	-10.0	-10.0
Equity Raised	20.4	1.0	0.0	0.0
Dividends paid	-8.3	-14.6	-21.3	-29.1
Other	-12.5	-5.5	0.0	0.0
Net Change in Cash	**8.4**	**-6.3**	**6.2**	**12.8**
Net Exch. Differences	0.0	0.0	0.0	0.0
Closing Cash Balance	**15.1**	**8.8**	**15.0**	**27.8**

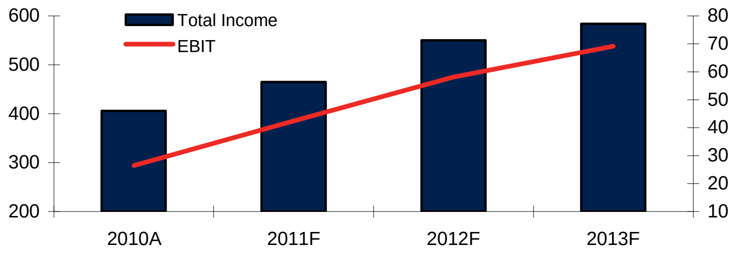
Board of Directors

Name	Position
Craig Farrow	Chairman
Vaughan Bowen	Managing Director / CEO
Max Bowen	Non-Executive Director
John Hynd	Non-Executive Director
Michael Simmons	Non-Executive Director

Shareholder	Shares(m)	%
Hunter Hall	12.4	10.1
Vaughan Bowen	10.3	8.3
Cornish Group Investments	10.3	8.3
National Australia Bank	8.6	7.0
Top 20 Shareholders	**71.7**	**58.2**

Balance Sheet ($m)	2010A	2011F	2012F	2013F
Cash	15.1	8.8	15.0	27.8
Receivables	55.8	66.3	76.9	80.0
Inventories	0.3	0.4	0.5	0.5
Investments	0.0	0.0	0.0	0.0
Fixed Assets	3.7	9.5	14.5	14.4
Intangibles	70.5	103.7	98.2	96.0
Other Assets	14.1	14.2	14.2	14.2
Total Assets	**159.5**	**202.8**	**219.2**	**232.9**
Creditors	54.2	63.7	75.3	80.0
Current Borrowings	5.1	5.1	5.1	5.1
Non-current Borrowings	11.4	29.7	19.7	9.7
Other Liabilities	11.7	12.9	10.5	12.3
Total Liabilities	**82.5**	**111.4**	**110.6**	**107.1**
Minority Interests	0.0	0.0	0.0	0.0
Shareholders Funds	**77.0**	**91.4**	**108.6**	**125.8**

EBIT/Revenue



Valuation	2010A	2011F	2012F	2013F
Normalised EBITDA Multiple				
EBITDA ($m)	31.4	49.1	67.1	75.5
EBITDA Multiple (x)	7.0	7.0	7.0	7.0
Net Debt (Cash) ($m)	1.5	26.1	9.8	-13.0
Implied Valuation ($m)	218.6	317.5	459.8	541.6
Per Share	**$1.95**	**$2.55**	**$3.68**	**$4.33**
Target PE Multiple				
EPS (cents)	14.4	22.1	30.8	37.0
PE Target (x)	12.5	12.5	12.5	12.5
Per Share	**$1.80**	**$2.77**	**$3.84**	**$4.63**

Discounted Cash Flow

Cost of Equity	11.8%	WACC	11.2%
Cost of Debt	5.9%	Terminal G. Rate	3.0%
Target Equity/Debt	90/10	**Per Share**	**$4.86**
Current Share Price Discount (Premium) to Val.n			36.5%

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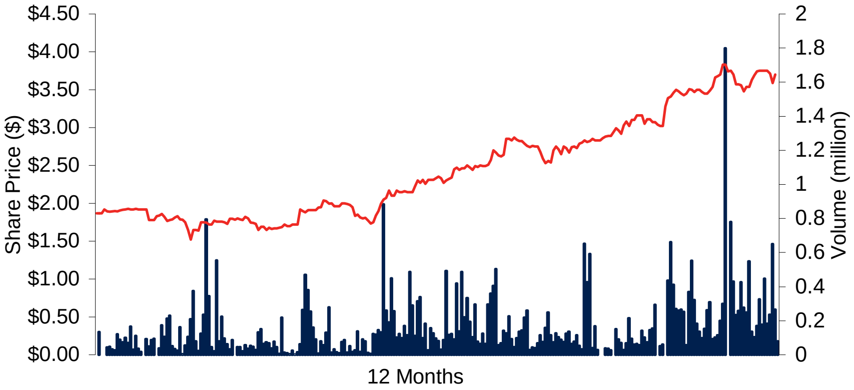
Recommendation History



Date	Type	Target Price	Share Price	Recommendation	Return

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