



BUY - \$1.80

M2 Telecommunications (MTU)

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Acquires Bell Networks- earnings lift in FY11

Company Data

ASX Code	MTU
Price	\$1.80
12 month price target	\$2.24
12 month dividend yield	7.7%
Implied return	32.1%
Shares on issue	121.5m
Market cap	\$218.7m
12 Month price range	\$0.675/\$1.99
Monthly turnover	3.614m

Forecast Changes

	2010F	2011F	2012F
NPAT	-	+4.2%	+4.6%
EPS	-	+4.2%	+4.6%
DPS	-	-6.6%	-6.2%

Earnings Summary

Yr to 30 June	2009	2010F	2011F	2012F
Lodge adj profit	8.1	20.8	27.5	29.3
Rep. Profit _(pre-sia)	7.5	18.0	24.5	26.6
EPS (¢)	8.9	16.2	20.2	21.9
EPS growth	26.6%	82.4%	24.7%	8.2%
P/E ratio	20.3 x	11.1 x	8.9 x	8.2 x
DPS (¢)	5.5	11.5	14.0	15.0
Yield	3.1%	6.4%	7.8%	8.3%
Franking	100%	100%	100%	100%
Payout ratio	62%	71%	69%	69%
EV / EBIT	20.8 x	8.0 x	6.2 x	5.6 x
EV / EBITDA	17.5 x	6.9 x	5.5 x	4.9 x
CFPS (¢)	9.9	11.8	23.5	25.7
Price / CF	18.2 x	15.3 x	7.6 x	7.0 x
NTA per share	-\$0.20	\$0.06	\$0.12	\$0.21
Pr / NTA	-9.0 x	30.3 x	15.6 x	8.5 x

Share Price Chart



Source: Iress Market Technology

Acquisition Update; MTU has announced an agreement to acquire the business assets of Bell Networks Voice & Data for \$4m in cash comprising of upfront and deferred payments (plus an additional bonus consideration based on performance). MTU will acquire the SMB customer contracts of Bell Networks and these contracts will fit under MTU's Retail division. The assets are expected to contribute around \$13m in annual recurring revenue and \$2m in EBITDA, which represents a purchase price of ~2x EBITDA. The sale agreement is expected to be completed in August 2010, and hence will have no impact of FY10 earnings.

The acquisition of Bell Networks closely **follows the bolt on acquisition of Clever Communications in May 2010**, which is forecast to contribute annualised revenue of \$8m and EBITDA of \$2.3m in FY11.

The **Commander and People Telecom acquisitions in 2HY09 have now been substantially integrated** with the major internal restructure completed. The remaining upside potential of these acquisitions is through the cross-selling of additional products (such as mobile and mobile broadband) to the expanded customer base. In the Retail division, the new order intake now exceeds the churn rate which is generating net growth in new customers.

In FY11, we expect that MTU will continue to benefit from rising economies of scale, driven by the integration of recent acquisitions, although we expect this to be partially offset by pricing pressure across both the wholesale and retail divisions.

MTU is currently finalising the **preferred supplier arrangements for a new company wide IT billing system**. We expect this investment will be \$5-\$7m over the next 2 years, with the majority expensed in FY11. This investment will support the framework for MTU's medium term growth and we expect that MTU will benefit materially from this investment from FY13 and beyond. Successful staged installation of the billing system across the divisions remains a short term risk to the business despite the opportunity.

We have slightly upgraded our earnings projections – **increasing FY11 and FY12 EPS forecasts by 4.2% and 4.6% respectively**. This is driven by expected revenue and earnings contribution from the Bell Networks acquisition plus improving EBITDA margin benefits within the retail division. Our DPS forecasts have been adjusted down by c6% to reflect a 70% payout ratio and likelihood of the company preserving capital for growth and debt repayment.

Valuation; Overall, we continue to view MTU favourably as a relatively defensive business with solid recurring cash flows, an entrenched position servicing the SME and wholesale Telco market, trading on an undemanding forecast FY11 P/E ratio of 8.9x. We expect FY11 EPS growth to be driven by organic expansion from new customer wins and the contribution from the Clever and Bell Network purchases. In addition, there is c\$8m+ balance sheet capacity for further bolt-on acquisitions during FY11. **We have upgraded our 12 month price target to \$2.24 per share (from \$1.95) and retain a BUY recommendation.**

M2 Telecommunications (MTU: \$1.80)

Mkt Cap: \$218.7m



Valuation data

Year ending Jun	2009	2010F	2011F	2012F
Lodge adj profit	8.1	20.8	27.5	29.3
Reported profit	7.5	18.0	24.5	26.6
EPS_{adj} (¢)	8.9	16.2	20.2	21.9
EPS growth	26.6%	82.4%	24.7%	8.2%
P/E ratio	20.3 x	11.1 x	8.9 x	8.2 x
DPS (¢)	5.5	11.5	14.0	15.0
Yield	3.1%	6.4%	7.8%	8.3%
Franking	100.0%	100.0%	100.0%	100.0%
Payout ratio	62%	71%	69%	69%
EV / EBIT	20.8 x	8.0 x	6.2 x	5.6 x
EV / EBITDA	17.5 x	6.9 x	5.5 x	4.9 x
CFPS (¢)	9.9	11.8	23.5	25.7
Price / CF	18.2 x	15.3 x	7.6 x	7.0 x
NTA per share	-\$0.20	\$0.06	\$0.12	\$0.21
Pr / NTA	-9.0 x	30.3 x	15.6 x	8.5 x

Balance sheet (\$M)

Year ending Jun	2009	2010F	2011F	2012F
Cash	6.7	14.1	6.5	9.1
Receivables	50.1	58.0	64.6	69.5
Inventories	2.6	1.1	1.2	1.3
Other	2.5	2.5	2.5	2.5
Current assets	61.9	75.6	74.8	82.3
Net PPE	5.1	6.1	10.4	14.1
Investments	0.0	0.0	0.0	0.0
Goodwill	70.3	70.5	73.7	71.0
Deferred tax assets	4.1	4.1	4.1	4.1
Other	0.1	0.1	0.1	0.1
Non-current assets	79.5	80.8	88.3	89.3
Total assets	141.4	156.4	163.1	171.6
Debt	16.3	16.7	12.2	7.2
Provisions	4.1	4.1	4.1	4.1
Other	72.6	57.9	59.0	63.5
Total liabilities	92.9	78.7	75.3	74.8
Equity / reserves	42.0	62.0	62.0	62.0
Retained profits	6.5	15.7	25.7	34.8
Total s/h funds	48.5	77.7	87.8	96.8
Minorities	0.0	0.0	0.0	0.0
Total funds emp.	58.1	80.4	93.5	95.0

Ratio analysis

Year ending Jun	2009	2010F	2011F	2012F
EBITDA / sales	6.5%	8.3%	9.5%	9.5%
EBITAg / sales	5.4%	7.1%	8.4%	8.4%
EBIT / sales	5.4%	7.1%	8.4%	8.4%
Return on assets	8.1%	19.3%	23.1%	23.9%
Return on equity	15.4%	23.2%	28.0%	27.4%
Return on funds emp.	24.7%	39.7%	41.6%	41.2%
Net debt / (cash) (\$M)	9.6	2.6	5.7	(1.8)
Debt / equity	33.5%	21.5%	13.9%	7.5%
Net debt / equity	19.7%	3.4%	6.5%	(1.9%)
Interest cover	23.9 x	15.9 x	33.4 x	42.9 x

Profit and loss (\$M)

Year ending Jun	2008	2009	2010F	2011F	2012F
Sales revenue	109.0	202.5	385.0	428.5	461.4
<i>growth over pcp</i>		85.9%	90.2%	11.3%	7.7%
EBITDA	8.8	13.1	32.0	40.9	44.0
Dep'n and amort'n	(1.3)	(2.1)	(4.5)	(4.7)	(5.2)
EBITAg	7.6	11.0	27.5	36.1	38.8
Goodwill amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	7.6	11.0	27.5	36.1	38.8
<i>growth over pcp</i>		44.9%	150.6%	31.4%	7.5%
Net interest expense	(0.1)	(0.5)	(1.7)	(1.1)	(0.9)
Pre-tax profit	7.5	10.5	25.8	35.1	37.9
Tax	(2.3)	(3.0)	(7.7)	(10.5)	(11.4)
<i>Effective tax rate</i>	31.2%	28.9%	30.0%	30.0%	30.0%
Preference dividends	0.0	0.0	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0	0.0
Lodge adjustments	0.0	0.7	2.7	3.0	2.7
Lodge adj profit	5.2	8.1	20.8	27.5	29.3
Reported profit (pre sig)	5.2	7.5	18.0	24.5	26.6
One-off items (post tax)	0.0	0.0	0.0	0.0	0.0
Reported net profit	5.2	7.5	18.0	24.5	26.6

Cashflow (\$M)

Year ending Jun	2008	2009	2010F	2011F	2012F
EBIT	7.6	11.0	27.5	36.1	38.8
Net interest paid	(0.3)	(0.7)	(1.7)	(1.1)	(0.9)
Dep'n and amort'n	1.3	2.1	4.5	4.7	5.2
Tax paid	(2.2)	(2.8)	(7.7)	(10.5)	(11.4)
Gross cash from op'ns	6.3	9.5	22.5	29.3	31.7
(Inc) / dec in w'k'g cap	0.0	(1.0)	(9.4)	(0.7)	(0.5)
(Inc) / dec in provisions	2.9	17.5	0.0	0.0	0.0
Other	(1.9)	(17.7)	0.0	0.0	0.0
Operating cashflow	7.3	8.3	13.1	28.6	31.2
<i>growth over pcp</i>					
Investing cashflows					
Capital expenditure	(0.6)	(0.9)	(2.0)	(6.0)	(6.2)
Asset sales	0.0	0.0	0.0	0.0	0.0
Investments	(9.6)	(9.7)	(15.4)	(11.2)	0.0
Divestments	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Financing cashflows					
Equity raised	0.0	0.5	20.0	0.0	0.0
Dividends paid	(2.8)	(4.3)	(8.8)	(14.5)	(17.5)
Chg in loans	9.9	6.0	0.5	(4.5)	(5.0)
Other non-op flow s	0.0	0.0	0.0	0.0	0.0
Net chg in cash	4.2	(0.2)	7.4	(7.6)	2.5

Interims (\$M)

Half yearly	1HY09	2HY09	1HY10	2HY10F
Sales revenue	87.1	115.4	187.7	197.3
EBITDA	6.0	7.1	15.3	16.7
EBIT	5.0	6.0	12.7	14.8
Lodge adj profit	3.2	4.9	9.5	11.2
Reported profit	3.2	4.3	8.2	9.9
EBITDA / sales	6.9%	6.1%	8.2%	8.4%
EPS (¢)	4.1	4.8	7.5	8.7
EPS growth on pcp	45.7%	32.3%	83.3%	81.7%
DPS (¢)	2.5	3.0	5.0	6.5
% of FY EBIT	45%	55%	46%	54%

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