



BUY - \$1.92

M2 Telecommunications (MTU)

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Issues upbeat FY11 Guidance

Company Data

ASX Code	MTU
Price	\$1.92
12 month price target	\$2.24
12 month dividend yield	7.7%
Implied return	32.1%

Shares on issue	121.5m
Market cap	\$233.3m
12 Month price range	\$0.675/\$1.99
Monthly turnover	1.432m

Forecast Changes

	2010F	2011F	2012F
NPAT	-	-	+2.7%
EPS	-	-	+1.8%
DPS	-	-	+3.3%

Earnings Summary

Yr to 30 June	2009	2010F	2011F	2012F
Lodge adj profit	8.1	20.6	27.3	30.1
Rep. Profit _(pre-sia)	7.5	17.4	24.1	27.1
EPS (¢) adj	9.6	18.5	22.5	24.8
EPS growth	26.6%	75.8%	27.3%	12.3%
P/E ratio	19.9 x	10.4 x	8.5 x	7.8 x
DPS (¢)	5.5	11.5	14.0	15.5
Yield	2.9%	6.0%	7.3%	8.1%
Franking	100%	100%	100%	100%
Payout ratio	62%	74%	70%	70%
EV / EBIT	22.1 x	8.8 x	6.6 x	5.8 x
EV / EBITDA	18.6 x	7.4 x	5.7 x	5.0 x
CFPS (¢)	9.9	11.8	24.3	26.8
Price / CF	19.4 x	16.2 x	7.9 x	7.2 x
NTA per share	-\$0.20	\$0.05	\$0.11	\$0.21
Pr / NTA	-9.6 x	37.3 x	18.2 x	9.3 x

Share Price Chart

MTU.ASX: 1.92



Source: Iress Market Technology

Guidance update MTU has re-affirmed FY10 guidance and issued FY11 earnings guidance for the first time. Guidance at the midpoint equates to FY11 Revenue of \$435m (+12%), EBITDA of \$42m (+39%) and underlying profit before amortisation of \$26m (+43%). MTU approximates amortisation of customer contracts to be \$3.2m for FY11. For the purposes of calculating adjusted net profit and earnings per share, we add back amortisation expenses.

FY11 profit forecast raised- The FY11 EBITDA guidance midpoint is \$1.1m above our forecasts, thus we have raised our forecast by 3% to \$42.0m. Partially offsetting this effect, we have marginally raised our amortisation forecast and depreciation expense to reflect the company guidance and impact of capex brought forward into FY11 relating to installation and upgrades to the existing IT and billing system. Upside potential to our earnings assumptions may emerge with a better than expected integration of the Bell Networks & Clever Communications acquisitions, executed during 2H10 and making an expected contribution of \$2m and \$2.3m to FY11 EBITDA respectively.

FY10 earnings forecast steady- The company has not upgraded FY10 earnings guidance, however we maintain that FY10 net profit will be reported at \$20.6m, above the upper end of \$18.7m guidance. Our forecasts are within a 10% reasonability range versus guidance. Our FY10 adjusted EPS forecast of 18.5 cps is 19% above MTU's adjusted guidance. This is due to variances in shares on issue assumptions; MTU has employed the closing shares on issue for FY10 of 121.5m, whilst Lodge employs weighted shares on issue of 111.4m for FY10. In like-for-like terms our adjusted EPS forecasts are 10% above MTU's guidance for FY10, in line with our expected variance versus NPAT.

Overall, the announcement is a clear positive, in that it provides clarity around the earnings outlook for FY11 driven by organic (8.2% of forecast revenue growth) and acquisitive (5.3% of forecast revenue growth). Revenue gains have been driven by the successful integration of the People Telecom & Commander acquisitions during FY10 and contribution of Clever Communications (\$8m Revenue & \$2.3m EBITDA) and Bell Networks (\$13m Revenue & \$2m EBITDA) acquisitions during FY11.

Solid top line growth is also likely to be supported at the margin, with expected EBITDA margin expansion to 9.6% in FY11 from 8.3% in FY10 as a result of cost efficiencies and rising scale. We do not envisage that the company will experience any material revenue slowdown during 1H11, as a result of the Federal Election. Further, as a pure re-seller, we do not believe that MTU is exposed to material additional infrastructure risk or competition risk under the proposed NBN fibre network, which aims to improve broadband speed to households.

On current multiples, MTU trades on an appealing FY11f P/E ratio of 8.5 xs with a forecast yield of 7.3%.

We retain a BUY recommendation and price target of \$2.24.

M2 Telecommunications (MTU: \$1.92)

Mkt Cap: \$233.3m



Valuation data

Year ending Jun	2009	2010F	2011F	2012F
Lodge adj profit	8.1	20.6	27.3	30.1
Reported profit	7.5	17.4	24.1	27.1
EPS_{adj} (¢)	9.6	18.5	22.5	24.8
EPS growth	26.6%	75.8%	27.3%	12.3%
P/E ratio	19.9 x	10.4 x	8.5 x	7.8 x
DPS (¢)	5.5	11.5	14.0	15.5
Yield	2.9%	6.0%	7.3%	8.1%
Franking	100.0%	100.0%	100.0%	100.0%
Payout ratio	62%	74%	70%	70%
EV / EBIT	22.1 x	8.8 x	6.6 x	5.8 x
EV / EBITDA	18.6 x	7.4 x	5.7 x	5.0 x
CFPS (¢)	9.9	11.8	24.3	26.8
Price / CF	19.4 x	16.2 x	7.9 x	7.2 x
NTA per share	-\$0.20	\$0.05	\$0.11	\$0.21
Pr / NTA	-9.6 x	37.3 x	18.2 x	9.3 x

Balance sheet (\$M)

Year ending Jun	2009	2010F	2011F	2012F
Cash	6.7	14.2	8.4	13.0
Receivables	50.1	58.0	65.8	70.9
Inventories	2.6	1.1	1.2	1.3
Other	2.5	2.5	2.5	2.5
Current assets	61.9	75.7	77.9	87.6
Net PPE	5.1	5.1	7.3	9.5
Investments	0.0	0.0	0.0	0.0
Goodwill	70.3	70.8	73.8	70.8
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	80.0	85.3	84.5
Total assets	141.4	155.8	163.1	172.1
Debt	16.3	16.7	12.2	7.2
Provisions	4.1	4.1	4.1	4.1
Other	72.6	57.9	60.2	64.8
Total liabilities	92.9	78.7	76.4	76.0
Equity / reserves	42.0	62.0	62.0	62.0
Retained profits	6.5	15.0	24.6	34.0
Total s/h funds	48.5	77.1	86.7	96.0
Minorities	0.0	0.0	0.0	0.0
Total funds emp.	58.1	79.6	90.6	90.3

Ratio analysis

Year ending Jun	2009	2010F	2011F	2012F
EBITDA / sales	6.5%	8.3%	9.6%	9.7%
EBITAg / sales	5.4%	7.0%	8.2%	8.4%
EBIT / sales	5.4%	7.0%	8.2%	8.4%
Return on assets	8.1%	18.9%	23.1%	24.9%
Return on equity	15.4%	22.6%	27.8%	28.2%
Return on funds emp.	24.7%	38.9%	42.0%	43.7%
Net debt / (cash) (\$M)	9.6	2.6	3.9	(5.7)
Debt / equity	33.5%	21.7%	14.1%	7.5%
Net debt / equity	19.7%	3.3%	4.5%	(6.0%)
Interest cover	23.9 x	13.8 x	27.7 x	46.5 x

Profit and loss (\$M)

Year ending Jun	2008	2009	2010F	2011F	2012F
Sales revenue	109.0	202.5	385.0	436.8	470.4
<i>growth over pcp</i>		85.9%	90.2%	13.5%	7.7%
EBITDA	8.8	13.1	32.0	42.0	45.5
Dep'n and amort'n	(1.3)	(2.1)	(5.2)	(6.2)	(6.0)
EBITAg	7.6	11.0	26.8	35.8	39.5
Goodwill amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	7.6	11.0	26.8	35.8	39.5
<i>growth over pcp</i>		44.9%	143.9%	33.6%	10.6%
Net interest expense	(0.1)	(0.5)	(1.9)	(1.3)	(0.9)
Pre-tax profit	7.5	10.5	24.8	34.5	38.7
Tax	(2.3)	(3.0)	(7.5)	(10.3)	(11.6)
<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	3.2	3.2	3.0
Lodge adj profit	5.2	8.1	20.6	27.3	30.1
Reported profit (pre sig)	5.2	7.5	17.4	24.1	27.1
One-off items (post tax)	0.0	0.0	0.0	0.0	0.0
Reported net profit	5.2	7.5	17.4	24.1	27.1

Cashflow (\$M)

Year ending Jun	2008	2009	2010F	2011F	2012F
EBIT	7.6	11.0	26.8	35.8	39.5
Net interest paid	(0.3)	(0.7)	(1.9)	(1.3)	(0.9)
Dep'n and amort'n	1.3	2.1	5.2	6.2	6.0
Tax paid	(2.2)	(2.8)	(7.5)	(10.3)	(11.6)
Gross cash from op'ns	6.3	9.5	22.6	30.3	33.1
(Inc) / dec in w'k'g cap	0.0	(1.0)	(9.4)	(0.9)	(0.6)
(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	13.2	29.5	32.5
<i>growth over pcp</i>					
Investing cashflows					
Capital expenditure	(0.6)	(0.9)	(2.0)	(5.2)	(5.2)
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)	(17.7)
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)	7.5	(5.8)	4.6

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	14.1
Lodge adj profit	3.2	4.9	9.5	11.1
Reported profit	3.2	4.3	8.2	9.2
EBITDA / sales	6.9%	6.1%	8.2%	8.4%
EPS (¢)	4.1	5.6	7.5	11.0
EPS growth on pcp	45.7%	32.3%	83.3%	97.9%
DPS (¢)	2.5	3.0	5.0	6.5
% of FY EBIT	45%	55%	47%	53%

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We have divided our recommendations into three main Categories:

Buy: Expected Total Return in excess of 15% over a 1 year period.

Hold: Expected Total Return between 0% and 15% over a 1 year period.

Sell: Expected Total Return less than 0% over a 1 year period.

Analyst Verification

I verify that I, **Ian Munro**, have prepared this research report accurately and that any financial forecasts and recommendations that are expressed are solely my own personal opinions. In addition, I certify that no part of my compensation is or will be directly or indirectly tied to the specific recommendation or financial forecasts expressed in this report.

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