M2 | Telecommunications

Annual Report 2005

Annual Report

The **M2 Vision**

To become Australia’s leading network-independent provider of value-enhanced telecommunications services to Small Enterprises.

M2 Telecommunications Group Limited

ABN : 74 091 575 021

Annual Report 2005

Contents

Annual General Meeting

The Annual General Meeting of M2 Telecommunications Group Limited will be held at the Hotel Charsfield, 478 St Kilda Road Melbourne on 7th October 2005 at 4pm.

The business of the meeting will be to consider the Financial Statements, the re-election of Directors and any other business arising.

A formal notice of meeting is enclosed with this Annual Report.

Chairman's Letter

Dear Shareholder

On behalf of the Board of M2 Telecommunications Group Limited ("M2"), I am pleased to be presenting our shareholders with this, our first Annual Report since our listing on the Australian Stock Exchange on October 29 2004.

Most importantly, I am proud to be able to report that the 2005 financial year was another year of growth for M2 in those areas which are likely to be of greatest interest to our shareholders, most particularly in the area of profitability, which, for the fourth consecutive year has increased markedly.

There are many highlights to report from the year that was, which are described in some detail within the CEO's Review of Operations following. However, below are those which I regard as perhaps the most noteworthy milestones of a busy year at M2:

- Earnings Before Interest and Tax (EBIT) of $2.36M, as compared with $0.77M in the previous year, representing an EBIT increase of 206%.
- Net Profit After Tax (NPAT) increased by 39% from the previous year to a new record high of $1.8M
- Revenues of $23.72M, as compared with $15.34M last year, an increase of 55%.
- Cash flow and cash assets grew strongly during the year.
- Completed a successful listing on the Australian Stock Exchange & maintained an average share price well above the issue price.
- M2's well established management group remained cohesive and united, with zero middle or senior management departures during the year.
- M2's first acquisition (Protel Communications) was completed in February 2005, providing various strategic benefits and incremental skills to the Company.
- M2's inaugural (interim) dividend was declared in April 2005, in accordance with the Board's stated dividend policy.

2005 financial year was another year of growth for M2 in those areas which are likely to be of greatest interest to our shareholders

Chairman's Letter

Looking ahead to the 2005/6 year, I am confident that the gains made during the last year has made M2 a more robust entity on several levels, which has positioned us favourably to take advantage of the many exciting opportunities which we expect to be presented over the months and years ahead.

Finally, let me thank you for your support as a shareholder of M2. You can be assured that there is a genuine commitment at Board and management level to continue to build upon the promising foundations laid over recent years, so as to continue to generate sustainable growth in the areas which matter most, and in turn, increase returns to our shareholders.

Yours faithfully

Max G Bowen
Chairman

Key Dates

Record Date for Dividend	14 October 2005
Dividend Paid	31 October 2005
Annual General Meeting	7 October 2005
Half Year End	31 December 2005
Interim Profit Announcement	28 February 2006
Final Year End	30 June 2006

Managing Director's Review

Introduction

The 2004/5 financial year contained several notable milestones and continued impressive growth in those areas which our Board and management team have agreed are the central building blocks for M2's long term profitability and sustainability in our fast changing industry.

The listing of M2 on the Australian Stock Exchange (ASX) on October 29 2004 was a significant step in the development of our Company, having provided a vehicle to enable us to take advantage of strategic opportunities as they arise.

In terms of financial performance, M2 continued its very pleasing growth curve of recent years, in terms of both revenue and, most importantly, "bottom line" profitability.

For the second consecutive year, M2 was named amongst Australia's fastest growing companies in the 2004 BRW Fast 100, having been ranked at number twenty seven on the list.

The following pages have been prepared to provide our shareholders with additional insight into the events of note at M2 during 2004/5, which I am confident will highlight those things which continue to make M2 unique and well equipped for continued success.

BRW named M2 as one of Australia's 100 fastest growing companies in 2003 & 2004

Financial Highlights

The year ended June 2005 was M2's fourth consecutive year of growth in both revenue and profitability, evidencing the Company's capability to grow strongly, whilst continuing to deliver sizable increases in profit. The graph below highlights this sustained growth.

M2's increased revenues during the year by more than 55% as compared with 2003/4. In dollar terms, this was the largest annual revenue growth ever achieved by M2, which illustrates the increasing effectiveness of our national sales channels, which were grown markedly during the year.

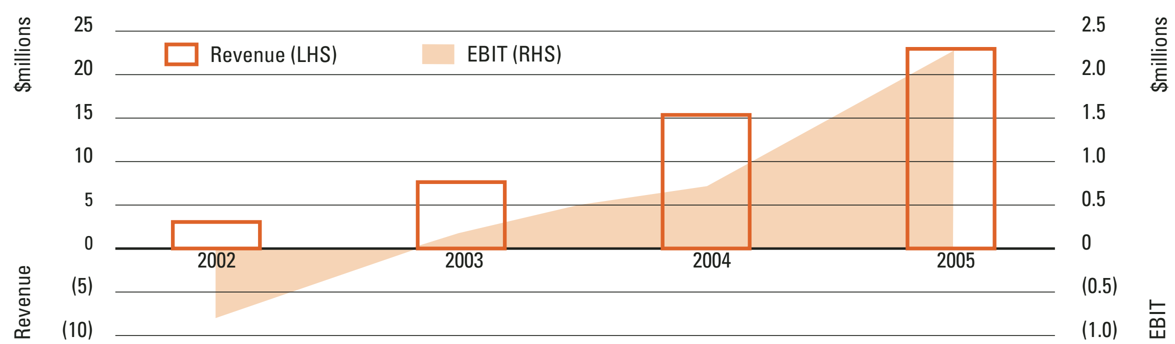
Another year of strong profit growth is the financial achievement of which we are most proud. M2's Earnings Before Interest and Tax (EBIT) and Net Profit After Tax (NPAT) results were up 206% and 39% respectively, as compared with the previous year.

Pleasing also was the growth in EBIT as a proportion of revenue, up from 5% last year to 10% in 2004/5, which illustrates that significant economies of scale are being realised as the Company becomes larger in revenue terms.

Whilst it is most encouraging that the Company has continued its strong growth curve, the profit expectations set for the business in 2004/5 were not fully realised, with the final NPAT result being marginally (approx 10%) below the level forecasted at the beginning of the year. The contributing factors were short term issues, which have been identified and proactively addressed over recent months.

In terms of the financial fundamentals of M2, we are proud to continue to boast a particularly robust balance sheet, with sizable and growing cash reserves and month-on-month positive cash flow. Prudent financial management remains a cornerstone of the M2 business, evidenced by negligible aged debtors and a provision for bad or doubtful debts of less than 0.52% of Company revenue.

Perhaps the most meaningful financial highlight from our shareholder's perspective was the declaration of M2's inaugural dividend in April 2005. This interim dividend was issued in accordance with Board's stated dividend policy. Pleasingly, the Board has also declared a final dividend equal to 1.50c per share, to be paid to shareholders in October 2005.



Managing Director's Review

Our fantastic team

I continue to maintain the view that it is entirely the commitment and calibre of the members of the M2 team which has made it possible for our Company to have achieved so many successful milestones since its incorporation just over five years ago. For this, I thank each and every member of our exceptional team.

At the end of the period, M2 employed nearly 70 people, up from around 40 the previous year. What continues to be an encouraging endorsement of the M2 culture is the number of our team who have been with us since the very beginning or for several years.

During the 2004/5 year, not a single member of our senior or middle management team departed M2. In fact, with the exception of casual personnel, staff turnover at M2 for the year was practically non-existent.

Numerous internal promotions were earned by members of our team during the year, which were much deserved and warmly received by the team at large.

The heavy emphasis placed upon promotion from within is made possible due to constant focus upon multi-skilling and an approach we refer to as "accountable autonomy", where M2 team members are actively encouraged to shape and develop their respective roles and/or departments, providing they remain accountable for their decisions and actions.

The pride in our team was illustrated when the Board unanimously approved the issue of a sizable parcel of M2 shares, issued to each member of the M2 team shortly prior to our ASX listing. The majority of our team are M2 shareholders, with many having increased their M2 share portfolios on their own accord during the year.

The M2 Charter

January 2005

Preamble

In December 2004, M2 Telecommunications Group Limited ("M2") celebrated its 5th anniversary, following incorporation of the Company on December 15 1999. This pleasing milestone was made possible through the effort and loyalty of our team, together with the support of our customers, suppliers, alliance partners and shareholders.

This 5 year journey has seen M2 navigate many obstacles, whilst shaping (sometimes reshaping!) itself into a steadily growing company of considerable character and strength, which now provides innovative telecommunications services to thousands of customers, career pathways to our team and returns to our shareholders.

We now move forward with the knowledge of what M2 stands for and what sets us apart. The M2 Charter represents a summary of those things, which, in combination, are the principles to which we are committed.

Our Charter

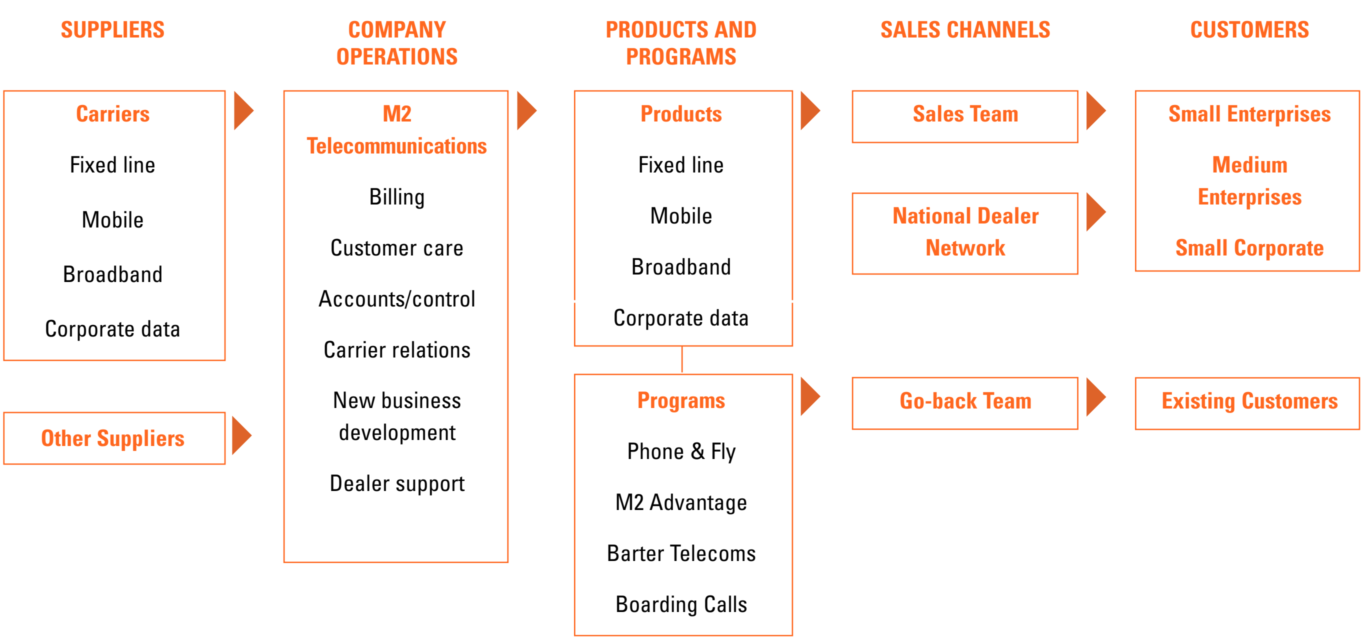
- To care for our customers in a manner which is respectful, professional and solutions oriented. The essence of our customer care philosophy is to treat our customers in a way which we would expect to be treated ourselves.
- To diligently protect the team culture which has become a defining feature of M2. To this end, we are committed to promotion from within, wherever possible, and to the encouragement of mutual respect amongst team members, "accountable autonomy" in decision making and an organisation free of petty politics and inefficient bureaucracy.
- To remain focused on small & medium enterprise customers. It is this customer group that we understand and have proven to be able to add real value. We will resist the temptation to attempt to become all things to all people.
- To be innovative in the services we offer our customers and in the means by which we promote our offerings. We remain committed to not simply doing things "the way it's always been done". However, we remain alert to and respectful of our competitors at all times.
- To be aggressive in our growth ambitions, whilst never losing sight of the interests and livelihoods of our stakeholders. Our primary stakeholders being our team, our shareholders, our customers, our suppliers and our alliance partners.
- To use technology wisely. We operate in a high technology field and are active in the adoption of new technology, where it facilitates improvement in operational efficiency and our customer offerings. However, we are also conscious to carefully consider which technologies to adopt and when.
- To be conscious of our place in the wider community. To this end, we are committed to becoming a benchmark company in terms of our social and environmental responsibility.

M2 Telecommunications

The M2 Charter (above), unveiled in January 2005, provides an insight into the core philosophies and principles upon which the M2 culture is built.

The year ahead will be marked by further growth in our existing core areas and expansion into new products and services, presenting more career opportunities for members of our existing team and for those who join M2 in the future.

M2 Telecommunications Business Model



Operational developments

The core operational platforms and systems which drive M2 were enhanced in various ways during the course of the year, with the aim of further improving operational efficiency, communication flows between divisions and to be prepared for the next wave of customer growth and new products.

During the year considerable effort was applied to the further development of internal information technology, so as to facilitate greater output per team member and faster response times to customer incidents. M2's proprietary Customer Relationship Management (CRM) platform is the centrepiece of these developments.

The acquisition of Protel Communications (see Acquisitions section following) has served as the catalyst for the development of incremental product knowledge and customer service skills, to enable the staged consolidation of all operations and customer care functions within M2's Melbourne headquarters.

M2's wholesale carrier relationships have expanded during the year, driven principally by the preparation for our upcoming launch into new product areas (see Looking Forward section following). M2's steadily increasing customer base and impeccable payment history has assisted considerably in securing favourable commercial terms with our wholesale carrier partners during the year.

The M2 business model (as illustrated in the chart above) remained fundamentally similar at the end of the 2004/5 year as at the beginning. The notable differences being (i) the expansion of our product suite to incorporate broadband and corporate data services, (ii) the expansion of our target customer base to include medium enterprise and small corporate customers and (iii) the addition of our Internal Sales / "Go-Back" team, to capitalise on the opportunity to market our new products to our expanding customer base.

Innovation

M2 continues to set itself apart from the telecommunications industry generally, through the creation and commercialisation of unique customer propositions and through its alternative approach to certain aspects of sales and operations.

In April 2005, M2 launched its Boarding Calls program, in alliance with Virgin Blue airlines. Following a similar model to M2's well established Phone & Fly, Boarding Calls has presented the opportunity to offer M2's services to the burgeoning base of Small Enterprise customers which have shifted loyalties to Virgin Blue, as a low cost carrier alternative.

In 2005, M2 has taken a leadership role with regard to its environmental policy, having dramatically reduced the amount of

Managing Director's Review

paper consumed in the preparation of its customer accounts. Via enhancement of its "E-bill" system, enabling customers to simply view their monthly accounts on-line, M2 has reduced its paper consumption by literally hundreds of thousands of pages a year.

Several new programs and process innovations are under consideration, testing or pre-launch at present, which will ensure that the 2005/6 year is again one where M2 continues to create and surprise.

Acquisitions

In line with M2's stated strategic goal of selectively acquiring like and/or complementary businesses, on February 2 2005, M2 acquired 100% of Protel Communications International Pty Ltd and Protel IP Technologies Pty Ltd (collectively referred to as "Protel"), both based in Sydney.

Protel represented an ideal strategic fit for M2, in that it specialised in the delivery of whole-of-service telecommunications to medium sized enterprises and small corporates, a market segment which M2 aspired to target, yet lacked certain key competencies in terms of bundled voice, data and mobile service offerings.

Whilst Protel is a smaller business than M2, it is month-on-month profitable, employs a team of specialist personnel and provides M2 with an established presence in the sizable Sydney marketplace.

In March 2005, Protel was re-branded as "M2 Protel" and now operates as the fully integrated medium enterprise & small corporate division of M2. Over recent months there has been significant growth in both the revenue and profitability of M2 Protel, illustrating the positive business fit which has been realised since the acquisition.

Several additional acquisition prospects are being considered as at the date of this Annual Report. The Board remains firm on its commitment to be highly selective in terms of the acquisitions it contemplates. With the organic growth of M2 continuing to move ahead strongly, we are in the fortunate position of being able to carefully and patiently execute our acquisition strategy.

M2Protel™
Corporate Telecommunications

Looking forward

I expect 2006 to be our most exciting and progressive year thus far, which, given the many milestones of recent years may appear to be a little ambitious. Notwithstanding, M2 at the end of 2005 will be a very different business in many ways, particularly in terms of the depth & quality of our product suite, which opens up far more of the market to M2 and provides the opportunity to increase the number of services delivered to our existing customers.

Mobiles : In late 2005, M2 is set to launch its single most aggressive sales and marketing push of its mobile telecommunications products ("M2 Mobile"). Having recently secured a unique and highly competitive mobile wholesale agreement with Singtel Optus, coupled with unique value-enhanced propositions exclusive to M2, I am confident that M2 Mobile will become a central new business generator for the Company over the coming months.

Broadband : September 2005 will see the launch of a range of high speed data services targeted particularly at M2's primary target customer, Small Enterprises. Through a newly formed association with Telstra Wholesale, M2 now possesses a full suite of high speed and premium grade data products, providing optimum Internet connectivity to our customers and pathways for emerging technologies such as Voice Over Internet Protocol (VOIP) and Voice Over DSL.

The broadening of M2's product offering into the rampantly expanding areas of mobile and high speed data, together with the formation of new wholesale alliances with tier-one telecommunications carriers has now positioned M2 well for the future, in terms our ability to access new and emerging products as they become readily commercialised.

In conclusion, please let me once again thank our fantastic people for your tireless efforts in again propelling M2 to new levels over the last year. And finally to our shareholders, your support is essential and very much appreciated.

Yours faithfully

Vaughan Bowen
Managing Director & CEO

Directors' Report

Your directors present their report for the year ended 30 June 2005.

DIRECTORS

The Directors in office during the financial year and at the date of this report are :

Max Garfield Bowen - Non-executive Chairman

Max Bowen provides the Board with the experience gained in a management and business career spanning more than four decades. Max's strengths lie in the areas of business development, financial analysis and organisation structuring. Following a successful early career in project management, Max spent over 20 years developing commercial property throughout Sydney and overseas. Over the last 10 years, Max 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. Max has served as non-executive chairman since the Company's incorporation.

Vaughan Garfield Bowen - Group Managing Director

Vaughan holds a Bachelor of Commerce degree (UNSW), is a member of the Australian Institute of Company Directors and in 2004 was named as a finalist in the Entrepreneur of the Year Southern Region 2004 award. Vaughan co-founded M2 in late 1999 and was appointed managing director following incorporation. Vaughan provides M2 with proven general management, strategic planning, marketing and financial analysis capabilities and has successfully steered the Company from a start-up technology enterprise to its current position as a fast growing and profitable national telecommunications company. Through his innovative approach to branding, sales and alliance marketing, Vaughan has developed a robust business model and a cost effective sales channel strategy, providing M2 with a considerable competitive advantage, evidenced by the strong, profitable growth the Company has enjoyed over recent years. Prior to joining M2, Vaughan spent several years managing and profitably growing the South East Asian operations of Secure Parking, one of the region's largest facilities management companies.

Dennis Nabeeh Basheer - Non-Executive Director

Dennis is an experienced company director with past focus on property development, project management and franchise developments. Since incorporation of the Company until late 2003, Dennis served as an executive director and was involved in corporate and channel sales for the M2's digital telecommunications products division. Dennis remains involved in the promotion of M2's products and services as a South Australian dealer.

Dean Leslie Gingell - Non-Executive Director

Dean has 20 years of experience in telecommunications, Internet and media industries. Dean was formerly chief operating officer, Unwired; deputy chief executive officer, Commander Communications; managing director, Fairfax Online; and chief executive officer of Telstra's OnAustralia (now Bigpond, Australia's largest internet service provider). Dean's resignation was due to a potential conflict of interest arising from his new full time employment position. Appointed 24 August 2004, resigned 7 December 2004.

John Sanford Hynd - Non-Executive Director

John holds a Bachelor of Laws degree from the University of Adelaide, is a Fellow of the Taxation Institute of Australia, a member of the Intellectual Property Society of Australia and New Zealand, a member of the Advisors Group with Family Business Australia and a former member of the Law Council of the Law Society of South Australia. John specialises in intellectual property legal affairs, with a particular focus upon technology industries. John's empathy for technology, coupled with a methodical legal / commercial approach to intellectual property, licensing and channel / distribution agreements, has provided the Company with valuable assistance in its strategic planning. John has served as a non-executive director of the Company since its incorporation.

Craig Lehmann Farrow - Non-Executive Director

Craig holds a Bachelor of Economics degree from the University of Adelaide and is a Fellow of the Institute of Chartered Accountants. He is a founding partner of Brentnalls SA, Chartered Accountants and former National Chairman of the Brentnalls National Affiliation of Accounting firms. Craig is a director or board adviser to several consulting and trading enterprises, and is currently National Chairman of the Institute of Chartered Accountant's Public Practice Advisory Committee. Craig is also highly awarded, including being a Fellow of the Governor's Leadership Foundation and receiving the Institute of Chartered Accountants 1999 National President's Award for services to the Institute and the profession. Craig has served as a non-executive director of the Company since its incorporation.

Directors' Report

The interests of the directors in the shares and options of the company and related body corporate at the date of this report is set out in Note 26 of the Financial Report.

COMPANY SECRETARY

Darryl Noel Inns

Darryl is the chief financial officer and company secretary. Darryl is a Certified Practising Accountant and has served in senior finance roles in technology and manufacturing companies in both Australia and in the United Kingdom. Appointed 23 July 2004.

Profit / Loss

The profit of the consolidated entity for the year ended 30 June 2005, after providing for income tax, amounted to $1,804,456 (2004 $1,299,343 profit).

Principal Activities

The principal activity of the consolidated entity during the period was the provision of telecommunication services to the business market.

Significant changes in the state of affairs

The companies within the consolidated entity were incorporated in December 1999.

As at 30 June 2005 the issued capital of the holding company was $7,911,207 (2004 $5,332,668), whilst the net shareholders' equity of the consolidated entity at that date was $7,198,591 (2004 $3,278,657).

Review of Operations

M2 Group experienced substantial revenue growth during the Period, generating Gross Revenue of $23,719,143 for the year to end June 2005, compared with $15,336,301 for the year to end June 2004 (55% increase in Gross Revenue over previous Period).

An Operating Profit of $1,804,456 was recorded for the year to end June 2005, compared with an Operating Profit of $1,299,343 for the year to end June 2004 (39% increase in Operating Profit over previous Period).

Please see the Managing Directors report for further details.

Events Since Balance Date

There were no post balance date events.

Likely Development & Expected Results

The Directors expect that the financial performance of the business remain strong in the 2005-06 year, particularly due to the growth in recurring sales of M2 Connect and M2 Protel, via its customer acquisition / retention programs and national sales distribution channels.

Environment Regulation & Performance

The consolidated entity's operations are not regulated by any significant environmental regulation under a law of the Commonwealth or of a State or Territory.

Dividends

	cents	$
Final dividends (fully franked) recommended: - On ordinary shares	1.5	890,503
Dividends paid in the year: - On ordinary shares	.78	463,061

Employees

The consolidated entity employed 70 people at 30 June 2005 (30 June 2004 : 45).

Options

There were nil options outstanding at the date of this report.

Directors' & Officers' Indemnity Insurance

The company has entered into a directors' & officers' insurance contract on 16 September 2004 for the purpose of insuring against any liability that may arise from the directors carrying out their duties and responsibilities in their capacity as officers of the company. The amount of the premium was $23,500.

Non-Audit Services

There were no non-audit services performed by the Auditors for the financial year.

Auditor's Independence

The directors received the following declaration from the auditor of M2 Telecommunications Group Limited.

ERNST & YOUNG

Santos House
91 King William Street
Adelaide SA 5000
Australia

GPO Box 1271
Adelaide SA 5001

Tel 61 8 8233 7111
Fax 61 8 8231 8050
DX 155 Adelaide

Auditor's Independence Declaration to the Directors of M2 Telecommunications Group Limited

In relation to our audit of the financial report of M2 Telecommunications Group Limited financial year ended 30 June 2005, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the Corporations Act 2001 or any applicable code of professional conduct.

Ernst & Young

Ernst & Young

Potter

Allan Potter
Partner
19 August 2005

Directors' Report

Directors' Remuneration

Remuneration Report

This report outlines the remuneration arrangements in place for directors and executives of M2 Telecommunications Group Ltd (the company).

Remuneration philosophy

The performance of the company depends upon the quality of its directors and executives. To prosper, the company must attract, motivate and retain highly skilled directors and executives.

To this end, the company embodies the following principles in its remuneration framework:

- Provide competitive rewards to attract high calibre executives
- Link executive rewards to shareholder value
- Significant portion of executive remuneration 'at risk', dependent upon meeting pre-determined performance benchmarks
- Establish appropriate, demanding performance hurdles in relation to variable executive remuneration

Nomination and Remuneration committee

The Nomination and Remuneration Committee of the Board of Directors of the company is responsible for determining and reviewing compensation arrangements for the directors, the chief executive officer (CEO) and the senior management team, amongst other things.

The Nomination and Remuneration Committee assesses the appropriateness of the nature and amount of remuneration of directors and senior managers on a periodic basis by reference to relevant employment market conditions with the overall objective of ensuring maximum stakeholder benefit from the retention of a high quality board and executive team.

Remuneration structure

In accordance with best practice corporate governance, the structure of non-executive director and senior manager remuneration is separate and distinct.

Non-executive director remuneration

Objective

The Board seeks to set aggregate remuneration at a level which provides the company with the ability to attract and retain directors of the highest calibre, whilst incurring a cost which is acceptable to shareholders.

Structure

The Constitution and the ASX Listing Rules specify that the aggregate remuneration of non-executive directors shall be determined from time to time by a general meeting. An amount not exceeding the amount determined is then divided between the directors as agreed. The current aggregate remuneration is $150,000 per year.

The amount of aggregate remuneration sought to be approved by shareholders and the manner in which it is apportioned amongst directors is reviewed annually. The board considers advice from external consultants as well as the fees paid to non-executive directors of comparable companies when undertaking the annual review process.

Each director receives a fee for being a director of the company.

Non-executive directors have long been encouraged by the board to hold shares in the company (purchased by the director on market). It is considered good governance for directors to have a stake in the company whose board he or she sits.

The remuneration of non-executive directors for the period ending 30 June 2005 is detailed in Table 1 on page 13 of this report.

Senior manager and executive director remuneration

Objective

The company aims to reward executives with a level and mix of remuneration commensurate with their position and responsibilities within the company and so as to:

- reward executives for company, business unit and individual performance against targets set by reference to appropriate benchmarks;
- align the interests of executives with those of shareholders;
- link reward with the strategic goals and performance of the company; and
- ensure total remuneration is competitive by market standards.

Structure

In determining the level and make-up of executive remuneration, the Nomination and Remuneration Committee reviewed market levels of remuneration for comparable executive roles from which the Committee makes its recommendations to the Board.

It is the Nomination and Remuneration Committee's policy that employment contracts are entered into with the Chief Executive Officer and the senior management.

Remuneration consists of the following key elements:

- Fixed Remuneration
- Variable Remuneration
  - Short Term Incentive ('STI');

The proportion of fixed remuneration and variable remuneration (potential short term incentives) is established for each senior manager by the Nomination and Remuneration Committee. Table 2 on page 13 details the variable component of the 4 most highly remunerated executives.

Fixed Remuneration

Objective

The level of fixed remuneration is set so as to provide a base level of remuneration which is both appropriate to the position and is competitive in the market.

Fixed remuneration is reviewed annually by the Nomination and Remuneration Committee and the process consists of a review of company wide, business unit and individual performance, relevant comparative remuneration in the market and internal and, where appropriate, external advice on policies and practices. As noted above, the Committee has access to external advice independent of management.

Structure

Senior managers are given the opportunity to receive their fixed (primary) remuneration in a variety of forms including cash and fringe benefits such as motor vehicles and expense payment plans. It is intended that the manner of payment chosen will be optimal for the recipient without creating undue cost for the company.

The fixed remuneration component of the 4 most highly remunerated senior managers is detailed in Table 2 on page 13.

Variable Remuneration — Short Term Incentive (STI)

Objective

The objective of the STI program is to link the achievement of the company's operational targets with the remuneration received by the executives charged with meeting those targets. The total potential STI available is set at a level so as to provide sufficient incentive to the senior manager to achieve the operational targets and such that the cost to the company is reasonable in the circumstances.

Structure

Actual STI payments granted to each senior manager depend on the extent to which specific operating targets set at the beginning of the financial year are met. The operational targets consist of a number of Key Performance Indicators (KPIs) covering both financial and non-financial measures of performance. Typically included are measures such as contribution to net profit after tax, customer service, risk management, product management, and leadership/team contribution. The company has predetermined benchmarks which must be met in order to trigger payments under the short term incentive scheme.

On an annual basis, after consideration of performance against KPIs, an overall performance rating for the company and each individual business unit is approved by the Nomination and Remuneration Committee. The individual performance of each executive is also rated and all three ratings are taken into account when determining the amount, if any, of the short term incentive pool is allocated to each executive. A bonus was paid to the executives on 5 August 2004, based on the financial performance of the company up to the end of the 2004 financial year.

The aggregate of annual STI payments available for executives across the company is subject to the approval of the Nomination and Remuneration Committee. Payments made are usually delivered as a cash bonus.

Company performance

The performance of the company can be illustrated by:

1. Performance of the share price across the financial year. On the 29 October 2004, M2 Telecommunications Group Ltd listed on the ASX at a listing price of $0.25. As at the date of this report, the share price is $0.36, and has consistently trading at a premium above the listing price of $0.25.
2. Earnings per share. The basic earnings per share has increased to 3.3 cents per share, an increase of 10% on the basic earnings per share at the same time last year (3.0 cents per share).

Employment contracts

The Managing Director, Vaughan Bowen, is employed under a contract. The current employment contract commenced on 20th August 2004, and was renewed on 19th August 2005 for a further term of 1 year.

Directors' Report

Emoluments' of directors of the Consolidated Entity

Table 1

Annual Emoluments

	Base Fee $	Bonus $	Other $	Superannuation $	Total $
V. Bowen	202,874	33,333	22,593	18,259	277,059
M. Bowen	24,000	-	-	-	24,000
J. Hynd	15,000	-	-	-	15,000
C. Farrow	15,000	-	-	-	15,000
D. Gingell	3,960	-	-	-	3,960
D. Basheer	15,000	-	-	-	15,000
Totals	**275,834**	**33,333**	**22,593**	**18,259**	**350,019**

Emoluments' of executive officers of the Consolidated Entity

Table 2

Emoluments' of executive officers of the Consolidated Entity

	Base Fee $	Bonus $	Other $	Superannuation $	Total $
S. Wicks (General Manager)	169,911	83,333	14,632	19,252	287,128
D. Inns (Chief Financial Officer)	92,423	33,333	11,913	8,318	145,987
M. Leahy (General Manager - Protel)	34,225	-	5,077	3,080	42,382
B. Mouy (Operations Manager)	77,103	15,000	-	6,891	98,994
Totals	**373,662**	**131,666**	**31,622**	**37,541**	**574,491**

Notes to Directors & Executive Officers Remuneration

The terms 'director' and 'officer' have been treated as mutually exclusive for the purposes of this disclosure.

The elements of emoluments have been determined on the basis of the cost to the company and the consolidated entity

Executives are those directly accountable and responsible for the operational management and strategic direction of the company and the consolidated entity. No other employees meet the definition of executive officer. All bonuses for the financial year have been paid and fully vested within the financial year.

No comparative figures have been presented as the company was an unlisted public company in the previous year.

Remuneration policy and tables 1 and 2 above have been audited.

Directors' Meetings

The number of directors' meetings held (including meeting of committees of Directors) and number of meetings attended by each of the Directors of the company during the financial year were:

	Board of Directors		Nomination & Remuneration Committee		Audit Committee	
	Held	Attended	Held	Attended	Held	Attended
V. Bowen	11	11	-	-	-	-
M. Bowen	11	11	-	-	-	-
J. Hynd	11	11	1	1	1	1
C. Farrow	11	11	1	1	1	1
D. Gingell	4	4	-	-	-	-
D. Basheer	11	11	1	1	-	-

At the date of this report the company had an Audit Committee and a Nomination and Remuneration Committee.

Members acting on the committees of the board were:

Nomination and Remuneration Committee
John Hynd (Chairman)
Craig Farrow
Dennis Basheer

Audit Committee
Craig Farrow (Chairman)
John Hynd

Tax Consolidation

Effective 1 February 2005, for the purposes of income taxation, M2 Telecommunications Group Ltd and its 100% owned subsidiaries have formed a tax consolidation group. Members of the group have entered into a tax sharing arrangement in order to allocate income tax expense to the wholly-owned subsidiaries on a pro-rata basis. In addition the agreement provides for the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations.

Signed in accordance with a resolution of the Board of Directors:

VAUGHAN BOWEN
Group Managing Director

Dated this 19th day of August 2005

Corporate Governance Statement

Corporate Governance Statement

The Board of Directors of M2 Telecommunications Group Ltd is responsible for the corporate governance of the consolidated entity. The Directors aspire to the highest standards of corporate governance that could be deemed appropriate for a company of M2 Telecommunications Group Ltd nature, size and activities.

Set out below are the key components of the Corporate Governance principles adopted by the Board. These components are set out consistent with the "Principals of Good Corporate Governance and Best Practice Recommendations" as released by the ASX Corporate Governance Council.

Lay solid foundations for management and oversight

The Board of Directors is responsible for setting the strategic direction and establishing the policies of M2 Telecommunications Group Ltd, for overseeing the financial position, and for monitoring the business and affairs on behalf of the shareholders, by whom they are elected and to whom they are accountable.

Responsibilities of management are delineated by formal authority delegations.

Structure the Board to add value

Due to the fact that:

- Each director of the company has a substantial shareholding (controlling approximately 45% of the issued capital of the company) in the company;
- Each of these directors have valuable and necessary skills, experience and expertise that the majority of the Board wishes to utilise

Then it is not considered appropriate that the Board should be independent directors.

The qualifications, skills and experience of all members of the Board are set out in the Directors' Report.

Also, given the small size of the Board, it is not considered appropriate that the separate Nomination Committee be set up. A Nomination and Remuneration Committee has been established by the Board. In respect of selecting new directors, the Board will assess the skills, experience and expertise of each of the prospective candidates in line with those skills, experience and expertise deemed necessary by the Board.

There are procedures in place, agreed by the board, to enable directors, in furtherance of their duties, to seek independent professional advice at the company's expense.

Nomination and Remuneration Committee

The Board has established a Nomination and Remuneration Committee, which meets at least annually, to ensure that the Board continues to operate within the established guidelines, including when necessary, selecting candidates for the position of director. The Nomination and Remuneration Committee comprises non-executive directors. The Nomination and Remuneration Committee comprises of the following members:

John Sandford Hynd (Chair)
Craig Lehmann Farrow
Dennis Nabeeh Basheer

For details of directors' attendance at meetings of the Nomination and Remuneration Committee, refer to page 14 of the Directors' Report.

Promote ethical and responsible decision making

The Board actively promotes ethical and responsible codes of conduct by its entire staff.

In addition to the legal restrictions of trading securities whilst in possession of unpublished price sensitive information concerning the consolidated entity, the Board has determined that all directors and senior management of the consolidated entity will be under an obligation to not trade in the Company's securities during the following periods:

1. Between 1 January each year until such time as the half year financial results of the Company are released to the ASX; and
2. Between 1 July of each year until such time as the full year financial results of the Company are released to the ASX.

Safeguard integrity in financial reporting

The Board has established an audit committee, which operates under a charter approved by the Board. It is the Board's responsibility to ensure that an effective internal control framework exists within the entity. This includes internal controls to deal with both the effectiveness and efficiency of significant business processes, the safeguarding of assets, the maintenance of proper accounting records, and the reliability of financial information as well as non-financial considerations such as benchmarking of operational key performance indicators. The Board has delegated the responsibility for the establishment and maintenance of a framework of internal control and ethical standards for the management of the consolidated entity to the audit committee.

The committee also provides the board with additional assurance regarding the reliability of financial information for inclusion in the financial reports. All members of the audit committee are non-executive directors.

The audit committee comprises of the following members:

Craig Lehmann Farrow (Chair)
John Sandford Hynd

Make timely and balanced disclosure

The consolidated entity has in place processes to ensure that the company announcements are factual, made in a timely manner and do not omit material information.

Respect the rights of shareholders

The consolidated entity is currently reviewing the most effective way in which it communicates with shareholders and is updating its website to meet the guidelines.

Recognise and manage risk

The risk profile of the Company will be monitored by the Audit Committee who assesses key risks at least annually (generally in line with the renewal of the consolidated entity's insurance programme).

Encourage enhanced performance

The performance of the board and key executives is reviewed regularly against both measurable and qualitative indicators. During the reporting period, the Nomination and Remuneration Committee conducted two performance evaluations which involved an assessment of each board member's and key executives' performance against specific and measurable qualitative and quantitative performance criteria. The performance criteria against which directors and executive are assessed is aligned with the financial and non-financial objectives of M2 Telecommunications Group Ltd. Directors whose performance is consistently unsatisfactory may be asked to retire.

Remunerate fairly and responsibly

The remuneration policy of the consolidated entity is set out in the Directors' Report.

Recognise the legitimate interests of stakeholders

As stated previously, the Board actively promotes ethical and responsible codes of conduct by its entire staff.

Financial Statements

Statement of Financial Performance for the Year Ended 30 June 2005

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Revenue from ordinary activities	2	23,719,143	15,336,301	843,352	–
Changes in inventories of finished goods and work in progress		–	(206,756)	–	–
Cost of Sales		(16,312,683)	(11,034,414)	–	–
Employee benefits expense		(2,683,152)	(1,460,601)	–	–
Provision for Employee Share Allotment		–	(254,000)	–	–
Depreciation and amortisation expenses	3	(444,951)	(550,040)	–	–
Borrowing costs expense	3	(10,914)	(11,197)	–	–
Royalties		–	(90,921)	–	–
Research & Development					
consumables, Subcontract services		–	(500)	–	–
Premises Rentals		(153,695)	(123,556)	–	–
Travelling & Accommodation		(158,559)	(90,123)	–	–
Advertising, Marketing & Promotion expenditures		(166,889)	(92,318)	–	–
Other expenses from ordinary activities		(1,248,706)	(625,914)	(183,288)	(2,975)
Reversal of Provision for Diminution of Investment		–	–	–	2,475,000
Profit/(Loss) from ordinary activities before income tax expense		2,539,594	795,961	660,064	2,472,025
Income tax (expense)/benefit relating to ordinary activities	4	(735,138)	503,382	(191,667)	54,111
Profit/(Loss) from ordinary activities after related income tax expense		1,804,456	1,299,343	468,397	2,526,136
Net Profit/(Loss)		1,804,456	1,299,343	468,397	2,526,136

Statement of Financial Performance for the Year Ended 30 June 2005 continued

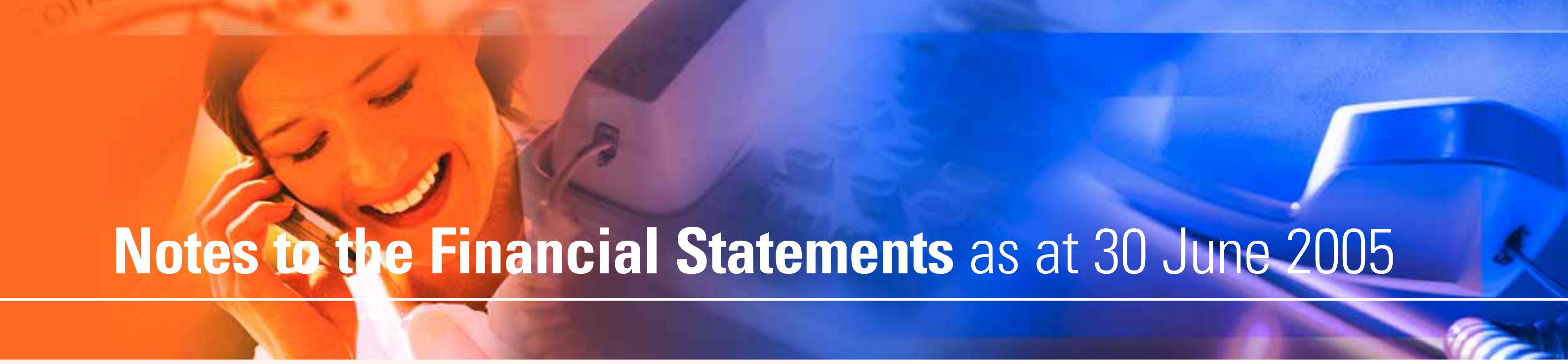
	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Net profit/(Loss) attributed to members of M2 Telecommunications Group Ltd and recognised directly in equity		1,804,456	1,299,343	468,397	2,526,136
Share Issue Costs		(521,462)	–	(521,462)	–
Total revenues, expenses and valuation adjustments attributable to members of the M2 Telecommunications Group Ltd and recognised directly in equity		(521,462)	–	(521,462)	–
Total changes in equity other than those resulting from transactions with owners as owners attributable to members of M2 Telecommunications Group Ltd		1,282,994	1,299,343	(53,065)	2,526,136
Basic Earnings per Share (cents per share)	23	3.3	3.0		
Diluted Earnings per Share (cents per share)	23	3.3	3.0		

Statement of Financial Position as at 30 June 2005

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
CURRENT ASSETS					
Cash assets		4,695,011	2,623,559	573,155	674,096
Receivables	6	2,858,352	1,913,545	–	–
Other	7	506,180	71,860	3,905	41,088
TOTAL CURRENT ASSETS		8,059,543	4,608,964	577,060	715,184
NON-CURRENT ASSETS					
Receivables	8	68,245	–	4,671,433	903,703
Investments	9	6,000	–	2,955,000	2,955,000
Property, plant and equipment	10	506,565	489,996	–	–
Deferred Tax Assets	4	702,091	503,382	702,091	503,382
Intangible assets	11	2,380,689	623,919	–	–
TOTAL NON-CURRENT ASSETS		3,663,590	1,617,297	8,328,524	4,362,085
TOTAL ASSETS		11,723,133	6,226,261	8,905,584	5,077,269
CURRENT LIABILITIES					
Payables	12	3,269,372	2,390,982	354,318	21,017
Current Tax Liabilities	4	911,139	–	911,139	–
Interest-bearing liabilities	13	29,436	27,431	–	–
Provisions	14	168,504	377,602	–	–
Other	15	23,938	–	–	–
TOTAL CURRENT LIABILITIES		4,402,389	2,796,015	1,265,457	21,017
NON-CURRENT LIABILITIES					
Interest-bearing liabilities	16	122,153	151,589	–	–
TOTAL NON-CURRENT LIABILITIES		122,153	151,589	–	–
TOTAL LIABILITIES		4,524,542	2,947,604	1,265,457	21,017
NET ASSETS		7,198,591	3,278,657	7,640,127	5,056,252
EQUITY					
Contributed Equity	17	7,911,207	5,332,668	7,911,207	5,332,668
(Accumulated Losses)/Retained profits	18	(712,616)	(2,054,011)	(271,080)	(276,416)
TOTAL EQUITY		7,198,591	3,278,657	7,640,127	5,056,252

Statement of Cash Flows for the Year Ended 30 June 2005

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
CASH FLOWS FROM OPERATING ACTIVITIES					
Receipts for customers		23,158,562	14,575,138	–	–
Payments to suppliers and employees		(21,292,559)	(12,630,973)	(49,045)	(38,418)
Interest received		189,995	40,275	39,594	–
Interest Paid		(10,914)	(11,197)	–	–
Dividend received		–	–	800,000	–
Net cash provided by (used in) operating activities	19	2,045,084	1,973,243	790,549	(38,418)
CASH FLOWS FROM INVESTING ACTIVITIES					
Acquisition of property, plant and equipment		(322,611)	(384,312)	–	–
Proceeds from/to Related Parties		–	(300,000)	–	–
Advances from/to subsidiary		–	–	(2,406,967)	33,000
Advances to associates		(68,245)	5,117	–	5,117
Cash paid for purchase of Business Assets		(344,869)	–	–	–
Purchase of controlled entities	19	(731,775)	–	–	–
Net cash provided by (used in) investing activities		(1,467,500)	(679,195)	(2,406,967)	38,117
CASH FLOWS FROM FINANCING ACTIVITIES					
Proceeds from borrowings		1,691	(1,400)	–	–
Proceeds from issue of shares		2,500,000	674,100	2,500,000	674,100
Payment of share issue costs		(521,462)	–	(521,462)	–
Repayment of borrowings		(23,300)	(24,793)	–	–
Finance lease principal		–	104,000	–	–
Dividends Paid		(463,061)	–	(463,061)	–
Net cash provided by (used in) financing activities		1,493,868	751,907	1,515,477	674,100
Net Increase in Cash Held		2,071,452	2,045,955	(100,941)	673,799
Opening Cash Balance		2,623,559	577,604	674,096	297
Closing Cash Balance	19	4,695,011	2,623,559	573,155	674,096



Notes to the Financial Statements as at 30 June 2005

1. Note 1: Statement of Significant Accounting Policies

The financial report covers the economic entity of M2 Telecommunications Group Ltd and controlled entities, and M2 Telecommunications Group Ltd as an individual parent entity. M2 Telecommunications Group Ltd is a listed public company, incorporated and domiciled in Australia.

The registered office of M2 Telecommunications Group Ltd is Level 2, 22 Horne Street, Elsternwick VIC 3185.

The financial statements have been prepared in accordance with the historical cost convention and are prepared on an accrual basis.

The financial report is a general purpose financial report prepared in accordance with the requirements of the Corporations Act 2001 which includes applicable Accounting Standards. Other mandatory professional reporting requirements (Urgent Issues Group Consensus Views) have also been complied with.

(a) Principles of consolidation

A controlled entity is any entity controlled by M2 Telecommunications Group Ltd. Control exists where M2 Telecommunications Group Ltd has the capacity to dominate the decision-making in relation to the financial and operating policies of another entity so that the other entity operates with M2 Telecommunications Group Ltd to achieve the objectives of M2 Telecommunications Group Ltd. A list of controlled entities is contained in Note 9 to the financial statements.

All inter-company balances and transactions between entities in the economic entity, including any unrealised profits or losses, have been eliminated on consolidation.

Where controlled entities have entered or left the economic entity during the year, their operation results have been included from the date control was obtained or until the date control ceased.

(b) Foreign currencies

Translation of foreign currency transactions

Transactions in foreign currencies of entities within the consolidated entity are converted to local currency at the rate of exchange ruling at the average exchange rate for the financial year.

Translation of financial reports of overseas operations

All overseas operations are deemed integrated as each is financially and operationally dependent on M2 Telecommunications Group Ltd. As such they are translated using the temporal method with any difference upon translation being taken to the Statement of Financial Performance. This is disclosed where material.

(c) Cash and cash equivalents

Cash on hand and in banks and short-term deposits are stated at the lower of cost and net realisable value. For the purposes of the Statement of Cash Flows, cash includes cash on hand and in banks, and money market investments readily convertible to cash within 2 working days, net of outstanding bank overdrafts.

Bank overdrafts are carried at the principal amount. Interest is charges as an expense as it accrues.

(d) Trade and other receivables

Trade receivables are recognised and carried at original invoice amount less a provision for any uncollectible debts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written-off as incurred.

Receivables from related parties are recognised and carried at the nominal amount due.

(e) Property, plant and equipment

Cost and valuation

The carrying amount of plant and equipment is reviewed annually by directors to ensure it is not in excess of the recoverable amount from these assets, the recoverable amount is assessed on the bases of the expected net cash flows, which will be received from the assets employment and subsequent disposal. The expected net cash flows have not been discounted to their present values in determining recoverable amounts.

In effect it is recorded at the lower of cost and recoverable amount.

Depreciation

The depreciable amount of all fixed assets including capital lease assets is depreciated on a straight line basis over the useful lives to the economic entity commencing from the time the asset is held ready for use. Leasehold improvements are depreciated over the shorter of either the unexpired period of the lease or the estimated useful lives of the improvements.

The depreciation rates used for each class of depreciable assets are:

Class of Fixed Asset	Depreciation Rate
Plant and equipment	10% – 100 %
Leased plant and equipment	10% – 40 %

(f) Leases

Leases of fixed assets where substantially all risks and benefits incidental to the ownership of the asset, but not the legal ownership, are transferred to entities in the economic entity are classified as finance leases. Finance leases are capitalised, recording an asset and a liability equal to the present value of the minimum lease payments, including any guaranteed residual values. Leased assets are depreciated on a straight line basis over their estimated useful lives where it is likely that the economic entity will obtain ownership of the asset over the term of the lease. Lease Payments are allocated between the reduction of the lease liability and the lease interest expense for the Period.

Lease payments for operating leases, where substantially all the risks and benefits remain with the lessor, are charged as expenses in the periods which they are incurred.

Lease incentives under operating leases are recognised as a liability. Lease payments received reduce the liability.

(g) Intangibles

Trademarks and Licences

Trademarks and Licences represents the consideration paid over the fair value of identifiable net tangible assets acquired at the time of acquisition of the digital telecommunications products business.

The trademarks and licenses are subject to an agreement between RVA Systems Pty Ltd and M2, and the assets are being amortised at the same rate as revenue is generated.

Goodwill

Goodwill represents the excess of the purchase consideration over the fair value of identifiable net assets acquired at the time of acquisition of a business or shares in a controlled entity.

Goodwill is amortised on a straight-line basis over the period during which benefits are expected to be received. This is taken as being 20 years.

(h) Research & Development Expenditure

Research and development costs

Research and development costs are expensed as incurred, except where future benefits are expected, beyond any reasonable doubt, to exceed those costs. Where research and development costs are deferred such costs are amortised over future periods on a basis related to expected future benefits. Unamortised costs are reviewed at each balance date to determine the amount (if any) that is no longer recoverable and any amount identified is written off.

The directors have resolved to expense all Research & Development expenditure.

All employee costs related to Research & Development are included under employment expenses.

(i) Trade and other payables

Liabilities for trade creditors and other amounts are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the consolidated entity.

Payables to related parties are carried at the principal amount. Interest, when charged by the lender, is recognised as an expense on an accrual basis.

Deferred cash settlements are recognised at the present value of the outstanding consideration payable on the acquisition of an asset discounted at prevailing commercial borrowing rates.

(j) Loans and borrowings

All loans are measured at the principal amount. Interest is charged as an expense as it accrues.

Finance lease liability is determined in accordance with the requirement of AASB 1008 : Accounting for Leases.

(k) Share capital

Ordinary share capital is recognised at the fair value of the consideration received by the company.

Any transaction costs arising on the issue of ordinary shares are recognised directly in equity as a reduction of the share proceeds received.

(l) Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Sale of goods

– Control of the goods has passed to the buyer.

Rendering of services

– Where the contract outcome can be reliably measured:

- control of a right to be compensated for the services has been attained and the stage of completion can be reliably measured. Stage of completion is measured by reference to labour hours incurred to date as a percentage of total estimated labour hours for each contract.

– Where the contract outcome cannot be reliably measured:

- revenue is recognised only to the extent that costs have been incurred.

Interest & Rental

– Control of a right to receive consideration for the provision of, or investment in, assets has been attained.

All Revenue is stated net of the amount of goods and services tax (GST)

(m) Investments in Subsidiaries

Investments in subsidiaries are recognised in the financial statements at directors' assessment of net recoverable amount.

(n) Income tax

Tax-effect accounting is applied using the liability method whereby income tax is regarded as an expense and is calculated on the accounting profit after allowing for permanent differences. To the extent timing differences occur between the time items are recognised in the financial statements and when items are taken into account in determining taxable income, the net related taxation benefit or liability, calculated at current rates, is disclosed as a future income tax benefit or a provision for deferred income tax. The net future income tax benefit relating to tax losses and timing differences is not carried forward as an asset unless the benefit is virtually certain of being realised.

Where assets are re-valued no provision for potential capital gains tax has been made.

The income tax expense for the year is calculated using the 30% tax rate.

(o) Employee Benefits

Provision is made for employee benefits accumulated as a result of employees rendering services up to the reporting date. These benefits include annual leave and long service leave.

Liabilities arising in respect of annual leave, sick leave and any other employee expected to be settled within twelve months of the reporting date are measured at their nominal amounts. All other employee benefit liabilities are measured at the present value of the estimated future cash outflow to be made in respect of services provided by employees up to the reporting date. In determining the present value of future cash outflows, the interest rates attached to government guaranteed securities which have terms to maturity approximating the terms of the related liability are used.

Employee benefits expenses and revenues arising in respect of the following categories:

- wages and salaries, non-monetary benefits, annual leave, long service leave, sick leave and other leave entitlements; and
- other types of employee benefits are charged against profits on a net basis in their respective categories.

(p) Period of Accounts

M2 Telecommunications Pty Ltd was incorporated on 29 October 1999.

Trading operations commenced on 15 December 1999 after the acquisition of the assets of Messagemate Australia Pty Ltd.

M2 Telecommunications Group Ltd was incorporated on 14 February 2000.

Protel Communications International Pty Ltd was acquired on 2 February 2005.

Protel IP Technology Pty Ltd was acquired on 2 February 2005.

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 2: Revenue					
Operating Activities					
– revenue from services		23,140,337	14,948,375	–	–
– interest received		189,995	40,275	43,352	–
– license income		369,400	228,774	–	–
– other revenue		–	–	–	–
– rental revenue		19,411	88,876	–	–
– services revenue		–	30,001	–	–
		23,719,143	15,336,301	43,352	–
Non-operating Activities					
– Dividends and distributions					
– Wholly owned subsidiaries		–	–	800,000	–
		–	–	800,000	–
Total revenue		23,719,143	15,336,301	843,352	–

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 3: Profit/(Loss) from Ordinary Activities					
Profit/(Loss) from ordinary activities before income tax has been determined after charging the following items :					
Cost of sales		16,312,683	11,241,170	–	–
Amortisation of non-current assets					
Trademarks and licences		118,546	233,443	–	–
Write off of Trademarks and Licences		–	117,664	–	–
Amortisation of Goodwill on Acquisition		32,562	–	–	–
Total Amortisation		151,108	351,107	–	–
Depreciation of non-current assets					
Plant and equipment		293,843	198,933	–	–
Bad and doubtful debts					
Trade debtors – other persons/bodies corporate		132,858	44,337	–	–
Borrowing costs expensed					
Interest expense		10,914	11,197	–	–
Total borrowing costs		10,914	11,197	–	–
Other Provisions					
Provision for employee benefits		44,902	(6,364)	–	–

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 4: Income Tax					
The prima facie tax, using tax rates applicable in the country of operation, on operating profit/(loss) differs from the income tax provided in the financial statements as follows:					
Prima facie tax on operating profit/(loss)		761,878	238,788	198,019	741,608
Tax effect of permanent differences					
Amortisation of intangible assets		–	10,872	–	–
Employee Share Allotment		–	76,200	–	–
Reversal of Provision for Diminution of Investment		–	–	–	(742,500)
Other items (net)		(26,740)	5,849	(6,352)	(4,235)
Income tax expense attributable to operating profit		735,138	331,709	191,667	(5,127)
Add future income tax benefit brought to account		–	(835,600)	–	(48,984)
Income tax expense/(benefit) attributable to operating activities		735,138	(503,382)	191,667	(54,111)
Future income tax benefit					
– timing differences		702,091	356,558	702,091	356,558
– tax losses		–	146,824	–	146,824
		702,091	503,382	702,091	503,382
Current tax payable		911,139	–	911,139	–

Effective 1 February 2005, for the purposes of income taxation, M2 Telecommunications Group Ltd and its 100% owned subsidiaries have formed a tax consolidation group. Members of the group have entered into tax sharing and tax funding arrangements in order to allocate income tax expense to the wholly-owned subsidiaries on a pro-rata basis. In addition the agreement provides for the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations.

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 5: Dividends paid or provided for on ordinary shares					
(a) Dividends paid during the year					
(i) Current year interim					
Unfranked dividends (0.78 cents per share)		463,061	–	463,061	–
Note 6: Receivables					
Trade debtors		2,997,008	1,975,890	–	–
Provision for doubtful debts		(138,656)	(62,345)	–	–
		2,858,352	1,913,545	–	–
(a) Movement in provision for doubtful debts					
– balance at beginning of year		(62,345)	(34,845)	–	–
– bad and doubtful debts provided for during the year		(76,311)	(27,500)	–	–
– balance at end of year		(138,656)	(62,345)	–	–
(b) Terms and conditions relating to the above financial statements					
(i) Credit sales are on 7 to 30 day terms					
Note 7: Other Current Assets					
Prepayments		182,302	41,088	–	41,088
Bartercard Trade Balance		223,493	–	–	–
Other		100,385	30,772	3,905	–
		506,180	71,860	3,905	41,088
Note 8: Receivables (Non-Current)					
Loans to associates		68,245	–	–	–
Wholly Owned Group					
– controlled entities		–	–	4,671,433	903,703
		68,245	–	4,671,433	903,703

Note 9: Controlled Entities

(a) Controlled entities

	Country of Incorporation	Percentage owned (%)	
		2005	2004
Parent Entity: M2 Telecommunications Group Ltd	Aust		
Subsidiaries of M2 Telecommunications Group Ltd:			
M2 Telecommunications Pty Ltd	Aust	100	100
Protel Communications International Pty Ltd	Aust	100	–
Protel IP Technology Pty Ltd	Aust	100	–
M2 New Zealand Ltd	NZ	–	100

		2005 $	2004 $	2005 $	2004 $
Investment in Subsidiaries					
Investment in M2 Telecommunications Pty Ltd		–	–	2,955,000	2,955,000
Investment in shares in BBX Holdings Limited		6,000	–	–	–
Total Investment in Subsidiaries		6,000	–	2,955,000	2,955,000
Net Asset position of Protel acquisition					
Total Assets	795,292				
Total Liabilities	793,828				
Net Assets	1,464				
Plant & Equipment purchased	28,437				

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 10: Property, Plant & Equipment					
Plant and equipment					
At cost		1,162,704	860,382	–	–
Provision for depreciation		(680,731)	(409,851)	–	–
		481,973	450,531	–	–
Service Equipment					
At cost		46,125	62,331	–	–
Provision for depreciation		(21,533)	(22,866)	–	–
		24,592	39,465	–	–
Plant and equipment under finance lease					
At cost		–	135,786	–	–
Provision for amortisation		–	(135,786)	–	–
		–	–	–	–
Total property, plant and equipment					
Cost		1,208,829	1,058,499	–	–
Provision for depreciation and amortisation		(702,264)	(568,503)	–	–
Total written down amount		506,565	489,996	–	–

Movements in Carrying Amounts

Movement in the carrying amounts for each class of property, plant and equipment between the beginning and the end of the current financial year.

	Plant and Equipment	Service Equipment	Leased Plant & Equipment	Total
Consolidated:				
Balance at the beginning of year	450,531	39,465	–	489,996
Additions	290,615	–	–	290,615
Disposals	–	(8,640)	–	(8,640)
Additions through acquisition of entity	28,437	–	–	28,437
Depreciation expense	(287,610)	(6,233)	–	(293,843)
Capitalised borrowing costs and depreciation	–	–	–	–
Carrying amount at the end of the year	481,973	24,592	–	506,565

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 11: Intangibles					
Trademarks and licenses – at cost		1,229,844	1,104,317	–	–
Accumulated amortisation		(344,667)	(480,398)	–	–
Total Trademarks and licenses		885,177	623,919	–	–
Goodwill on Acquisition	19	1,528,074	–	–	–
Accumulated amortisation		(32,562)	–	–	–
Total Goodwill on Acquisition		1,495,512	–	–	–
		2,380,689	623,919	–	–
Note 12: Payables					
Trade creditors		559,782	1,119,890	17,934	–
Other creditors		2,486,229	1,210,504	336,384	21,017
Withholding Tax Payable		101,048	31,531	–	–
Goods and Services Tax		122,313	29,057	–	–
		3,269,372	2,390,982	354,318	21,017
Note 13: Interest Bearing Liabilities (Current)					
Borrowings – secured					
Bank loans		29,436	27,431	–	–
		29,436	27,431	–	–

Terms and conditions relating to the above financial instruments

(i) The bank loans are repayable monthly.
Interest rates are 7.39% and 6.62%.

The bank loans are secured directly over the assets financed.

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 14: Provisions					
Provision for Employee Share Allocation		–	254,000		
Employee benefits	21	168,504	123,602	–	–
		168,504	377,602	–	–
Note 15: Other (Current)					
Loans from related parties		23,938	–	–	–
		23,938	–	–	–

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 16: Interest Bearing Liabilities (Non-Current)					
Borrowings – secured					
Bank loans		122,153	151,589	–	–
		122,153	151,589	–	–

Terms and conditions relating to the above financial instruments

(i) The bank loans are repayable monthly.
Interest rates are 7.39% and 6.62%.

The bank loans are secured directly over the assets financed.

Note 17: Contributed Equity

	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Issued and paid up capital				
Ordinary Shares				
At the beginning of the reporting Period	5,332,668	4,658,568	5,332,668	4,658,568
Shares Issued during the year				
– Options exercised	–	674,100	–	674,100
– Initial Public Offer	2,500,000	–	2,500,000	–
– Acquisition of Protel business entities	600,000	–	600,000	–
Total Shares issued	3,100,000	674,100	3,100,000	674,100
Costs associated with IPO	(521,461)	–	(521,461)	–
At reporting date	7,911,207	5,332,668	7,911,207	5,332,668
Number of Shares				
	No.	No.	No.	No.
At the beginning of reporting Period	46,453,063	43,082,563	46,453,063	43,082,563
Shares issued during the year				
– Options exercised	–	3,370,500	–	3,370,500
– Employee Share Allotment	1,270,000	–	1,270,000	–
– Initial Public Offer	10,000,000	–	10,000,000	–
– Acquisition of Protel business entities	1,643,835	–	1,643,835	–
At reporting date	59,366,898	46,453,063	59,366,898	46,453,063

All shares on issue are fully paid

(a) Terms and conditions of contributed equity

Ordinary Shares
Ordinary shares have the right to receive dividends as declared and in the event of winding up the company, to participate in the proceeds from the sale of all surplus assets in proportion to the number of and amounts paid up on shares held.

Ordinary shares entitle their holder to one vote, either in person or by proxy, at a meeting of the company.

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 18: (Accumulated Losses)/Retained Profits					
(Accumulates Losses)/Retained Profits at the beginning of the financial year		(2,054,011)	(3,353,354)	(276,416)	(2,802,552)
Net Operating Profit/(Loss)		1,804,456	1,299,343	468,397	2,526,136
Dividend provided for and paid		(463,061)	–	(463,061)	–
(Accumulated Losses)/Retained Profits at the end of the financial year		(712,616)	(2,054,011)	(271,080)	(276,416)
Note 19: Cash Flow Information					
(a) Reconciliation of Cash Flow from Operations with Profit from ordinary activities after Income Tax					
Profit from ordinary activities after income tax		1,804,456	1,299,343	468,397	2,526,136
Non-cash flows in profit from Ordinary activities					
Amortisation		151,108	351,107	–	–
Depreciation		293,843	198,933	–	–
Provision for employee benefits		44,354	(6,364)	–	–
Provision for employee share allotment		–	254,000	–	–
Provision for doubtful debts		76,311	27,500	–	–
Provision for Reversal of Diminution of Investment		–	–	–	(2,475,000)
Net Loss on disposal of property, plant & equipment		6,395	4,362	–	–
Changes in assets and liabilities, net of the effects of purchases and disposal of subsidiaries					
Increase in trade and term debtors		(929,631)	(937,147)	–	–
Increase in prepayments		(159,845)	–	37,183	–
Increase in inventories		–	206,756	–	–
Increase in FITB		(198,709)	(503,382)	(198,709)	(48,984)
Increase in trade creditors and accruals		728,872	1,123,671	484,445	518
Increase in tax provision		911,139	–	–	–
Increase in Other Assets		(683,209)	(45,536)	(767)	(41,088)
Net cash flow (used in) operating activities		2,045,084	1,973,243	790,549	(38,418)
(b) Reconciliation of Cash Flows					
Cash balance comprises					
Cash on hand		500	400	–	–
Cash at bank		783,528	994,817	573,155	674,096
Deposits at call		3,910,983	1,628,342	–	–
Closing bank balance		4,695,011	2,623,559	573,155	674,096

	$
(c) Acquisition of Controlled Entity	

On 2 February 2005, M2 Telecommunications Pty Ltd acquired 100% of the voting share capital of Protel Communications International Pty Ltd and Protel IP Technology Pty Ltd, both unlisted Australian companies specialising in the telecommunications sector.

	$
The components of the acquisition cost were:	
Consideration	
– shares issued in M2 Telecommunications Group Ltd (MTU)	600,000
– cash paid	900,000
Total Consideration	1,500,000
Net assets of Protel (including Protel Communications International Pty Ltd and Protel IP Technologies Pty Ltd) at 2 February 2005	
Cash	168,225
Trade debtors	547,759
Property, plant & equipment	28,437
Other	50,871
Total assets	795,292
Trade payables & other accruals	611,877
Provisions	83,913
Other	98,038
Total liabilities	793,828
Net Assets	1,464
Transaction Costs	29,538
Goodwill arising on acquisition	1,528,074
	1,500,000
Net cash effect	
Cash consideration paid	900,000
Cash included in net assets acquired	(168,225)
Cash paid for purchase of controlled entities as reflected in the statement of cashflows	731,775

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 20: Expenditure Commitments					
(a) Lease expenditure commitments					
(i) *Operating leases (non-cancellable):*					
Minimum lease payments					
– not later than one year		39,338	39,029	–	–
– later than one year and not later than five years		140,621	170,168	–	–
– aggregate lease expenditure contracted for at balance date		179,959	209,197	–	–

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 21: Employee Benefits & Employee Numbers					
Employee Benefits					
The aggregate employee benefits liability is comprised of					
Provisions (current)	14	168,504	123,602	–	–
Employee Numbers					
The number of employees at 30 June 2005 were 70 (2004: 45)					
Note 22: Subsequent Events					
No events of a material nature have arisen since the end of the financial year, which will have an effect on the financial statements.					
Note 23: Earnings per share					
Basic earnings per share (cents per share)		3.3	3.0	–	–
Diluted earnings per share (cents per share)		3.3	3.0	–	–
		2005 Number of shares	**2004 Number of shares**		
Weighted average number of ordinary shares used in calculating basic earnings per share:		54,984,656	43,091,797	–	–
Weighted average number of ordinary shares used in calculating basic earnings per share:		54,984,656	43,091,797	–	–
		2005 $	**2004 $**		
Value of earnings used in the calculation of basic and diluted earnings per share		1,804,456	1,299,343		

Notes to the Financial Statements continued

Note 24: Directors Disclosure

The names of parent entity directors who have held office during the financial year are:	Appointed	Resigned
V.G. Bowen	15 February 2000	
D.N. Basheer	15 February 2000	
M.G. Bowen	18 February 2000	
C.L. Farrow	18 February 2000	
D.L. Gingell	24 August 2004	7 December 2004
J.S. Hynd	18 February 2000	

	Notes	CONSOLIDATED 2005 $	CONSOLIDATED 2004 $	THE COMPANY 2005 $	THE COMPANY 2004 $
Note 25: Auditors Remuneration					
Amounts received or due and receivable by the auditors of M2 Telecommunication Group Ltd for:					
– an audit or review of the financial report of the entity and any other entity in the consolidated entity		45,000	20,000	45,000	20,000
Ernst & Young, Australia are auditors of the holdings company and all subsidiaries.					
Note 26: Related Party Transactions					
Transactions between related parties are on normal commercial terms and conditions no more favourable than those available to other parties unless otherwise stated					
a) Transactions with Related parties:					
Transactions with director related parties					
Accountancy fees were paid (or were payable) to Brentnalls SA under discounted terms and conditions. C.L. Farrow is a partner of the firm Brentnalls SA		4,260	22,811	–	–
Legal fees were paid (or were payable) to Hynd & Co Pty Ltd under discounted terms and conditions. J.S. Hynd is a director of the firm Hynd & Co Pty Ltd		48,087	42,804	–	–
Commission payments were paid to Dennis N Basheer Nominees on commercial terms. Dennis Basheer is a director of Dennis N Basheer Nominees.		41,300	10,012	–	–

(b) Equity instruments of directors

(i) Interests in the equity instruments of entities in the consolidated entity held by directors of the reporting entity and their director-related entities at balance date, being the number of instruments held.

M2 Telecommunications Group Ltd			
Specified Directors	*Opening Balance*	*Issued/(sold) during the year*	*Closing Balance as at 30 June 2005*
V.G. Bowen	750,000	231,666	981,666
D.N. Basheer	5,304,906	(60,000)	5,244,906
J. S. Hynd	2,832,524	–	2,832,524
M.G. Bowen	18,059,146	(1,126,872)	16,932,274
C.L. Farrow	2,200,000	(1,200,000)	1,000,000
Specified Executives	*Opening Balance as at 1 July 2004*	*Issued/(sold) during the year*	*Closing Balance as at 30 June 2005*
S. Wicks	100,000	1,900,000	2,000,000
D. Inns	412,500	(233,334)	179,166
B. Mouy	100,000	75,000	175,000
M. Leahy	–	739,727	739,727
Total Shareholdings for specified directors and executives	29,759,076	326,187	30,085,263

(c) All financial benefits provided by M2 Telecommunications Group Ltd or its controlled entities to related parties were provided on arm's length terms.

Note 27: Segment Information

(a) Primary Segment

Business Segments	Telecommunications Products		Telecommunications Service Provider		Eliminations		Consolidated	
	2005	2004	2005	2004	2005	2004	2005	2004
Revenue								
Sales to customers outside the consolidated entity	388,811	1,054,881	23,330,332	14,281,420	–	–	23,719,143	15,336,301
Other revenues from customers outside the consolidated entity	–	–	–	–	–	–	–	–
Inter-segment revenues	–	–	–	–	–	–	–	–
Share of net profit of equity accounted investments	–	–	–	–	–	–	–	–
Total segment revenue	388,811	1,054,881	23,330,332	14,281,420	–	–	23,719,143	15,336,301
Unallocated Revenue							–	–
Total consolidated revenue							23,719,143	15,336,301
Results								
Segment result	(71,700)	(19,876)	2,611,294	815,837	–	–	2,539,594	795,961
Unallocated expenses							–	–
Consolidated entity profit from ordinary activities before income tax expense							2,539,594	795,961
Income tax expense							(735,138)	503,382
Consolidated entity profit from ordinary activities after income tax expense							1,804,456	1,299,343
Extraordinary item							–	–
Net Profit							1,804,456	1,299,343
Assets								
Segment Assets	1,781,857	1,997,273	10,121,514	4,054,303	(859,742)	(707,242)	11,043,629	5,344,334
Unallocated Assets							679,504	881,927
Total Assets							11,723,133	6,226,261
Liabilities								
Segment Liabilities	1,406,618	994,944	3,863,346	3,323,787	(859,742)	(707,242)	4,410,222	4,060,760
Unallocated Liabilities					(627,623)	(903,703)	114,320	239,818
Total Liabilities							4,524,542	2,947,604

(a) Primary Segment

Business Segments	Telecommunications Products		Telecommunications Service Provider		Eliminations		Consolidated	
	2005	2004	2005	2004	2005	2004	2005	2004
Other segment information: Equity accounted investments included in segment assets	–	–	–	–	–	–	–	–
Acquisition of property, plant and equipment, intangible assets and other non-current assets	–	–	302,322	384,312	–	–	302,322	384,312
Depreciation	17,634	31,718	276,210	167,215	–	–	293,844	198,933
Amortisation	118,546	351,107	32,562	–	–	–	151,108	351,107
Non-cash expenses other than depreciation and amortisation	–	–	132,858	66,685	–	–	132,858	66,685

(b) Secondary Segment

Geographic Segments	Australia		Non-Australian Companies		Eliminations		Consolidated	
	2005	2004	2005	2004	2005	2004	2005	2004
Segment revenue	23,719,143	15,302,610	–	33,691	–	–	23,719,143	15,336,301
Segment Assets	11,723,133	6,226,261	–	–	–	–	11,723,133	6,226,261
Other segment information:								
Acquisition of property, plant and equipment, intangible assets and other non-current assets	302,322	384,312	–	–	–	–	302,322	384,312

Note 28: Financial Instruments

(a) Interest rate risk

The consolidated entity's exposure to interest rate risks and the effective interest rates of financial assets and financial liabilities, both recognised and unrecognised at the balance date, are as follows:

Financial Instruments	Floating Interest Rates		Fixed interest rate maturing in:				Non-interest bearing		Total carrying amount as per Balance Sheet		Weighted average effective interest rate		Contract repricing or maturity date
			1 year or less		Over 1 to 5 years								
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005 %	2004 %	
(i) Financial assets													
Cash	783,528	994,817	–	–	–	–	500	400	784,028	995,217	3.75%	3.56%	at call
Receivables – trade	–	–	–	–	–	–	2,858,352	1,913,545	2,858,352	1,913,545	N/A	N/A	
Receivables from associates	–	–	–	–	–	–	68,245	–	68,245	–	N/A	N/A	
Short Term Deposits	–	–	3,910,983	1,628,342	–	–	–	–	3,910,983	1,628,342	5.4%	5.23%	fixed rate finance contracts
Total financial assets	783,528	994,817	3,910,983	1,628,342	–	–	2,927,097	1,913,945	7,621,608	4,537,104			
(ii) Financial Liabilities													
Trade Creditors and accruals	–	–	–	–	–	–	4,180,511	2,390,982	4,180,511	2,390,982	N/A	N/A	
Bank loans	–	–	29,436	27,431	122,153	151,589	–	–	151,589	179,020	7.01%	7.01%	fixed rate finance contracts
Total Financial Liabilities	–	–	29,436	27,431	122,153	151,589	4,180,511	2,390,982	4,332,100	2,570,002			

Net fair values

The aggregate net fair values of financial assets and financial liabilities both recognised and unrecognised, at balance date, are as follows.

	2005 $		2004 $	
	Carrying Amount	Net Fair Value	Carrying Amount	Net Fair Value
(i) Financial assets				
Cash	784,028	784,028	995,217	995,217
Short term deposits	3,910,983	3,910,983	1,628,342	1,628,342
Receivables from associates	68,245	68,245	–	–
Receivables	2,858,352	2,858,352	1,913,545	1,913,545
Total financial assets	7,621,608	7,621,608	4,537,104	4,537,104
(ii) Financial liabilities				
Trade creditors and accruals	4,180,511	4,180,511	2,390,982	2,390,982
Borrowings	151,589	151,589	179,020	179,020
Deferred cash settlement	–	–	–	–
Total financial liabilities	4,230,100	4,230,100	2,570,002	2,570,002

The following methods and assumptions are used to determine the net fair values of financial assets and liabilities.

Recognised financial instruments

Cash, cash equivalents and short term deposits: The carrying amount approximates fair value because of their short-term to maturity.

Borrowings: carrying amount approximates fair value because of their short term to maturity.

Credit risk

The company's maximum exposure to credit risk at balance date in relation to each class of recognised financial assets is the carrying amount of those assets as indicated in the balance sheet.

Note 29: Contingent Liabilities and Contingent Assets

Contingent Liabilities

In accordance with the share sale agreement for the Protel business, an additional amount of $500,000 is payable to the vendors in reaching specific profit milestones. The milestones are determined by various factors and recovery is determined if profit falls below the agreed level.

Contingent Assets

According to an agreement with Optus, an amount of $150,000 is payable to M2 in reaching a specific milestone. The probability in reaching the milestone is likely, but is determinant on various factors.

Note 30: Impact of adopting Australian equivalents to IFRS

M2 Telecommunications Group Ltd is in the process of transitioning its accounting policies and financial reporting from current Australian Accounting Standards (AGAAP) to Australian equivalents of International Financial Reporting Standards (AIFRS) which will be applicable for the financial year ended 30 June 2006. Priority has been given to the preparation of an opening balance sheet in accordance with AIFRS as at 1 July 2004, M2's transition date to AIFRS. This will form the basis of accounting for AIFRS in the future, and is required when M2 prepares its first fully AIFRS compliant financial report for the year ended 30 June 2006.

M2 currently expects that the most significant impacts will be in the areas described below.

(i) Under AASB 136 *Impairment of Assets*, the recoverable amount of an asset is determined as the higher of its net selling price and value in use. The group's current accounting policy is to determine the recoverable amount of an asset on the basis of discounted cash flows. The group's assets including goodwill will be tested for impairment on transition and each subsequent reporting date as part of the cash generating unit to which they belong. This may result in impairment losses being recognised under AIFRS.

(ii) Under AASB 3 *Business Combinations* goodwill would not be permitted to be amortised but instead is subject to impairment testing on an annual basis or upon the occurrence of triggers which may indicate a potential impairment. Currently, the group amortises goodwill over its useful life but not exceeding 20 years. The Group has not elected to apply AASB 3 retrospectively and hence, prior year amortisation would not be written-back as at the date of transition.

(iii) Under AASB 116 *Property, Plant and Equipment*, the Group would be required to include as part of the cost of its leasehold improvements, an estimate of the costs to remove those improvements at the end of the lease term where such an obligation exists to the lessor. These costs are not recognised under AGAAP. A corresponding liability would also be recognised under AIFRS in accordance with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.

(iv) Under AASB 112 *Income Taxes* the group would be required as at the date of acquisition to recognise the tax effect of fair value adjustments in a business combination, which in turn would effect the amount of goodwill recognised. Such deferred taxes are not recognised under AGAAP. On transition, the recognition of deferred taxes would be to be recognised in retained earnings and not as an adjustment to goodwill.

Restated AIFRS Statement of Cash Flows for the year ended 30 June 2005

No material impacts are expected to the cash flows presented under AGAAP on adoption of AIFRS.

Directors' Declaration

In accordance with a resolution of the directors of M2 Telecommunications Group Ltd, I state that :

(1) In the opinion of the directors:

(a) the financial statements, notes and the additional disclosures included within the directors report designated as audited of the consolidated entity are in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2005 and of their performance for the year ended on that date; and

(ii) complying with Accounting Standards and Corporations Regulations 2001; and

(b) this declaration has been made after receiving the declarations required to be made to the directors in accordance with section 295A of the Corporations Act 2001 for the financial period ending 30 June 2005.

(c) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

On behalf of the Board

Vaughan Bowen
Managing Director

Dated at Melbourne this 19th day of August 2005

Independent Auditor's Report

ERNST & YOUNG

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91 King William Street
Adelaide SA 5000
Australia

GPO Box 1271
Adelaide SA 5001

Tel 61 8 8233 7111
Fax 61 8 8231 8050
DX 155 Adelaide

Independent audit report to members of M2 Telecommunications Group Limited

Scope

The financial report and directors' responsibility
The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for M2 Telecommunications Group Limited and the consolidated entity, for the year ended 30 June 2005. The consolidated entity comprises both the company and the entities it controlled during that year.

The directors of the company are responsible for preparing a financial report and the additional disclosures (Remuneration Policy as included in the Remuneration Report, Table 1: Emoluments' of directors of the Consolidated Entity and Table 2: Emoluments' of executive officers of the Consolidated Entity included in the directors report designated as audited ('the additional disclosures')) that gives a true and fair view of the financial position and performance of the company and the consolidated entity, and that complies with Accounting Standards in Australia, in accordance with the *Corporations Act 2001*. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report and the additional disclosures.

Audit approach
We conducted an independent audit of the financial report and the additional disclosures in order to express an opinion on them to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report and the additional disclosures is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report and the additional disclosures present fairly, in accordance with the *Corporations Act 2001*, including compliance with Accounting Standards in Australia, and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the company's and the consolidated entity's financial position, and of their performance as represented by the results of their operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report and the additional disclosures; and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

ERNST & YOUNG

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

We performed procedures to assess whether the substance of business transactions was accurately reflected in the financial report and the additional disclosures. These and our other procedures did not include consideration or judgement of the appropriateness or reasonableness of the business plans or strategies adopted by the directors and management of the company.

Independence

We are independent of the company, and have met the independence requirements of Australian professional ethical pronouncements and the *Corporations Act 2001*. We have given to the directors of the company a written Auditor's Independence Declaration a copy of which is included in the Directors' Report.

Audit *opinion*

In our opinion, the financial report and the additional disclosures included in the directors report designated as audited of M2 Telecommunications Group Limited are in accordance with:

(a) the *Corporations Act 2001*, including:

  (i) giving a true and fair view of the financial position of M2 Telecommunications Group Limited and the consolidated entity at 30 June 2005 and of their performance for the year ended on that date; and

  (ii) complying with Accounting Standards in Australia and the *Corporations Regulations 2001*; and

(b) other mandatory financial reporting requirements in Australia.

Ernst + Young

Ernst & Young

J Potter

Allan Potter
Partner
Adelaide
19 August 2005

ASX Additional Information

Additional information required by the Australian Stock Exchange Ltd and not shown elsewhere in this report is as follows.

The information is current as at 31st July 2005.

(a) Distribution of equity securities

The number of shareholders, by size of holding, in each class of share are:

		ORDINARY SHARES	
		Number of Holders	Number of shares
1	1,000	2	501
1,001	5,000	46	193,008
5,001	10,000	119	982,174
10,001	100,000	268	9,049,310
100,001	and over	55	49,141,905
		490	59,366,898
The number of shareholders holding less than a marketable parcel of shares are:		51	209,198

(b) Twenty largest shareholders

The names of the twenty largest holders of quoted shares are:

	LISTED ORDINARY SHARES	
	Number of shares	Percentage of ordinary shares
1 MGB Holdings Pty Ltd	16,932,274	28.52%
2 Dennis N Basheer Nominees Pty Ltd	5,244,906	8.93%
3 Westpac Custodian Nominees Limited	4,660,973	7.94%
4 Wicks Group Pty Ltd <Wicks Family A/C>	2,000,000	3.41%
5 Marcello Barbaro	1,926,000	3.28%
6 Wyatt Pty Ltd	1,600,000	2.72%
7 Cogent Nominees Pty Limited	1,595,445	2.72%
8 Hyland Securities Pty Ltd	1,232,524	2.10%
9 Crofar Pty Ltd <Crofar Unit A/C>	1,000,000	1.70%
10 Vaughan Bowen	981,666	1.65%
11 Troy Bowen	795,000	1.35%
12 Resorts International (Australia) Pty Ltd	764,368	1.30%
13 Michael Leahy	739,727	1.26%
14 Treloar Pty Ltd <Meagher Family A/C>	666,666	1.14%
15 Robert Bruce	662,500	1.13%
16 Merrill Lynch (Australia) Nominees Pty Ltd	569,000	0.97%
17 Lance Tegg	486,063	0.83%
18 Dean Eichhorn	466,000	0.79%
19 Neston Pty Ltd	441,967	0.75%
20 Melinda Inns	400,000	0.68%
	43,165,079	72.71%

(c) Substantial shareholders

	NUMBER OF SHARES
1 MGB Holdings Pty Ltd	16,932,274
2 Dennis N Basheer Nominees Pty Ltd	5,244,906
3 Westpac Custodian Nominees Limited	4,660,973

(d) Voting Rights

All ordinary shares carry one vote per share without restriction.

Corporate Directory

Directors

Max Bowen (Chairman)
Vaughan Bowen
Dennis Basheer
Craig Farrow
John Hynd

Company Secretary

Darryl Inns

Registered Office

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Level 2, 22 Horne Street
Elsternwick, VIC, 3185
Telephone: (03) 9524 7555
Facsimile: (03) 9524 7599
Web Site: www.m2.com.au

Solicitors

Landers & Rogers Lawyers
Level 12, 600 Burke Street
Melbourne, VIC, 3000

Accountants

HLB Mann Judd
Level 1, 160 Queen Street
Melbourne, VIC, 3000

Auditor

Ernst & Young
Santos House
91 King William Street
Adelaide, SA, 5000

Share Registry

ASX Perpetual Registrars Limited
Level 4, 333 Collins Street
Melbourne, VIC, 3000

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