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MGM Wireless Limited (MWR)

Speculative Buy

Unique Franchise Offering Socio-Economic Benefits

\$0.057

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Key Points

MGM Wireless' flagship product uses an automated system to combat school truancy and improve student safety.

SMS messages are automatically generated from the school and sent to parents of children who are not in class advising of absenteeism and seeking explanation.

Schools who have implemented MGM Wireless' software have reported a 30-70% improvement in school attendance.

Summary

Market Capitalisation	\$8.9M
Share Price	\$0.057
52 week low	\$0.03
52 week high	\$0.07
Ave Monthly Vol (year rolling)	2.843M

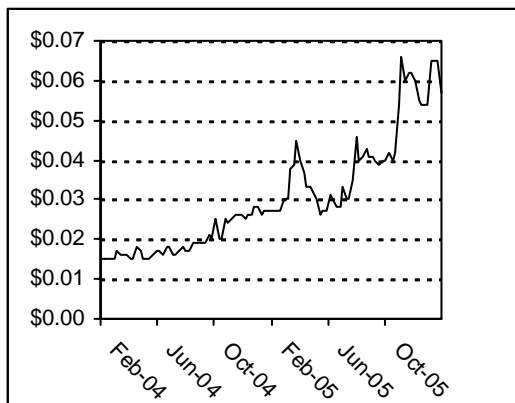
Key Financials

Year End	FY04 Actual	FY05 Actual	FY06 Est.
Revenue (\$m)	406	1,080	2,275
EBIT (\$m)	(600)	(522)	319
Reported NPAT (\$m)	(580)	(497)	335
Adj. NPAT (\$m)	(437)	(301)	335
Adj. EPS (c)	-0.4	-0.2	0.2
Growth (pcp)	0.0%	-54%	-130%
Adj. PE Ratio (x)	-13.5	-27.3	24.5
DPS (c)	0.0	0.0	0.0
Div Yield	0.0%	0.0%	0.0%
Franking	0.0%	0.0%	0.0%
EV (\$M)	8.5	8.2	8.0
EV/EBITA	-18.6	-25.1	25.0
ROE	0.0%	-39.1%	22.9%
EBIT Margin	-147.6%	-48.4%	14.0%

Company Overview

- MGM Wireless is a developer of software that utilises and converges internet and mobile technology. Its messageyou™ Schools application has been specifically developed to target school truancy, using an automated system that sends messages to parents when their children are not at school.
- With worldwide truancy levels of up to 12%, and the mobile phone industry still growing, there is significant market potential for MGM's software. MGM currently holds approx 200 contracts throughout Australia and New Zealand. The potential Australian market covers some 2,500 secondary schools and 4,000 primary schools.
- Reduced truancy levels have related socio-economic benefits such as increased educational outcomes; child safety; reduced youth crime; and improved relations between schools and parents. MGM's strategy is to sell the rights to use its technology in certain geographic regions to licensees. This will enable MGM to penetrate international markets, where significant growth potential exists.
- The global market size, lack of competition, quality product offering and business model provide significant scope for growth. As such we recommend MGM Wireless as a Speculative Buy.

Share Price Graph (A\$)



Business Overview

Socio-Economic and Efficiency Benefits

Provides mobile phone messaging solutions that converge internet and mobile technology.

MGM Wireless operates as a single-source provider of mobile phone messaging solutions, focusing on developing management solutions that utilise and converge internet and mobile technology. The Company's lead product enables PC users to send and receive messages from their desktop to mobile phones.

Specifically targets school truancy.

The system has been developed to specifically target school truancy, with its flagship messageyou™ Schools software application using an automated system that sends messages to parents when their children are not at school seeking a reason for non-attendance. Schools which have implemented MGM's software have reported a 30-70% improvement in student absenteeism.

Socio-economic benefits for pupils, schools and parents.

In addition to reduced truancy levels, there are a number of socio-economic benefits such as child safety; increased educational levels; reduced crime; and improved relations and communication between schools and parents. These socio-economic benefits together with the administrative efficiencies and cost savings for schools, allows MGM to market their software at a higher price than they would be able to on technology alone.

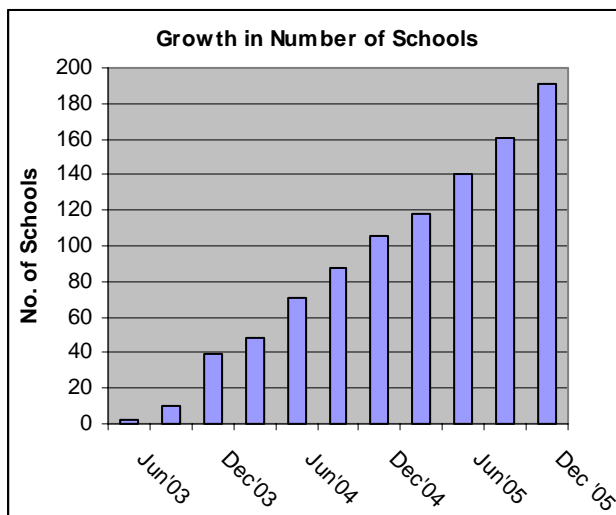
There are also efficiency gains for the schools with the costs associated with using the messageyou™ Schools system significantly less than the traditional methods of informing parents of student non-attendance.

Truancy and MGM's Potential Markets

Global truancy levels are typically 10-12%.

The Western World is faced with truancy levels of typically 10-12%. Australia is no exception, with state and federal government education policy specifically identifying truancy as a problem to be tackled.

There are approximately 2,600 Australian secondary schools, with MGM's messageyou™ Schools service currently operating in close to 200 as evident in the chart below. MGM is not at this stage targeting the 4,000 strong primary school sector, where truancy levels are somewhat lower. The Australian marketplace clearly offers considerable scope for growth, in addition to management's stated ambitions of expanding overseas. With over 57,000 High schools and another 110,000 Primary schools in the US alone, the overseas market offers considerable potential with global patent applications having been made, in anticipation of this expansion.



Global marketplaces offer considerable growth potential.

MGM's product dependence on mobile telephony is statistically supported, with the Australian mobile phone industry a large and accepted market. A saturation level of 80% has been reached, with over 99% of businesses operating with a mobile phone. As one of the major communication tools in the developed world, and with worldwide truancy levels at up to 12%, there is huge market potential for MGM's software.

Dependence on mobile technology is statistically supported.

Growth Strategy

Revenue Streams

MGM derives income from its technology in four distinct ways:

1. Initial School Establishment/Set-Up fees
2. Annual Customer Renewal fees
3. SMS Transmission charges
4. Up-Front Licence fees

The first three sources of revenue provide a recurring income stream, whilst the fourth provides an irregular boost as licences for specific geographic regions are sold.

Quality systems and a strong emphasis on training and maintenance supports MGM's product offering.

Each new school signing up for MGM's software pays an initial fee covering system set-up, training, maintenance and the first full year of use. After initially offering one year contracts, MGM now markets the software on a three year basis, with an annual renewal fee levied on each anniversary. The technology is marketed at the high end, with quality systems, and a strong back up training and maintenance function included in the package.

An SMS fee is received by MGM each time an SMS transmission is sent through its own message network. On an average school day, the parents of approximately 8-10% of students are sent notification of an unexplained absence. With close to 200 schools, containing an average of 750 students, this amounts to a not insignificant 12,000 to 15,000 messages per day.

The fourth revenue source is more irregular, particularly at this early stage in MGM's growth, representing the licence fees for the sale and service rights to specific geographic regions. MGM receives an initial up-front fee, with ongoing royalty fee payments for all new sales, on-going customer renewals and SMS transmissions.

Overseas expansion is the key to long-term growth.

There is considerable scope for growth in set-up fees, annual renewal fees, and SMS transmission fees. However, we appreciate that with all but one remaining Australian license sold, management must secure international license sales, to avoid revenues reverting back to more modest levels.

Government Funding as a Growth Driver

Combating school truancy is supported by State and Federal Governments.

A portion of Australian government school funding is dependent on student numbers and satisfactory attendance levels. With Federal and State governments investing billions of dollars into education, there is an increasing awareness that students should attend school regularly to receive the benefit of that investment. The South Australian Government granted a \$1 million package to improve reporting of student absences to parents and tackle truancy in schools in 2003. The Federal Government followed suite, identifying student attendance as a key area of spending for its \$1 billion 'Investing in Our Schools' Program. Ongoing government funding and educational policy will likely increase the rate of take up of MGM's software.

Expansion of the Licensee Business Model

Licensee business model allows scope for international expansion.

MGM Wireless has a very strong intent to grow the business. Whilst keen to increase the rate of growth, management are conscious not to carry too much cost with a focus on selling the sales and service rights for certain geographic regions to carefully chosen licensees.

Good geographic spread within Australia, and more recently New Zealand.

The licensee is first trained, and then provides all sales and consulting staff for that region. MGM has retained its licences in NSW and sold licenses for WA/NT/SA, VIC/TAS and QLD. We expect NSW to be sold next, with the New Zealand licence another prospect now that the first few schools have signed up. Beyond this, the sizeable European and North American marketplaces offer long-term growth potential.

New Products

MGM have developed a new software package, message™WatchLists, which allows schools to automate the entire process of school-parent communication, not only by SMS, but by landline voicemail, email and letter. The system incorporates patented technology which applies social criteria to alert school staff to potential high-risk situations for students. With ongoing software improvements and further research and development, MGM's product offering remains strong.

Key Risks

Competitors

Market leader with limited and lower quality competition.

MGM Wireless is one of only a handful of players in the Australian marketplace, positioned as market leader with first mover advantage. With initial research and development costs high, intellectual property rare and lead times long, MGM has an element of protection, whilst its well regarded systems should differentiate it from inferior offerings.

Government Funding

Current educational policies support the combating of truancy.

A change in educational policy could divert school funds away from combating truancy. As such policy plays a large role in succession to government, this should not pose a significant risk. Nonetheless, spend on MGM's products are ultimately reliant on both federal and state government funding, with any re-channelling or alternative initiatives a risk.

Licensing

International expansion crucial for long term growth. An investment in MGM must be considered speculative.

We commend MGM's strong intent to grow the business with management having a successful track record across a number of IT ventures. However overseas expansion in particular can bring with it significant and unforeseen costs and risks. Any failure to secure ongoing international licence sales represents the main risk to MGM's high growth strategy. Our FY06 estimates assume further licences are sold for NSW and New Zealand, and MGM must replicate these successes globally. An investment in MGM must therefore be considered as speculative.

Whilst licensing reduces the costs of labour and relocation, there is the additional risk of losing control over the operations of the business. Whilst MGM does retain an element of control, with each agreement subject to ongoing achievement of sales and service performance levels, licensees must employ capable salespeople who are crucial to growing the business.

Costs

Management must build an effective cost structure as MGM grows.

Once the initial development has been completed, MGM's software is not expensive to produce. However management are conscious to maintain the high regard given to the MGM brand and typically employ highly trained and well remunerated technical and sales staff, resulting in high employee expenses. With MGM still in its infancy and operating in a new industry, it does not have the luxury of simply following similarly comparable and effective cost structures. This is important for management as the business grows, and we are pleased that R&D costs will be scaled back to a more conservative 15% of gross revenues, against the 34% of FY05. We view this as achievable now that the new message™WatchLists software has been fully developed.

Investment Summary

Market leader, with successful licensee strategy.

MGM Wireless has a lead position with its core messageyou™Schools software, and is successfully rolling out its licensee strategy. The business model allows rapid expansion internationally, with the first sales in New Zealand adding promise. With potential license sales for NSW and NZ, the short term revenue stream is expected to be strong. Thereafter international expansion will be the driver of earnings although Australian sales should continue to grow.

Significant potential exists if MGM can expand globally. Rated as a Speculative Buy.

If MGM can capitalise on the global market for combating school truancy, there exists significant potential. The market size, lack of competition, quality product offering and business model provide scope for growth, and justify our Speculative Buy recommendation.

MGM WIRELESS LIMITED - Summary of Forecasts**MWR \$ 0.057****PROFIT & LOSS SUMMARY (A\$'000s)**

Period	FY04A	FY05A	FY06E
Total Revenue	406	1,080	2,275
<i>Growth (pcp)</i>	<i>0.0%</i>	<i>165.8%</i>	<i>110.6%</i>
EBITDA	(437)	(306)	340
Dep'n/Other Amort'n	(19)	(21)	(22)
Amort'n of Goodwill	(143)	(196)	0
EBIT	(600)	(522)	319
Net Interest	20	20	16
Pre-Tax Profit	(580)	(502)	335
Tax Expense	0	0	0
Minorities	0	5	0
Net Abnormals	0	0	0
Reported Profit	(580)	(497)	335
Adj. NPAT	(437)	(301)	335
<i>Growth (pcp)</i>	<i>n/a</i>	<i>31.0%</i>	<i>211.2%</i>

PER SHARE DATA

Period	FY04A	FY05A	FY06E
Adj. EPS (c)	(0.4)	(0.2)	0.2
<i>Growth (pcp)</i>	<i>0.0%</i>	<i>-50.5%</i>	<i>-211.2%</i>
Dividend (c)	0.0	0.0	0.0
Franking	0%	0%	0%

KEY RATIOS

Period	FY04A	FY05A	FY06E
EBITDA/Sales Margin %	-107.6%	-28.3%	15.0%
EBIT/Sales Margin %	-147.6%	-48.4%	14.0%
EBIT Interest cover (x)	n/a	n/a	n/a
Current ratio (x)	6.9	4.0	2.9
Net Debt : Equity (%)	-30.6%	-49.9%	-53.8%
ROE (%)	0.0%	-39.1%	22.9%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%

VALUATION MULTIPLES

Period	FY04A	FY05A	FY06E
Undiluted Adj. PER (c)	(13.5)	(27.3)	24.5
Dividend Yield (%)	0.0%	0.0%	0.0%
EV/EBITA (x)	(18.6)	(25.1)	25.0
EV/EBIT (x)	(14.1)	(17.4)	29.3

BALANCE SHEET SUMMARY

Period	FY04A	FY05A	FY06E
Cash	379	649	872
Receivables	155	273	587
Inventories	0	0	0
Other	1	5	5
Total Current Assets	534	927	1,465
Investments	0	0	0
Inventories	0	0	0
Property Plant & Equip	89	108	156
Intangibles	694	498	498
Other	0	0	0
Total Non-Current Assets	782	606	654
TOTAL ASSETS	1,317	1,533	2,119
Accounts Payable	70	223	474
Borrowings	0	0	0
Provisions	8	7	23
Other	0	0	0
Total Current Liab	78	230	497
Borrowings	0	0	0
Provisions	0	0	0
Other	0	0	0
Total Non-Current Liab	0	0	0
TOTAL LIABILITIES	78	230	497
TOTAL EQUITY	1,239	1,303	1,622

CASH FLOW SUMMARY

Period	FY04A	FY05A	FY06E
EBIT (excl Abs/Extr)	(600)	(522)	319
Add: Depreciation	19	21	22
Amortisation	143	196	0
Change in Pay.	0	153	251
Less: Tax paid	0	0	0
Net Interest	20	20	16
Change in Rec.	0	(117)	(315)
Change in Inv.	0	0	0
Gross Cashflows	(417)	(250)	293
Capex	(5)	(40)	(70)
Free Cashflows	(422)	(290)	223
Dividends Paid	0	0	0
Net Cash Flow	(422)	(290)	223

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TC Corporate Pty Ltd, a wholly owned subsidiary of Taylor Collison, has a retainer to provide corporate advisory services to MGM Wireless. Taylor Collison has derived fees from previous capital raisings.

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