

INTERMOCO LIMITED (INT)

Embedded Network Contract Flow Driving Annuity-Style Growth

SPECULATIVE

6 July 2011

Share Trading Info

ASX Code	INT
Current Share Price (cps)	0.4
Trading Low /High (Rolling Year)	0.2c - 1.1c
Ordinary Shares* (m)	2,475.7
Mkt Capitalisation (\$m)	9.9
Cash as at 31 March 2011 (\$m)	1.2

* Shareholder Approval sought for a 1 for 20 Share Consolidation at an EGM on 29 July 2011

Board of Directors*

John Evans	Non Executive Chairman
Ian Kiddle	Chief Executive Officer
Andrew Meehan	Executive Director
Simon Kemp	Non Executive Director
Bob Gestro	Non Executive Director

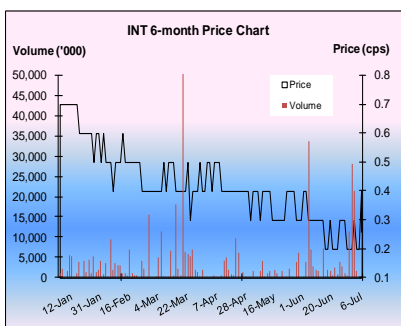
* Further details on Pages 13 & 14

Major Shareholders

Copulos Group	10.2%
Entity Holdings P/L	6.0%
Gestro Super Fund	4.1%

Important Disclosure

Investors should be aware that Intermoco Ltd is a corporate client of Alpha and that Alpha will receive a consultancy fee from Intermoco Ltd for compiling this research report.



Intermoco Limited (ASX Code: INT) is a leading provider of water, energy, voice and data management solutions with a focus on the provision of embedded networks to property developers.

KEY POINTS

- INT has an annuity-style revenue base that is underpinned by unique long-term embedded network contracts that are typically 7-15 years in length. At a group level, the revenue base is diversified across the embedded network business, ongoing product sales to utilities, and Smart Meter products.
 - Strategic partnerships entered into with Optus (white labeling) and NEC (who provide the telephony infrastructure for the supply and installation of embedded networks) in 2009 enabled INT to gain a stronger foothold into the lucrative property development sector, to ensure a strong project pipeline.
 - Since the establishment of the embedded networks business model, INT has won contracts with a total value of approximately \$26 million since October 2009. Each of these are long term contracts of five or more years. (See Table 2 on page 9)
- INT estimate that the partnerships developed with property developers would provide potential access to between 50 and 100 project sites.**
- According to the Blue Book (2011), the size of the embedded network market constructed in the last ten years alone is estimated to be over 200,000 Residential Units which equates to over \$0.3 billion per annum in potential revenue in addition to further potential revenues from Commercial Property developments.
 - Future revenue growth is underpinned by the large number of long-term embedded network systems contracts secured in FY2011 that have started, or about to start, contributing to revenue.

Further, the sales pipeline for embedded networks, as well as the uptake of the embedded networks model, remains very strong, hence strengthening the company's recurring revenue base and providing earnings visibility for FY2011. Up to 10 new projects are expected over the next 12 months. In addition, the company continues to look for future acquisitions that are likely to vertically integrate the INT business model and strengthen the company's revenues.

- **Revenue downgraded but NPAT steady:** INT have downgraded forecast revenue for FY2011 to approximately \$3.5 million as a result of further unanticipated delays in relation to product delivery and project services. Despite the lower revenue, INT have been able to improve their gross margin as the company has transitioned from an outsourced billing service to a full embedded networks provider. As a result of this transition, as well as cost containment, the company expect NPAT loss to be broadly in line with FY2010 (-\$3.25 million). INT's gross margins for embedded networks are over 30% across all services/utilities (electricity, telephone, internet, etc) and 50% for product sales.
- **Leveraging revenue growth off cost base:** According to management, the present structure of the company's cost base is such that if the company doubled its revenues, then the cost base would only increase by around 30%. The key factors underpinning this are:
 1. **The minimal costs associated in acquiring additional embedded network contracts from existing clients.**

Once INT sign a new client (i.e. a property developer), the terms and details of the initial agreement with that developer are rolled over from project to project. This allows many of the costs incurred in securing the initial contract (e.g. business proposals, marketing) to be circumvented when INT enter into contracts for further developments with that developer.
 2. **Downward trend in the cost of acquiring new clients,** supported by low-cost referrals, increased market presence and awareness amongst developers of INT's embedded network offering.
 3. A large portion of overheads are tied to the products business.
- **Recurring revenue model expected to improve free cashflow:** The prospects of improving revenue at minimal incremental costs should improve the company's level of free cashflow going forward, particularly as operating cashflows have recently been lumpy, primarily because INT have worked to secure contracts and client base for its embedded network offering.
- Cash costs are being well managed, particularly in light of the long sales cycle of its embedded network contracts. Working capital requirements and cash costs are now under control (see Figure 3 on page 12), with the company returning to a positive operating cashflow position in the March 2011 quarter.

KEY FINANCIALS

Sufficient Funding

INT have sufficient cash and access to cash (net trade debtors of +\$0.52 million as at the end of the March 2011 quarter) to fund its operations in the short term. The cash balance as at the end of the March 2011 quarter was \$1.2 million. The outstanding convertible notes have been repaid and INT is now debt free.

INT's balance sheet as at 31 December 2010 is detailed below.

Half Year Ended (\$m)	31 Dec 2010	30 June 2010
Assets		
Cash	0.93	2.87
Trade and other receivables	1.20	1.20
Inventories	0.52	0.17
Other assets	0.16	0.01
Total Current Assets	2.81	4.24
Financial assets	0.78	0.78
Property, Plant & Equipment	0.67	0.71
Intangible assets	2.16	2.16
Total Non Current Assets	3.60	3.65
TOTAL ASSETS	6.41	7.89
Liabilities		
Trade and other payables	1.29	1.40
Short term borrowings	0.40	0.03
Long term borrowings	0.19	0.21
Current Provisions	0.08	0.10
Non Current Provisions	0.01	0.04
Financial liabilities (Belgravia Notes)	2.10	2.10
TOTAL LIABILITIES	4.07	3.89
NET ASSETS	2.34	4.00

Possible Additional Funding from Non-Strategic Investment

INT have a current non-strategic investment in a private New Zealand company called Energy Mad, which designs, manufactures and sells energy efficient lighting under the Ecobulb® and Ecospiral® brands in North America. INT hold 5.5 million shares in Energy Mad.

According to the 2010 Annual Report, INT's written-down value on its investment in Energy Mad as at 2010 was \$0.778 million, which represented a 9.06% stake in the Energy Mad. Energy Mad is expected to list on the New Zealand Stock Exchange later this calendar year. Based on the current valuation for Energy Mad, an IPO would imply a value for INT's shareholding significantly higher than the stated book value referred to above. INT is currently negotiating alternatives to realise this value – INT's Executive Director Andrew Meehan has been nominated to the Energy Mad Board during the IPO process.

Rights Issue not Undertaken to Fund Working Capital

On 10 January 2011, INT announced a capital raising via a one-for-nine non-renounceable rights issue at 0.5 cents per share to raise \$1.159 million.

The primary purpose of the rights issue, completed on 2 March 2011, was to fund redemption of the balance of convertible notes issued to Belgravia Strategic Equities P/L (Belgravia). By way of background, INT issued Belgravia with convertible notes valued at \$2.1 million, which were redeemable on 10 January 2011.

INT has redeemed part of the convertible notes to the value of \$1.1 million, and Belgravia agreed to defer redemption of the balance (\$1 million) until after completion of the rights issue.

NEW APPOINTMENTS STRENGTHEN BOARD

On 4 May 2011, INT announced the appointment of a John Evans as Non Executive Chairman (replacing Andrew Plympton, who resigned on 30 April 2011) as well as the re-appointment of Bob Gestro as Non Executive Director.

Mr Gestro has previously served as a Board member of Intermoco from February 2009 to April 2010. His re-appointment to the Board is instructive, as he has a deep understanding of the Intermoco business model, having served as CEO from February 2009 and, subsequently, Executive Chairman at the time of his departure from the Board in April 2010. He was also an Executive of the company prior to his Board appointment in February 2009. Mr Gestro is also a major shareholder of the company, with a 4.1% holding.

1. EMBEDDED NETWORK SERVICES

1.1 Overview

An embedded network is an integrated utility management platform that allows users to access all their utilities, including electricity, water, gas, telephony and data services from the one service provider within a privately owned environment (i.e. Building to gated community). INT calls its embedded network offering Intermoco Connect.

An embedded network exists in both greenfield and brownfield development sites and are now becoming standard installations in the construction of new residential buildings in Australia. The process for the establishment of a greenfield embedded network is typically simpler than that for a brownfield network, as it is likely that there will not be consumers at the time of establishment.

Developers, builders and principals have traditionally had to provide a significant amount of infrastructure to enable these services to be available at their developments. An embedded network retains ownership of those assets with the developer/principal. INT, as the manager of the embedded network, forms a partnership with the developer/principal to negotiate, procure, implement, bill and manage all of the ongoing services and support underlying those infrastructures within the developments.

1.2 Why Use an Embedded Network?

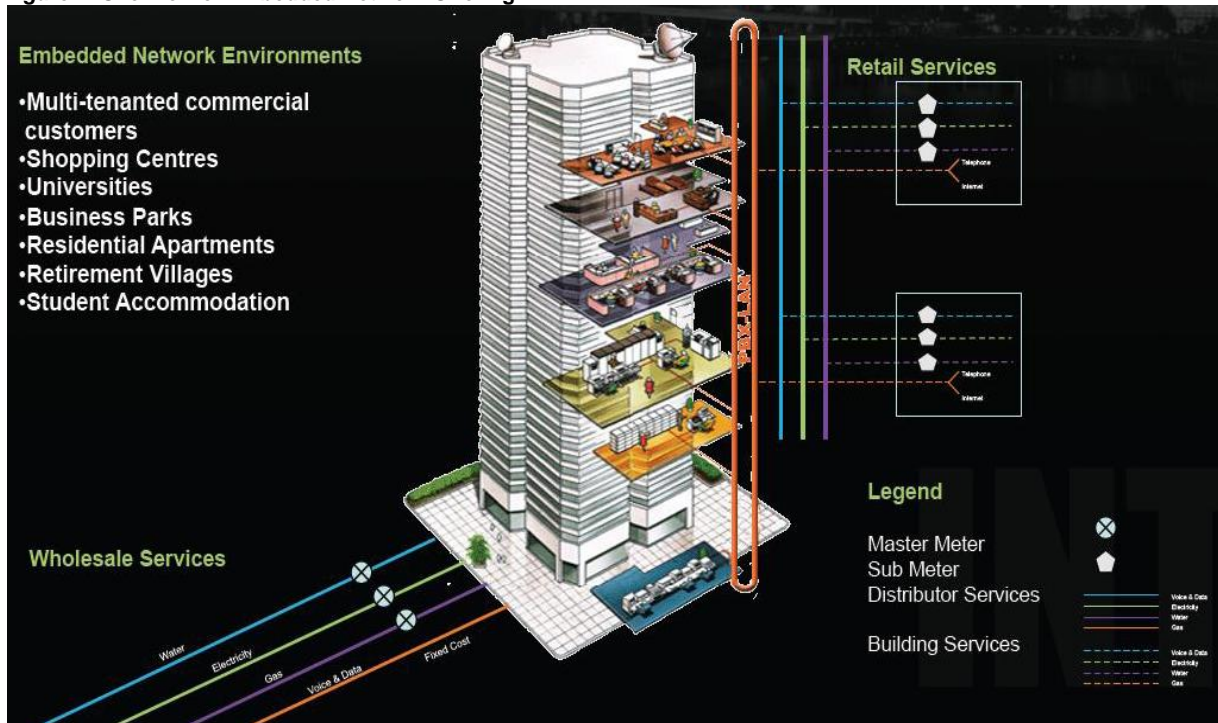
INT provides an end to end solution to the builder/principal which increases the yield on the building, which in turns increases the value of their asset.

INT generate revenue from wholesale to retail sales, providing tenants with better than market rate services and in the process generates revenues for both INT and the property owner. Thus, INT is able to develop an annuity-type business in conjunction with the developer/principal, who is now generating an income stream from infrastructure that they were previously obliged to provide and handover to other retailers i.e. Telstra, etc..

The **benefit for tenants** are that they are able to access utilities via Intermoco Connect at better than retail rates on utility services.

Utility wholesalers benefit from using embedded networks because they are assured of supplying their services (i.e. electricity, water, gas, etc) to 100% of the tenants in the building. Further, the cost to the utility of acquiring the tenants as clients is effectively zero, as the cost of acquiring clients is borne entirely by INT.

Figure 1: Overview of Embedded Network Offering



Source: INT Presentation, March 2010

1.2 Strategic Partnerships

In order to develop an embedded network that would become an end-to-end solution for the provision of all utilities, INT formed key strategic partnerships with Optus and NEC in 2009. The partnership with NEC provides INT with:

1. The necessary infrastructure for the supply and installation of the embedded network,
2. Access to NEC's customer base, as both NEC and INT are able to sell each other's products and services within each other's customer base and
3. The opportunity to expand its operations by leveraging off NEC's national and international presence.

In November 2009, INT entered into a wholesale partner agreement with Optus to white label voice and data products and services, which led to INT securing its first embedded network contract shortly thereafter.

Table 1: Summary of Advantages for Utility Wholesalers and Property Owners using Embedded Network Systems; and Intermoco as the service provider

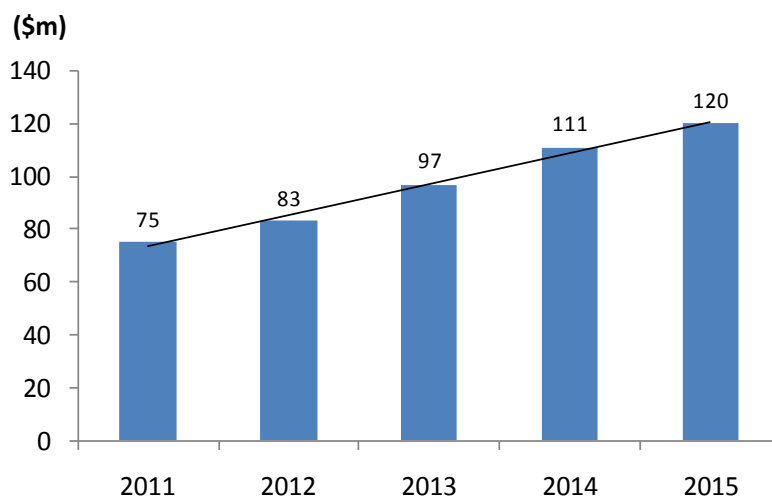
Utility Wholesaler	Property Owner	Intermoco
Greater customer penetration	Annual revenue stream	Service provider
Greater volume	Increased yield (+ value) of property	Long term contracts (7-15 years)
Lower cost of delivery	Provides return on infrastructure within building	Annuity-style revenue stream
Lower margin + Higher volume = Increased revenue		

1.3 Contract Wins and Market Potential

Contracts won by INT were initially sourced from the residential and commercial property sectors, as well as the aged care sector thereafter. In addition to these sectors, an embedded network is possible for populated environments such as shopping centres, universities, business parks and student accommodation. These are key target markets for INT, in addition to property developers (in particular apartments).

Figure 2 highlights the forecast growth in the embedded network market size for new apartments.

Figure 2: Embedded Network Market Size Estimates - New Apartments



Source: IBIS WORLD Industry Report E4112

INT has strategically targeted the property development sector in order to provide it with access to:

- Long term contracts (typically five and seven years, but can be up to 15 years), underpinning recurring, annuity-style revenues;
- Future property developments in order to secure strong project flow. For example, INT has a partnership with Buildcorp and INT have already secured a contract for an embedded network in April 2010, for a commercial property in Victoria, worth \$2.7 million over five years. At present, Buildcorp is working on up to 17 construction projects in the greater Melbourne area, with other projects under consideration. INT are expecting additional project flow to follow the initial agreement.

Further, property developers are writing into their building specifications the terms and details of the initial agreements entered into with INT, and these are being rolled over from project to project ensuring INT is well positioned to win more projects from a developer with whom an initial agreement is entered into.

INT estimate that the partnerships developed with property developers would provide potential access to between 50 to 100 project sites.

Table 2 details the key contracts won since INT entered into strategic partnerships with NEC and Optus Wholesale to develop its embedded network system. In addition to securing new contracts, INT has won a contract extension from Tindall and recently secured a second contract from the one developer (Statewide Developments' Kingsway Towers development).

It is also worth noting that INT have historically had a high success rate in converting prospects into clients, however, not all of the contracts are secured within the anticipated timeframe, mainly due to factors beyond INT's control.

1.3.1 Recent Contract Wins

As evidenced from Table 2 below, announcements on new contract wins/extensions have increased in frequency since October 2010. The most recent contract win was announced on 24 May 2011, a partnership with Melbourne-based property developer MAB Corporation. As with many of INT's contracts with property developers, MAB Corporation have a strong pipeline of projects worth over \$2 billion, including New Quay Docklands, University Hill and Merrifield.

INT has also made headway into the commercial property development market, which for embedded networks is characterised by fewer customer numbers but higher margins in comparison to residential property developments. One example is the agreement entered into with Capital Corporation (Sydney-based) in April 2011, which is INT's first entry into the Sydney market and hence an avenue for further project opportunities, either with Capital Corporation's future projects, or in the wider Sydney market for both residential and commercial property developments.

Table 2: Key Projects Secured/Extended since Establishment of Embedded Network Systems

Client	Announcement Date	Development/s	Revenue Stream	
			Amount	Contract Term
MAB Corporation	24 May 2011	Industry Business Hub (Commercial property development in South Melbourne)	\$1.5 million + \$70k in capital costs recovered immediately	5 years
Corporate Property Development¹	13 April 2011	Atlas Norwest (Sydney)	\$1.5 million + \$98k in upfront capital costs recovered in April/May 2011	5 years
Statewide Developments	2 Feb 2011	Kingsway Towers (425 tenants)	\$3.5 million + \$118k in capital costs recovered in 3Q FY12	5 years
Statewide Developments	12 Jan 2011	Aqua Villa & Sol Rio	\$2.1 million + \$70k in upfront capital costs recovered in 3Q FY11	5 years
R Corporation	25 Nov 2010	211 residential units in South Yarra (VIC)	\$2.5 million + \$150k in upfront capital costs recovered in 3Q FY11	5 years
Retirement Village Association	27 Oct 2010	Retirement Villages	\$4.0 million (two contracts) + \$0.2m in upfront capital costs	5 years
Buildcorp	8 April 2010	Commercial Property in Bell St Preston (VIC)	\$2.7 million	5 years
Hamton	1 March 2010	Commercial Property in Bell St Preston (VIC)	\$3.0 million over 5 years (initial contract)	15 years
Tindal	6 August 2009	Casero residential development, Hawthorn (VIC)	\$1.2 million	Initial 5 year term, extended to 15 years on 25 May 2010
Aged Care Residence	15 Oct 2009	Aged Care facility with >300 apartments	\$4 million	5 years + 5 year option

¹ First *Intermoco Connect* customer in NSW

1.4 Revenue Model

In addition to the value of the contract, INT typically receive a capital expenditure payment (that is either paid by the client upfront, or recovered later) to cover initial expenditure on installation of electricity, voice and data hardware and equipment.

INT receives revenue from developments once they are completed and tenanted. The timeframe between execution of a contract and INT beginning to receive revenues varies from project to project.

In general terms, the above timeframe can occur over a 12 month period. To illustrate:

- i. The recently-announced MAB contract, announced in May 2011, is expected to generate revenue immediately;
- ii. The R Corporation contract, announced in November 2010, generated initial revenue in January 2011 and
- iii. The Buildcorp contract, announced in April 2010, began generating revenue in April 2011.

INT's gross margins for embedded networks are over 30% across all services/utilities (electricity, water, etc). The variation in margins exists because some services/infrastructure are better than others in different environments. Gross margins for product sales are ~50%.

INT experiences compound revenues as new embedded networks are added and typically developers then specify INT for their next projects.

1.5 Market Positioning

Domestically, INT is one of a limited number of companies providing a complete embedded network solution across all utilities, including energy, water, gas, telephony and data. INT's business model is unique as it is the only company offering embedded network solutions by entering into partnership with its clients.

INT is the only ASX-listed company offering embedded network solutions, with the comparable companies identified below all privately owned. Most companies offering embedded networks only supply electricity. A summary of the key competitors is included below:

- **Active Utilities** specialise in embedded networks and provide voice, data and other utility services and has "long-standing relationships with Australia's largest ICT, power and utility suppliers".
- **Trans Tasman Energy Group** (based in Melbourne) are specialist energy consultants. Part of their offering is procuring energy solutions for embedded networks. Its clients range from governments and some of the largest corporations to owners of small commercial buildings.
- **EMU Solutions** is a consultant specialising in the establishment of greenfield and brownfield embedded networks and provides consultancy services for existing embedded networks. The majority of their clients are based in Victoria and range from bodies corporate, developers, owners, managers in the commercial, retail, industrial & multi-residential sectors.

2. UTILITY PRODUCTS AND SERVICES

INT provides a complete end-to-end scalable solution, comprising products, software and services to a diverse client base (including utilities, corporations, local councils and government departments) to help them monitor, manage and minimise their consumption of electricity, gas and water. In particular, INT undertake installation of meters and offer internet-enabled billing, energy management and metering maintenance services.

Utility customers include Sydney Water, Origin Energy, Jemena and over 30 metropolitan and regional utilities providers in the energy and water management sectors across Australia. In May 2010, INT entered into a 3-year licensing agreement with Sydney Water for the use of INT's meter reading system, via the internet.

3. KEY FINANCIALS

3.1 Forecast Revenue

INT has forecast revenue for FY2011 to be \$3.5 million, compared with revenue of \$5.94 million in FY2010. This forecast is significantly less than expected as a result of further unanticipated delays in relation to product delivery and project services. In particular:

1. A major Queensland project that has an embedded network contract with INT (worth approximately \$2 million) has been delayed for reasons outside of INT's control. This has resulted in a deferral of revenue from FY2011.
2. Product sales have been impacted by suppliers' delays in delivering products to INT as a result of the re-direction of products towards rectification works from the Queensland floods. INT currently hold product orders of \$1.169 million which are awaiting supply.

Revenue in FY2010 was split 50%/50% between the Embedded Networks and Smart Metering businesses. With the increased focus on embedded networks and the commencement of revenue for a number of embedded network contracts in FY2011, full year revenue contribution is likely to be in the order of 75%/25% in favour of Embedded Networks.

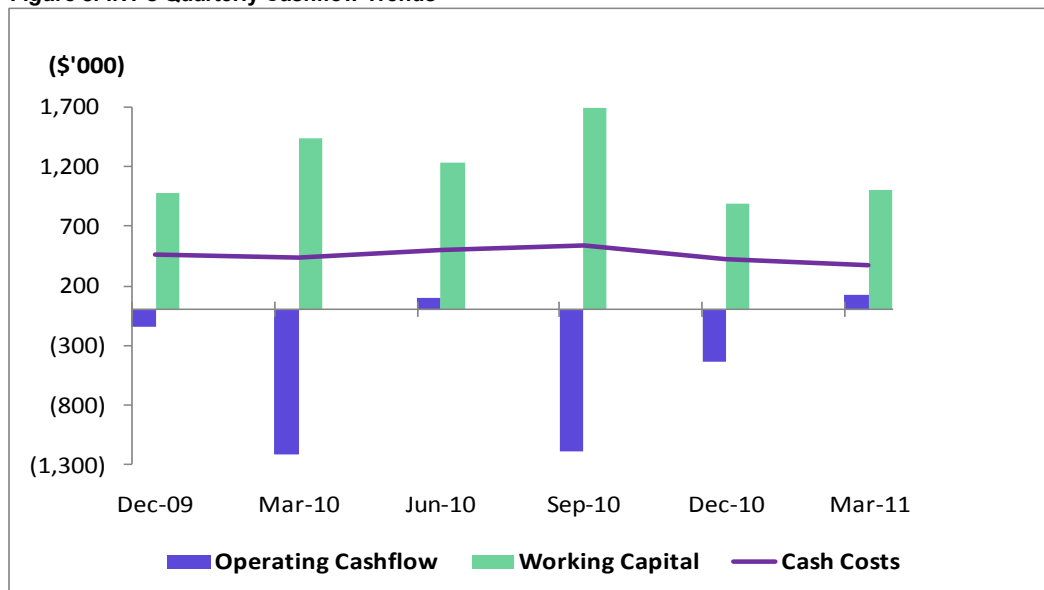
INT currently have seven embedded networks contracts in operation. Billing is currently occurring in line with expectations and is expected to increase as the developments are fully tenanted. These include four previously-announced embedded network contracts have been commissioned and have started to generate revenue. These include Ravida (\$0.2 million; 5-year contract), Lynch St Apartments (\$1.2 million; 5-year contract); Vivida (\$0.58 million contract) and the Bell St Preston development with Buildcorp (\$2.7 million; 5-year contract).

3.2 Cashflow Trends

INT became cashflow positive in the 4th quarter of FY2010, but recorded a negative cashflow result for the 1st quarter of FY2011, due mainly to timing delays on some embedded network contracts (i.e. revenue contribution was later than expected). The company has since returned to being operating cashflow positive for the 2nd quarter of FY2011.

A key feature of INT's cashflow management is that operating costs have been well controlled over the last six quarters, as shown in Figure 3. The repayment of the convertible notes has reduced costs by a further \$0.25 million in interest payments.

Figure 3: INT's Quarterly Cashflow Trends



4. BOARD OF DIRECTORS

DIRECTOR	INTEREST IN INT	BACKGROUND
John Evans <i>Non Exec Chairman</i>	5.8m ord shares	<p>Mr Evans was appointed as the Non Executive Chairman on 4 May 2011. His areas of professional expertise are in Strategic Business Planning and Advising, and in Finance. He has held a range of public and private company directorships across a range of industries that include Property Development, Healthcare, Mining Services, Legal Services, and Employment & Training.</p> <p>Mr Evans holds a Bachelor of Commerce (Honours) degree and is a Fellow of the Institute of Chartered Accountants in Australia, and a member of CPA Australia and the Australian Institute of Company Directors. He is currently a Non Executive Director of ASX-listed companies Medivac Limited and HealthLinX Limited.</p>
Ian Kiddle <i>CEO</i>	~23.22m ord shares	<p>Mr Kiddle has more than 29 years experience within the Telecommunications and Utility industries and markets, having held senior positions and directorships incorporating roles within Sales, Marketing, Business Development and Operations, across many technologies, markets and regions (in particular the Asia Pacific markets).</p> <p>Mr Kiddle is recognised as a leader within "Embedded Network" environments, including but not limited to Power, Voice and Data. Mr Kiddle has successfully built and operated his own business, specialising in Embedded Networks.</p> <p>He was appointed CEO of INT in January 2010 and had been the company's Business Development Director since April 2009.</p>
Andrew Meehan <i>Executive Director</i>	~28.22m ord shares	<p>Mr Meehan has had an extensive career in the Utility industry, with particular emphasis on the Water sector. Over the last 20 years, he has been CEO or Director of a number of private companies within the Utility industry, including as co-founder and Managing Director of AMRS.</p> <p>He founded Utility Data Solutions (UDS) and managed the sale and transition to INT in July 2007.</p>
Simon Kemp <i>Non Exec Director</i>	~8.02m ord shares	<p>Mr Kemp has many years experience in the electrical, communications and other industries. He has had Senior Management experience with what is now known as Downer Engineering and has served on the board of the National Electrical and Communication Association as Federal and State President.</p> <p>He was also instrumental in setting up one of the first group apprenticeship training schemes which went on to employ over 400 apprentices.</p> <p>Mr Kemp has also set up several private companies of various disciplines all of which are trusted to provide service and continue to trade successfully.</p>



Bob Gestro
Non Exec Director

~100.33m ord
shares

Mr Gestro was re-appointed to the Board on 4 May 2011, having previously served as a Board member of Intermoco from February 2009 to April 2010. He was appointed CEO in February 2009 and subsequently served as Executive Chairman at the time of his departure from the Board.

Mr Gestro has been involved in Metering for over 36 years, including over 25 years experience in energy and water management services companies and has held positions with AGL, Email Metering and Schlumberger (where he held the position of General Manager for 10 years).

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