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Price
EUR2.65

Target
EUR3.05

Previous
Buy

Buy

Clever blend of growth and safety

Smart M&A deals in 2009 have improved the portfolio's risk profile while simultaneously freeing up resources to fund additional expansion targets and increasingly generous dividends. The investment case continues to offer an attractive mix of safe earnings prospects and growth potential.

Italy Utilities

Terna

COMPANY UPDATE

29 September 2009

Reuters TRN.MI
Bloomberg TRN IM
Index DJ Stoxx 600

In brief

- > **Wise reshuffle of asset portfolio in 2009**
- > **Attractive investment opportunities in merchant lines**
- > **Absolute view: Buy, target price EUR3.05**
- > **Jungle status: sector-relative Buy**

In detail

2009 M&A further enhancing the portfolio's risk profile

Year to date, M&A has clearly improved the risk profile of Terna's business portfolio. Terna has swapped its interest in its Brazilian subsidiary, Terna Participações, for a EUR1.2bn high-voltage grid in Italy acquired from ENEL. Now, 100% of its assets consist of regulated activities located in Italy. M&A deals were also smartly concluded. The acquisition of the high-voltage grid was virtually at a discount to RAB, taking into account that its yearly turnover and some peripheral assets were not considered in the final valuation. The EUR0.8bn inflow from the equity of the Brazilian assets represents double the undisturbed market valuation, driving to a capital gain of close to EUR0.4bn.

New investment opportunities

The de-gearing from the sale of Brazil's operations gives more balance sheet flexibility, adding new investment targets to the group's capex plans. New investment chances are related to the development of Italy-Balkans interconnection lines. Intergovernmental agreements between Italy and the Balkan states have been recently concluded. Among the projects closer to the sanctioning phase we see the line connecting to Montenegro. Contractual terms are expected to be rather attractive for Terna: the project development should be ruled by relatively long-term pacts (26 years) and it is expected to yield IRRs of 12-14%.

Generous dividend payments

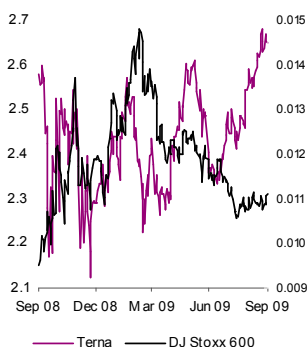
In addition to new investment opportunities, the resources freed up by the sale of the stake in Terna Part will also likely be partly allocate to further enrich the next few years dividend payments. We expect revised dividend projections to lift yields by about 50bp to almost 7%.

Latest financials

Market cap (EURbn)	5.3
Free float	65%
Shares outstanding (m)	2,000
Daily trade volume ('000)	7,415
YTD abs. performance	13%
52-week high (EUR)	2.68
52-week low (EUR)	2.13
Enterprise value (EURm)	10,524
Net debt (EURm)	4,761

(EUR)	2008	2009E	2010E
Sales	1,395.2	1,335.8	1,441.1
EBITDA	994.7	987.9	1,067.7
EBIT	714.3	667.7	716.0
Pretax profit	534.4	492.7	518.0
Net profit (adj)	313.4	271.7	305.7
EPS (adj)	0.16	0.17	0.19
DPS	0.16	0.16	0.17
PE	16.9	15.3	13.9
EV/sales	6.5	7.9	7.6
EV/EBITDA	9.1	10.7	10.2
EV/EBIT	12.6	15.8	15.2
Net div. yield	5.9%	6.1%	6.3%

Financial year end: 31 December



Defensive and growing

A supportive set of rules for transmission tariffs yield high visibility to the group's earnings profile. Recent regulator's initiatives made the transmission's revenues basically immune to the economic downturn effects on volumes. Terna is expected to invest EUR3.4bn in five years, driving the 2014E tariff RAB to EUR10bn (5% CAGR).

Investment conclusion**Jungle status: sector-relative Buy**

The stock trades at a valuation in line with the group's RAB. Our 7% premium-to-RAB target price of EUR3.05 (backed by expected benefits from development capex and cost outperformance) offers 15% upside. We reiterate our Buy rating on the stock.

Key financials

Company profile

Terna is the main Italian electricity transmission operator. It owns 39,400 Km (around 98%) of the national transmission grid. Terna also controls several transmission concessions in Brazil totaling more than 3,300km lines.

Top shareholders

CDP	30.0%
ENEL	5.1%

Events calendar

Q3-09 Results	12/11/2009
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Income statement, 31 December (EURm)

	2008	2009E	2010E	2011E
Sales	1,395.2	1,335.8	1,441.1	1,499.2
EBITDA adjusted	994.7	987.9	1,067.7	1,124.0
EBITA adjusted	714.3	667.7	716.0	751.3
EBIT adjusted	714.3	667.7	716.0	751.3
Net financial	-179.9	-175.0	-198.0	-212.0
Non recurring items	0.0	0.0	0.0	0.0
Associates	0.0	0.0	0.0	0.0
PBT	534.4	492.7	518.0	539.3
Income tax	-193.0	-177.4	-186.5	-194.2
Tax rate (%)	36.1%	36.0%	36.0%	36.0%
Others	0.0	0.0	0.0	0.0
Minorities	-13.9	-25.2	-25.8	-26.5
Reported net earnings	327.5	290.1	305.7	318.6
Adjustments	-14.1	-18.4	0.0	0.0
Adj. net earnings (group)	313.4	271.7	305.7	318.6

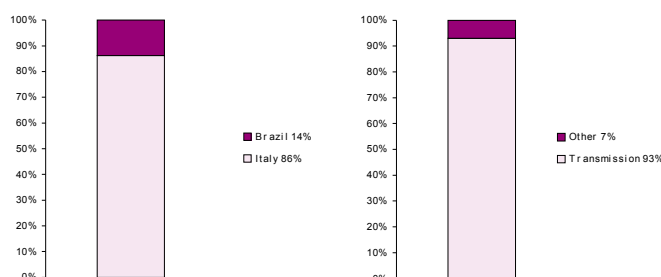
Cash-flow statement (EURm)

	2008	2009E	2010E	2011E
Net earnings	341.4	315.4	331.5	345.2
D&A	280.4	320.1	351.7	372.7
Change in TWC	-109.9	195.1	-41.0	-38.1
Other changes & non-cash	0.0	0.0	0.0	0.0
Operating cash flow	511.9	904.8	718.2	757.8
Capex	-993.0	-1,977.7	-803.6	-781.7
Free cash-flow	-481.1	-1,072.9	-85.3	-23.9
Disposals	0.0	0.0	0.0	0.0
Financial investments	0.0	0.0	0.0	0.0
Investing cash flow	-993.0	-1,977.7	-803.6	-781.7
Change in equity	0.2	0.0	0.0	0.0
Change in debt	1,379.1	1,404.1	426.4	370.6
Dividends	-308.4	-321.9	-331.7	-337.2
Others	73.2	0.0	0.0	0.0
Financing cash flow	1,144.1	1,082.2	94.7	33.4
Change in cash & equivalents	663.0	9.3	9.4	9.5
Change in net debt	716.1	1,394.8	417.0	361.1

Ratios

	2008	2009E	2010E	2011E
Sales growth (%)	3.5%	-4.3%	7.9%	4.0%
EBITDA growth (%)	1.7%	-0.7%	8.1%	5.3%
EBIT growth (%)	-1.2%	-6.5%	7.2%	4.9%
Net earnings growth (%)	-9.4%	-13.3%	12.5%	4.2%
Gross margin (%)	0.0%	0.0%	0.0%	0.0%
EBITDA margin (%)	71.3%	74.0%	74.1%	75.0%
EBIT margin (%)	51.2%	50.0%	49.7%	50.1%
Net earnings margin (%)	22.5%	20.3%	21.2%	21.3%
Net debt/equity (%)	155.6%	213.3%	224.4%	231.4%
Net debt/EBITDA (%)	338.4%	481.9%	484.9%	492.8%
ROE (%)	14.8%	13.0%	14.3%	14.5%
ROCE (%)	12.1%	9.7%	9.1%	9.0%
Equity/total assets (%)	22.9%	20.0%	19.9%	19.8%
TWC/sales (%)	5.9%	6.2%	5.8%	5.6%
Operating CF/sales (%)	36.7%	67.7%	49.8%	50.5%
Capex/sales (%)	71.2%	148.1%	55.8%	52.1%
FCF/sales (%)	-34.5%	-80.3%	-5.9%	-1.6%
Capex/D&A (%)	354.1%	617.8%	228.5%	209.8%
Dividend pay out (%)	100.8%	94.1%	87.0%	85.4%

Sales split – Geographical and divisional



Balance sheet, 31 December (EURm)

	2008	2009E	2010E	2011E
Cash and equivalents	929.4	938.7	948.1	957.6
Account receivables	1,945.0	1,964.5	1,984.1	2,003.9
Other current assets	17.7	17.9	18.1	18.2
Current assets	2,892.1	2,921.0	2,950.2	2,979.7
Goodwill	203.9	203.9	203.9	203.9
Other intangible assets	279.3	279.3	279.3	279.3
Property, plant & equipment	6,041.3	7,698.9	8,150.7	8,559.8
Financial assets	38.2	38.2	38.2	38.2
Fixed assets	6,562.7	8,220.3	8,672.1	9,081.2
Short-term debt	273.2	275.9	278.7	281.5
Accounts payable	1,880.6	1,899.4	1,918.4	1,937.6
Other current liabilities	472.2	668.1	627.9	590.7
Current liabilities	2,626.0	2,843.4	2,825.0	2,809.7
Long-term debt	4,022.0	5,423.4	5,847.1	6,214.9
Pension provisions	153.9	157.0	160.1	163.3
Other long-term liabilities	489.2	486.1	483.0	479.8
Long-term liabilities	4,665.1	6,066.5	6,490.2	6,858.0
Shareholders' equity	2,076.8	2,119.2	2,169.2	2,228.7
Minority interest	86.9	112.1	138.0	164.5
Total shareholders' equity	2,163.7	2,231.4	2,307.1	2,393.2
Net debt	3,365.8	4,760.6	5,177.7	5,538.8
Trade working capital	82.1	82.9	83.8	84.6
Capital employed	6,134.4	7,596.9	8,089.7	8,536.9
Total assets	9,454.8	11,141.3	11,622.3	12,060.9

Per share (EUR)

	2008	2009E	2010E	2011E
EPS adjusted	0.16	0.17	0.19	0.20
EPS reported	0.16	0.18	0.19	0.20
CFPS	0.31	0.35	0.38	0.40
BVPS	1.04	1.06	1.08	1.11
DPS	0.16	0.16	0.17	0.17
Year-end nb of shares(m)	2,000.0	2,000.0	2,000.0	2,000.0
Av. diluted nb of shares(m)	2,000.0	2,000.0	2,000.0	2,000.0

Valuation

	2008	2009E	2010E	2011E
P/E	16.9	15.3	13.9	13.4
P/BV	2.6	2.5	2.4	2.4
P/CF	8.5	7.5	7.0	6.7
Dividend yield	5.9%	6.1%	6.3%	6.4%
FCF yield	-8.7%	-18.9%	-1.5%	-0.4%
EV/sales	6.5	7.9	7.6	7.5
EV/EBITDA	9.1	10.7	10.2	10.0
EV/EBITA	12.6	15.8	15.2	15.0
EV/EBIT	12.6	15.8	15.2	15.0
EV/capital employed	1.5	1.5	1.4	1.4

Disclosures

Disclosure checklist - Potential conflict of interests

Stock	ISIN	Disclosure (See Below)	Currency	Price
ENEL	IT0003128367	nothing to disclose	EUR	4.26
Terna	IT0003242622	nothing to disclose	EUR	2.65
Terna Participacoes	BRTRNACDAM14	nothing to disclose	BRL	39.69

Source: Factset closing prices of 25/09/2009

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We have not disclosed the recommendation to the issuer before its dissemination and the recommendation has not been amended following this disclosure.

Rating ratio Kepler Capital Markets Q2 2009

Rating breakdown	A	B
Buy	48.3%	0.0%
Hold	10.7%	0.0%
Reduce	37.8%	0.0%
Not Rated/Under Review/Accept Offer	3.2%	0.0%
Total	100.0%	0.0%

Source: Kepler Capital Markets

A: % of all research recommendations

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