

Company

5 November 2009 | 8 pages

TERNA SpA (TRN.MI)

 Equity

9M09 Preview

- A healthy set of results** — We expect a solid set of results for 9M with EBITDA at €757m (consensus €755), flat on last year but with Brazil now being deconsolidated. EBIT should be €533m (€528 consensus) down 4% on last year. Results will be out on November 10th conference call at 4.15pm CET +44 (20) 30032666.
- Disposal of Brazil could lead to higher dividends** — Terna has just closed the disposal of its Brazilian subsidiary. In previous conference calls Terna said the proceeds of the disposal would have beefed up the dividend. We estimate €0.165 p.s. FY09. If management see upside to this number at results we would expect it to support the share price.
- Electricity demand down but not a problem** — Electricity demand in Italy fell 6.3% YTD, new data for October should be announced next week, hopefully showing demand is bottoming out. Yet Terna has agreed with the regulator to insulate its revenues from volumes for this and next year, hence recent weakness in demand should not affect its accounts or its Capex programme.
- One of our preferred stocks in Europe** — Despite trading on high P/Es, we believe Terna's share price currently reflects just the RAB and nothing for the attractive premium returns on Capex. The dividend yield is also attractive in the context of our sector and we believe there is upside risk to our numbers, which should make it a preferred stock for those seeking defensiveness in our sector.

Buy/Medium Risk	1M
Price (05 Nov 09)	€2.70
Target price	€3.00
Expected share price return	11.1%
Expected dividend yield	6.1%
Expected total return	17.2%
Market Cap	€5,402M
	US\$8,038M

Price Performance (RIC: TRN.MI, BB: TRN IM)



TERNA SpA (EUR)

Year to 31 Dec	2007A	2008A	2009E	2010E	2011E
Sales (€M)	1,348.2	1,396.0	1,517.7	1,618.3	1,684.5
Net Income (€M)	413.9	328.3	348.0	352.2	388.9
Diluted EPS (€)	0.21	0.16	0.17	0.18	0.19
Diluted EPS (Old) (€)	0.21	0.16	0.17	0.18	0.19
PE (x)	13.0	16.4	15.5	15.3	13.9
EV/EBITDA (x)	8.1	8.5	8.2	8.2	8.1
DPS (€)	0.16	0.16	0.17	0.18	0.18
Net Div Yield (%)	5.9	6.1	6.3	6.5	6.5

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See Appendix A-1 for Analyst Certification and important disclosures.

Fiscal year end 31-Dec	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	13.0	16.4	15.5	15.3	13.9
EV/EBITDA adjusted (x)	8.1	8.5	8.2	8.2	8.1
P/BV (x)	2.4	2.5	2.5	2.5	2.4
Dividend yield (%)	5.9	6.1	6.3	6.5	6.5
Per Share Data (€)					
EPS adjusted	0.21	0.16	0.17	0.18	0.19
EPS reported	0.21	0.16	0.17	0.18	0.19
BVPS	1.14	1.08	1.09	1.10	1.12
DPS	0.16	0.16	0.17	0.18	0.18
Profit & Loss (€M)					
Net sales	1,348	1,396	1,518	1,618	1,685
Operating expenses	-626	-681	-706	-754	-756
EBIT	723	715	812	864	929
Net interest expense	-117	-180	-236	-279	-285
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	606	535	576	586	644
Tax	-173	-193	-214	-219	-241
Extraord./Min.Int./Pref.div.	-19	-14	-14	-14	-14
Reported net income	414	328	348	352	389
Adjusted earnings	414	328	348	352	389
Adjusted EBITDA	978	996	1,119	1,216	1,284
Growth Rates (%)					
Sales	3.2	3.5	8.7	6.6	4.1
EBIT adjusted	5.2	-1.1	13.5	6.5	7.5
EBITDA adjusted	8.8	1.8	12.4	8.7	5.6
EPS adjusted	12.4	-20.7	6.0	1.2	10.4
Cash Flow (€M)					
Operating cash flow	849	537	782	749	704
Depreciation/amortization	255	280	307	352	355
Net working capital	47	-101	127	44	-40
Investing cash flow	-659	-748	-1,910	-785	-610
Capital expenditure	-600	-747	-785	-785	-610
Acquisitions/disposals	-60	-1	-1,125	0	0
Financing cash flow	-146	866	225	36	-94
Borrowings	415	1,380	582	376	256
Dividends paid	-311	-320	-330	-340	-350
Change in cash	44	656	-902	0	0
Balance Sheet (€M)					
Total assets	8,044	9,455	10,122	10,537	10,795
Cash & cash equivalent	247	902	0	0	0
Accounts receivable	1,541	1,730	1,663	1,640	1,640
Net fixed assets	5,613	6,036	6,899	7,722	8,005
Total liabilities	5,770	7,291	7,940	8,343	8,562
Accounts payable	1,772	1,881	1,931	1,950	1,909
Total Debt	2,916	4,295	4,878	5,254	5,510
Shareholders' funds	2,274	2,164	2,182	2,194	2,233
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	72.5	71.3	73.7	75.2	76.2
ROE adjusted	18.7	14.8	16.0	16.1	17.6
ROIC adjusted	9.8	8.4	8.6	8.4	8.4
Net debt to equity	117.4	156.8	223.6	239.5	246.8
Total debt to capital	56.2	66.5	69.1	70.5	71.2

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9M09 Preview

Figure 1. 9M results summary (€ m)

	9M08A	9M09 E	Growth	Cons.
Total revenues	1,040	996	-4%	990
Opex	(281)	(239)	-15%	
EBITDA	759	757	0%	755
D&A	(201)	(224)	11%	
EBIT	558	533	-4%	528
Financial charges	(103)	(137)	33%	
PBT	455	396	-13%	
Taxes	(156)	(142)	-9%	
Minorities/Disc.Ops	(16)	71	n.m.	
Net profits	283	325	15%	295

Source: Company Reports, Citi Investment Research and Analysis

TERNA SpA

Company description

TERNA is the electricity transmission company of Italy, holding a market share of c96%. Its transmission operations are entirely regulated, as are its operations in Brazil. In Italy, TERNA also provides transmission services to ENEL, its parent company, as well as to other clients outside the ENEL group.

Investment strategy

We rate Terna Buy/Medium Risk (1M). Terna is a solid defensive stock that benefits from a clear and stable regulatory environment that allows for incentives on investments for new infrastructure. We expect volumes in the electricity market to be driven by a more extensive use of electricity for residential and industrial usages allowing for an average growth of c.1% pa. Thanks to the regulatory framework, Terna distinguishes itself for its earnings and cash flow predictability that we believe make it a stock to favour for those investors seeking defensiveness in the sector.

Valuation

We value Terna using a RAB-based approach for its Italian transmission activities, which are the core business of Terna. To this end, we adopt a RAB-based DCF where for the terminal value we use the RAB as at the end of 2015 (coinciding with the end of the third regulatory period) whereas over 2009-14 we discount the cash flows that we estimate Terna will generate given the allowed return (by the regulator) of 6.9% (real, pre-tax) on its existing assets and the 2.6% premium allowed on new investments. These cash flows are then discounted using a WACC in line with the allowed return. This valuation is then benchmarked against the trading multiples of comparable European utilities and results in a premium to RAB (end of 2009) of 11%, which is consistent with the premium observed for similar regulated businesses in Europe. For its non-core activities, we use a 2009E EV/EBITDA multiple of 7x. Our SOTP valuation is €3.00, which is where we set our target price. We then compare Terna's profits and EBITDA to the multiples of other listed European utilities

Risks

We rate Terna Medium Risk because of the following factors that could prevent achievement of our target price. Terna's profitability could be undermined by investments outside Italy, such as those in Brazil and the Balkans, for which at present we have little information and could increase the risks of Terna's operations. In Brazil Terna could decide to commit more capital were opportunities to arise, such as the Brazilian State's need to expand its existing transmission grid. Although on the one hand we acknowledge that such investments could potentially be profitable, on the other hand the lower transparency of regulation would alter Terna's overall risk profile, increasing it. A similar argument applies to the Balkans where state-owned companies are being privatised and little is known about regulation and regulators, which, where they exist, have no proven track record in terms of stability and consistency. Finally, Terna faces the risk that some of its projects could be delayed or executed at a cost that is higher than that recognised by the regulator. Also, the government could decide to levy taxes on regulated utilities, thus affecting its profitability. We think risks of new taxes or a negative regulatory review are the main risks that could impede the share price reaching our target price. On the upside, the fact that Terna could announce more cost savings or a higher capex plan than we expect, could lead the share price to exceed our target price.

Appendix A-1

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TERNA SpA (TRN.MI)

Ratings and Target Price History

Fundamental Research

Analyst: Alberto Ponti



Chart current as of 24 October 2009

	Date	Rating	Target Price	Closing Price
1	29-Nov-06	*2M	*2.50	2.55
2	31-Jan-07	*1M	*2.85	2.66

	Date	Rating	Target Price	Closing Price
3	12-May-08	*2M	*3.00	2.84
4	9-Feb-09	*1M	3.00	2.48

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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