

## COMPANY UPDATE

# Terna (TRN.MI)

Sell

## Updating estimates ahead of 9M09 results (November 10)

### What's changed

Terna is due to announce its 9M09 results on November 10, with a conference call at 4:15pm CET. We revise our estimates for new inflation assumptions for Italy, for investments in photovoltaic assets (announced in July) and for a capital gain of more than €400 mn from the disposal of Terna Part (closed this week). Our 2009E reported EPS rises to €0.39 from €0.25.

### Implications

We expect 9M EBITDA of €760 mn, in line with last year's €759 mn. Last year's EBITDA included Terna's Brazilian operation (Terna Part), which has been sold and will be reported as discontinued operations in the current year, while we expect the 2009 result to include a €57 mn contribution from the HV grid acquisition from Enel (TELAT). Net of these, we forecast an underlying EBITDA increase of 9%. We forecast 9M EBIT of €537 mn (-4% yoy) and net income of €327 mn, up 15% yoy. We expect lower financial expense yoy on an underlying basis, reflecting a lower cost of debt (last year's financial charges included a €54 mn non-recurring benefit from derivatives; stripping these out, financial expenses would fall 26% yoy). Historically, the interim dividend (also due to be announced) has been 37% of the full-year dividend: we do not expect a special dividend following the disposal of Terna Part, but rather forecast a full-year dividend for 2009 of €0.175/share, with a high payout (96%).

### Valuation

We retain a Sell rating on Terna, with a 12-month RAB-based SOTP price target of €3.10 (from €3.00). With only 14% potential upside, we see better value elsewhere and prefer stocks with exposure to commodity prices or economic recovery.

### Key risks

Key risks to our price target include changes in regulation, or weaker than expected commodity prices.

### INVESTMENT LIST MEMBERSHIP

Pan-Europe Sell List

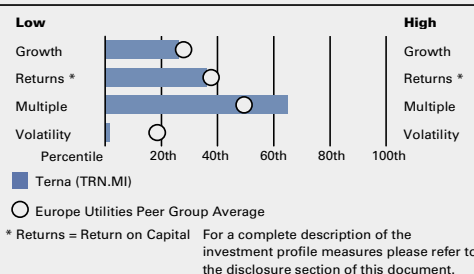
### Coverage View: Neutral

Italy:  
Power

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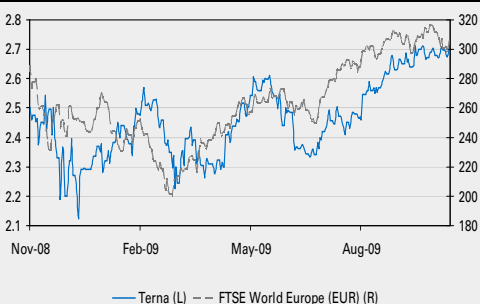
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### Investment Profile



Key data	Current			
Price (€)	2.71			
12 month price target (€)	3.10			
Upside/(downside) (%)	14			
Market cap (€ mn)	5,422.5			
Enterprise value (€ mn)	9,417.0			
	12/08	12/09E	12/10E	12/11E
<b>Revenue (€ mn) New</b>	<b>1,395.2</b>	<b>1,361.6</b>	<b>1,482.6</b>	<b>1,579.9</b>
Revenue revision (%)	(0.6)	2.7	2.5	5.9
<b>EBIT (€ mn) New</b>	<b>714.4</b>	<b>716.3</b>	<b>752.0</b>	<b>812.6</b>
EBIT revision (%)	(1.1)	4.4	(2.2)	1.3
<b>EPS (€) New</b>	<b>0.16</b>	<b>0.39</b>	<b>0.19</b>	<b>0.19</b>
EPS (€) Old	0.17	0.25	0.20	0.19
EV/EBITDA (X)	9.0	9.3	9.1	8.8
P/E (X)	16.3	6.9	14.3	14.0
Dividend yield (%)	5.9	6.5	6.6	6.6
FCF yield (%)	(4.8)	(5.4)	(7.9)	(2.7)
CROCI (%)	6.8	7.0	7.1	7.2

### Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	11.5	10.4	8.4
Rel. to FTSE World Europe (EUR)	5.0	(5.9)	2.7

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 11/06/2009 close.

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# Terna: Summary financials

Profit model (€ mn)	12/08	12/09E	12/10E	12/11E	Balance sheet (€ mn)	12/08	12/09E	12/10E	12/11E
Total revenue	1,395.2	1,361.6	1,482.6	1,579.9	Cash & equivalents	779.7	279.7	279.7	279.7
Operating costs	(400.5)	(344.0)	(377.2)	(381.1)	Accounts receivable	1,730.4	1,116.5	1,200.9	1,263.9
R&D	--	--	--	--	Inventory	17.7	17.7	17.7	17.7
Lease payments	0.0	0.0	0.0	0.0	Other current assets	25.9	19.1	22.3	25.0
Other operating profit/(expense)	0.0	0.0	0.0	0.0	<b>Total current assets</b>	<b>2,553.7</b>	<b>1,433.0</b>	<b>1,520.6</b>	<b>1,586.3</b>
<b>EBITDA</b>	<b>994.7</b>	<b>1,017.6</b>	<b>1,105.4</b>	<b>1,198.8</b>	Net PP&E	6,035.8	6,880.6	7,577.3	7,971.1
Depreciation & amortisation	(280.4)	(301.2)	(353.3)	(386.2)	Net intangibles	279.3	289.3	299.3	309.3
<b>EBIT</b>	<b>714.4</b>	<b>716.3</b>	<b>752.0</b>	<b>812.6</b>	Total investments	166.1	166.1	166.1	166.1
Net interest income/(expense)	(179.9)	(154.1)	(165.8)	(210.1)	Other long-term assets	419.9	419.9	419.9	419.9
Associates	0.0	0.0	0.0	0.0	<b>Total assets</b>	<b>9,454.8</b>	<b>9,188.8</b>	<b>9,983.2</b>	<b>10,452.7</b>
Profit/(loss) on disposals	0.0	0.0	0.0	0.0	Accounts payable	1,880.6	0.0	0.0	0.0
Others (recurring)	0.0	0.0	0.0	0.0	Short-term debt	239.2	0.0	0.0	0.0
<b>Pretax profits</b>	<b>534.5</b>	<b>562.2</b>	<b>586.3</b>	<b>602.5</b>	Other current liabilities	129.6	1,361.6	1,482.6	1,579.9
Income tax	(193.0)	(198.4)	(207.5)	(214.4)	<b>Total current liabilities</b>	<b>2,249.4</b>	<b>1,361.6</b>	<b>1,482.6</b>	<b>1,579.9</b>
Tax rate (%)	36.1	35.3	35.4	35.6	Long-term debt	3,955.3	4,221.4	4,877.4	5,242.5
Minorities	(13.9)	0.0	0.0	0.0	Other long-term liabilities	1,086.4	1,061.4	1,036.4	1,011.4
Preferred dividends	0.0	0.0	0.0	0.0	<b>Total long-term liabilities</b>	<b>5,041.7</b>	<b>5,282.8</b>	<b>5,913.8</b>	<b>6,253.9</b>
<b>Net income (pre-exceptionals)</b>	<b>327.6</b>	<b>363.8</b>	<b>378.7</b>	<b>388.1</b>	<b>Total liabilities</b>	<b>7,291.1</b>	<b>6,644.3</b>	<b>7,396.4</b>	<b>7,833.8</b>
Other non-recurring items post tax	0.0	420.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
<b>Net income</b>	<b>327.6</b>	<b>783.8</b>	<b>378.7</b>	<b>388.1</b>	<b>Total common equity</b>	<b>2,076.8</b>	<b>2,544.5</b>	<b>2,586.8</b>	<b>2,618.9</b>
<b>EPS (underlying) (€)</b>	<b>0.16</b>	<b>0.18</b>	<b>0.19</b>	<b>0.19</b>	<b>Minority interest</b>	<b>86.9</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
EPS (basic, reported) (€)	0.16	0.39	0.19	0.19	<b>Total liabilities &amp; equity</b>	<b>9,454.8</b>	<b>9,188.8</b>	<b>9,983.2</b>	<b>10,452.7</b>
Weighted shares outstanding (mn)	2,000.7	2,000.9	2,000.9	2,000.9	Capitalised leases	0.0	0.0	0.0	0.0
Common dividends declared	316.1	350.2	360.2	360.2	<b>Capital employed</b>	<b>6,358.2</b>	<b>6,765.9</b>	<b>7,464.2</b>	<b>7,861.4</b>
DPS (€)	0.16	0.18	0.18	0.18	Adj for unfunded pensions & GW	(235.5)	(230.5)	(225.5)	(220.5)
Dividend payout ratio (%)	96.5	96.3	95.1	92.8	<b>Adj capital employed</b>	<b>6,122.7</b>	<b>6,535.4</b>	<b>7,238.7</b>	<b>7,640.9</b>
Dividend cover (X)	1.0	1.0	1.1	1.1	<b>Gross cash invested</b>	<b>10,885.9</b>	<b>10,903.8</b>	<b>11,940.4</b>	<b>12,708.8</b>
<b>Growth &amp; margins (%)</b>	<b>12/08</b>	<b>12/09E</b>	<b>12/10E</b>	<b>12/11E</b>	<b>Ratios</b>	<b>12/08</b>	<b>12/09E</b>	<b>12/10E</b>	<b>12/11E</b>
Revenue growth	3.5	(2.4)	8.9	6.6	CROCI (%)	6.8	7.0	7.1	7.2
EBITDA growth	1.7	2.3	8.6	8.5	CROCI/WACC (X)	1.2	1.1	1.3	1.3
EBIT growth	(1.2)	0.3	5.0	8.0	ROIC (%)	7.8	9.0	7.0	7.0
Net income growth	(20.9)	139.3	(51.7)	2.5	ROIC/WACC (X)	1.3	1.5	1.3	1.3
EPS growth	(20.9)	11.0	4.1	2.5	ROA (%)	3.7	3.9	4.0	3.8
DPS growth	4.6	10.8	2.9	0.0	WACC (%)	5.8	6.1	5.6	5.5
EBITDA margin	71.3	74.7	74.6	75.9	Inventory days	4.6	4.7	4.4	4.1
EBIT margin	51.2	52.6	50.7	51.4	Asset turnover (X)	0.2	0.2	0.2	0.2
<b>Cash flow statement (€ mn)</b>	<b>12/08</b>	<b>12/09E</b>	<b>12/10E</b>	<b>12/11E</b>	Net debt/equity (%)	157.8	154.9	177.7	189.5
Net income	327.6	363.8	378.7	388.1	EBITDA interest cover (X)	5.5	6.6	6.7	5.7
D&A add-back (incl. ESO)	280.4	301.2	353.3	386.2	<b>Valuation</b>	<b>12/08</b>	<b>12/09E</b>	<b>12/10E</b>	<b>12/11E</b>
Minority interest add-back	13.9	0.0	0.0	0.0	EV/sales (X)	6.1	6.7	6.6	6.5
Net (inc)/dec working capital	23.0	(27.9)	33.3	31.7	EV/EBITDA (X)	8.6	9.0	8.8	8.6
Other operating cash flow	(25.0)	(25.0)	(25.0)	(25.0)	EV/EBITDA (X)	8.6	9.0	8.8	8.6
<b>Cash flow from operations</b>	<b>619.8</b>	<b>612.1</b>	<b>740.4</b>	<b>780.9</b>	EV/EBIT (X)	11.9	12.8	13.0	12.6
Capital expenditures	(762.0)	(780.0)	(1,060.0)	(790.0)	P/E (X)	16.3	14.9	14.3	14.0
Acquisitions	(213.0)	(1,152.0)	0.0	0.0	Dividend yield (%)	5.9	6.5	6.6	6.6
Divestitures	0.0	809.0	0.0	0.0	FCF yield (%)	(4.8)	(5.4)	(7.9)	(2.7)
Others	0.0	0.0	0.0	0.0	EV/GCI (X)	0.8	0.9	0.8	0.8
<b>Cash flow from investing</b>	<b>(975.0)</b>	<b>(1,123.0)</b>	<b>(1,060.0)</b>	<b>(790.0)</b>	EV/adj. capital employed (X)	1.6	1.5	1.4	1.4
Dividends paid (common & pref)	(327.5)	(316.0)	(336.4)	(356.0)	Price/book (X)	2.2	2.1	2.1	2.1
Inc/(dec) in debt	1,299.2	26.9	656.0	365.1	Note: Ratios are adjusted for leases where appropriate. Only separately disclosed where significant and ongoing.				
Other financing cash flows	0.0	0.0	0.0	0.0	Note: Last actual year may include reported and estimated data.				
<b>Cash flow from financing</b>	<b>971.7</b>	<b>(289.1)</b>	<b>319.6</b>	<b>9.1</b>	Source: Company data, Goldman Sachs Research estimates.				
<b>Total cash flow</b>	<b>471.0</b>	<b>(500.0)</b>	<b>0.0</b>	<b>0.0</b>					
Capex/D&A (%)	271.8	259.0	300.0	204.6					
Reinvestment rate (%)	127.7	121.9	149.9	105.4					
Cash flow cover of dividends (X)	1.9	1.8	2.0	2.1					
Free cash flow cover of dividends (X)	(0.8)	(0.8)	(1.2)	(0.4)					

## Analyst Contributors

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## 9M preview: We forecast EBITDA of €760 mn, net income €327 mn

### Exhibit 1: Terna 9M09 preview: Brazil discontinued, TELAT consolidated from April 1

(€mn)	9M09 GS†	9M08A	y-o-y	Comment
Revenues Italy	1,006	902	12%	Underlying in line with H1 trend + contribution from TELAT acquisition
Revenues Brazil	0	138	-100%	Discontinued post sale
<b>Total revenues</b>	<b>1,006</b>	<b>1,040</b>	<b>-3%</b>	
EBITDA Italy	760	646	18%	
EBITDA Brazil	0	113	-100%	
Operating costs	-246	-281	-13%	Typically higher proportion of costs in 2H
<b>Total EBITDA</b>	<b>760</b>	<b>759</b>	<b>0%</b>	<b>Organic EBITDA up 10% yoy</b>
Depreciation & Provisions	-223	-201	11%	In line with 1H run rate
<b>EBIT</b>	<b>537</b>	<b>558</b>	<b>-4%</b>	
Financial Expense	-116	-103	12%	€53mn of derivative and IAS impacts in 2008, assumed non-recurring
Capital gains				We expect the Terna Part gain to be booked in 4Q
<b>PBT</b>	<b>422</b>	<b>455</b>	<b>-7%</b>	
Tax	-150	-156	-4%	Using tax rate of 35% in Q3
Others/discontinued	73			Brazil (discontinued), helped by strengthening BRL
Minorities	-18	-16	13%	
<b>Reported net income</b>	<b>327</b>	<b>283</b>	<b>15%</b>	
<b>Reported EBITDA</b>	<b>760</b>	<b>759</b>	<b>0%</b>	
M&A adjustments	-57	-113		Impact of TELAT in 2009 and Brazil in 2008
<b>Organic EBITDA</b>	<b>703</b>	<b>646</b>	<b>9%</b>	
<b>EPS</b>	<b>0.16</b>	<b>0.14</b>		

Source: Company data, Goldman Sachs Research estimates.

Our 12-month RAB-based SOTP price target for Terna increases to €3.10 from €3.00. This is the result of:

- the inclusion of the NPV of the solar projects in our price target (€0.05/share of NPV);
- an increase to our inflation assumption for the Italian RAB revaluation for 2009 to 2%, in line with our latest economists's forecasts (from 0%);
- a reduction to our expected rate of return for the next regulatory period, starting in 2012, from 7.4% to 6.9%, following the latest regulatory proposals for Snam Rete Gas (we believe this is unlikely to lead to higher tariff increases, and thus keep it unchanged at 6.9% from 2012, versus a 50 bp increase before).

Our higher forecast revenues, EBITDA and depreciation are linked to higher expected incentives on dispatching activities, an acceleration of capex for the years 2009-2012 (with the recent Italian legislation changes making the authorization process easier), and some additional revenues from the additional investments in solar photovoltaics on the non-used land around their existing substations (€300 mn over three years).

### Exhibit 2: Terna SOTP-based 12-month price target of €3.10

RAB-based valuation for end 2009E	Terna RAB-based SOTP		Notes
	EUR mn	EUR ps	
Italian RAB end 2009	8,022	4.01	Rab used for 2011 tariffs (18 months time lag)
ELAT	1,152	0.58	Transaction value (RAB)
Non regulated activities	153	0.08	6x 2009E EBITDA
Less net debt	-3,942	-1.97	End 2009E net debt
Other liabilities	-82	-0.04	Provisions for risks end 2009E
<b>Terna equity-RAB value</b>	<b>5,304</b>	<b>2.65</b>	<b>Equity-RAB end 2009E</b>
NPV cost outperformance (including GRN dispatching)	280	0.14	Estimate at 31.12.2009, for two regulatory periods
NPV spread between returns WACC, 2 periods	89	0.04	c.0.3% return spread for two regulatory periods
NPV 2-3% incentive on €5bn of expansion capex to 2016	657	0.33	2-3% incremental return for two more regulatory periods for 12 years
NPV from solar projects	110	0.05	30% premium to invested capital + capex invested to end 2009
Deferred taxes	-235	-0.12	Assuming €20mn pa cash outflows
<b>Total RAB-value adjustments</b>	<b>901</b>	<b>0.45</b>	<b>Implies 17% premium to RAB</b>
<b>Total RAB-based valuation for Terna</b>	<b>6,205</b>	<b>3.10</b>	

Source: Goldman Sachs research estimates.

## Reg AC

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**Growth** is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

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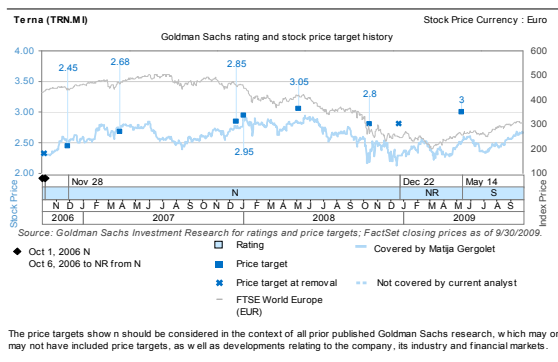
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## Price target and rating history chart(s)



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