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Price  
EUR2.74

Target  
EUR3.10

Previous  
Buy

**Buy**

## The sun still shines on Terna's Buy case

We have modelled a new dividend policy into our forecasts (setting a plain 7% yield over 2009-13) as well as the new solar energy investment initiative. The fast allocation of resources freed up by the sale of the Brazil subsidiary is further evidence of Terna's smart approach to managing its asset portfolio.

Italy Utilities

# Terna

COMPANY UPDATE

12 November 2009

Reuters TRN.MI  
Bloomberg TRN IM  
Index DJ Stoxx 600

### In brief

- > **New dividend policy beats our expectations**
- > **Exit yield of 7%, 100bp better than previous guidance**
- > **Improving visibility of new solar energy initiative**
- > **Target price fine-tuned from EUR3.05 to EUR3.10, Buy reiterated**

### In detail

#### Generous ahead of expectations

The balance sheet resources freed up by the sale of the stake in Brazil subsidiary Terna Participações have led Terna to unveil a more generous dividend policy than we had expected. The new payout regime calls for 4% DPS growth a year using DPS 2008 as a calculation basis instead of 2005. To these "base" dividends Terna will spread over the next four years an additional EUR150m portion of the capital gain from the sale of its Brazilian subsidiary. While we were modelling this (EUR150m gain) to be added to the ordinary dividends, we had not assumed the change in calculation basis. Also, 2009E interim DPS of EUR0.07 (+18% YOY) was well above our EUR0.062 forecast.

#### 7% dividend yield looks safe until 2013

Terna detailed how the EUR150m in additional dividends will be spread out over the next four years: EUR52m will be added to 2009E dividends, EUR43m to 2010E, EUR35m to 2011E and EUR20m to 2012E DPS. Factoring in this guidance, we calculated a new 2009E DPS of EUR0.19, increasing to EUR0.195 in 2011 and then remaining (at least) flat for the remainder of the period of the business plan (which occurs in a new regulatory interval). The new yield is therefore about 7%, versus our previous assumption of 6.4% and the about 6% average implied by previous guidance.

#### Sungrid is now included in our estimates

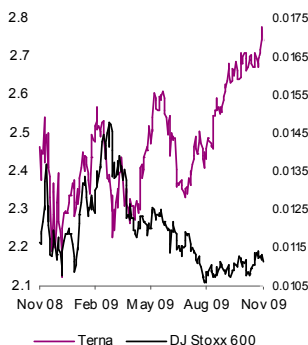
As disclosed last July, Terna will invest another portion of Terna Part's proceeds to develop photovoltaic plants, exploiting unused lands near some (about 70) of its substations. As the initiative is gaining visibility, we decided to model it into our official estimates. Terna specified that it aims to install 100MW of solar capacity (in July it indicated a 70-100 MW range) and that it had already secured the first authorisations for some of the planned plants. It will invest more than EUR300m, entirely over 2010. We model the initiative to yield 10% IRR. Its NPV adds EUR0.05 per share to our previous target price.

### Latest financials

Market cap (EURbn)	5.5
Free float	65%
Shares outstanding (m)	2,000
Daily trade volume ('000)	9,593
YTD abs. performance	17%
52-week high (EUR)	2.77
52-week low (EUR)	2.13
Enterprise value (EURm)	9,585
Net debt (EURm)	3,986

(EUR)	2008	2009E	2010E
Sales	1,395.2	1,343.0	1,456.3
EBITDA	994.7	995.1	1,082.6
EBIT	714.3	682.3	722.4
Pretax profit	534.4	522.3	540.4
Net profit (adj)	313.4	319.2	346.9
EPS (adj)	0.16	0.16	0.17
DPS	0.16	0.19	0.19
PE	16.9	17.2	15.8
EV/sales	6.5	7.1	7.2
EV/EBITDA	9.1	9.6	9.6
EV/EBIT	12.6	14.0	14.4
Net div. yield	5.9%	6.9%	7.0%

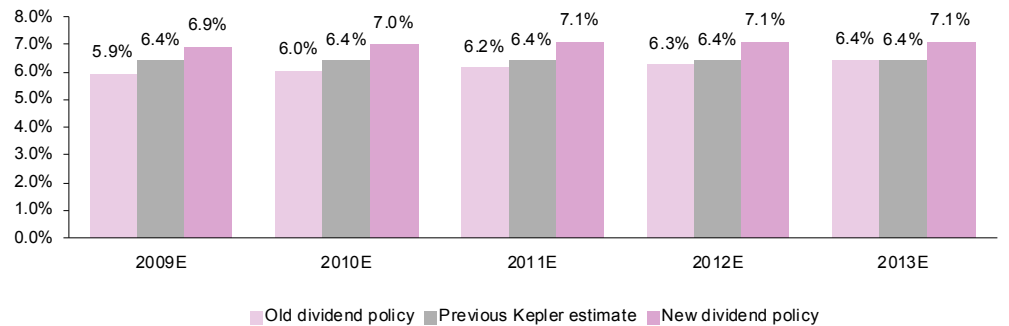
Financial year end: 31 December



**Table 1: New dividend policy (EUR per share)**

	2008 DPS	2009E	2010E	2011E	2012E	2013E
DPS with "old" policy (EUR)	0.158	0.163	0.166	0.169	0.173	0.176
<b>New dividend policy</b>						
DPS with 4% yearly increase (EUR)	0.158	0.164	0.171	0.178	0.185	
Distribution of additional EUR150m (EUR p.s.)		0.026	0.022	0.018	0.010	
<b>Total "new" DPS</b>		<b>0.190</b>	<b>0.192</b>	<b>0.195</b>	<b>0.195</b>	<b>0.195</b>

Source: Kepler Capital Markets

**Chart 1: Dividend yield (%)**

Source: Kepler Capital Markets

**Table 2: Sungrid's snapshot**

	2010E	2011E	2012E	2013E
Capex (EURm)	320.0			
<b>Installed capacity (MW)</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Load factor (hours/year)	679	1,358	1,358	1,358
<b>Production (GWh)</b>	<b>67.9</b>	<b>135.8</b>	<b>135.8</b>	<b>135.8</b>
ARPU (EUR/MWh)	408.3	399.7	400.1	400.4
Revenues (EURm)	27.7	54.3	54.3	54.4
<b>EBITDA (EURm)</b>	<b>21.8</b>	<b>46.4</b>	<b>46.4</b>	<b>46.3</b>
EBIT (EURm)	13.8	30.4	30.4	30.3

Source: Kepler Capital Markets

## Investment conclusion

### Buy reiterated, target price fine-tuned +2% to EUR3.10

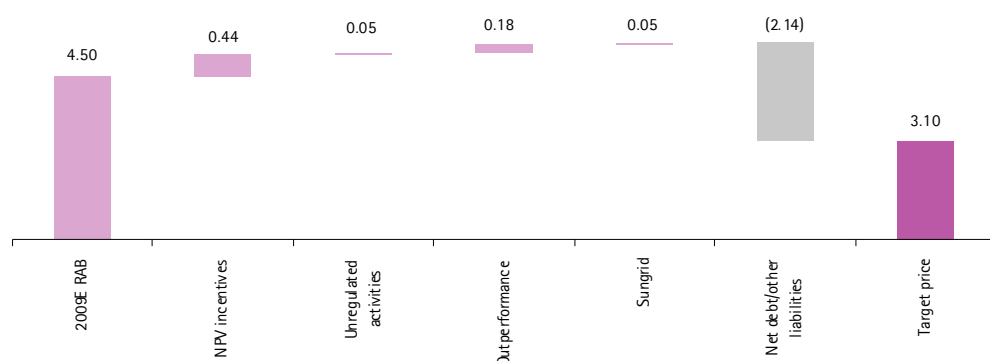
The new dividend policy surprised us on the upside with an exit yield of 7%, 60bp better than expectations and about 100bp ahead of yields implied by previous guidance.

On top of the EUR150m devoted to enrich dividend payments, the investment in the photovoltaic plants is a smart move to quickly allocate another portion of the resources freed up from the disposal of the Brazilian operations and further evidence of Terna's genuine shareholder value-centric style to managing its asset portfolio.

The initiative will allow double-digit returns (we modelled 10% IRR) by exploiting and maximising the value of ancillary assets (unused lands near some of the group's substations). Terna admitted that it aims to quickly monetise the rewards of its investment by considering the sale of Sungrid as soon as the plants are fully up and running (it will nonetheless maintain ownership of the lands where the plants are installed). Meanwhile, we expect further growth opportunities to materialise (such as the Italy-Balkans interconnection lines).

Expectations of a rich dividend flow, value-enhancing expansion opportunities – all strengthen an already sound investment case (high visibility on the group's cash flow profile granted by a stable and supportive regulatory framework). We have fine-tuned our target price from EUR3.05 to EUR3.10 to factor in the expected returns on the investment in the solar plants. We reiterate our Buy rating on Terna.

Chart 2: SOP (EUR per share)



Source: Kepler Capital Markets

Table 3: P&amp;L

(EURm)	3rd regulatory period (Italy)					4th regulatory period (Italy)			
	2007	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E
<b>Revenues</b>	<b>1,348</b>	<b>1,395</b>	<b>1,343</b>	<b>1,456</b>	<b>1,553</b>	<b>1,608</b>	<b>1,689</b>	<b>1,739</b>	<b>1,802</b>
Grid fee - Italy	1,061	1,060	1,195	1,322	1,390	1,442	1,519	1,562	1,618
Other energy items	43	48	78	52	52	52	53	58	64
Regulated activities - Brazil	150	180							
Other activities - Italy	78	90	70	55	57	60	63	64	65
Other activities - Brazil	16	17							
Sungrid				28	54	54	54	54	54
<b>Operating costs</b>	<b>370</b>	<b>401</b>	<b>348</b>	<b>374</b>	<b>377</b>	<b>377</b>	<b>380</b>	<b>382</b>	<b>385</b>
<b>EBITDA</b>	<b>978</b>	<b>995</b>	<b>995</b>	<b>1,083</b>	<b>1,175</b>	<b>1,231</b>	<b>1,309</b>	<b>1,356</b>	<b>1,416</b>
Italy	848	831	995	1,061	1,129	1,185	1,263	1,310	1,370
Brazil	130	164							
Sungrid				22	46	46	46	46	46
<b>D&amp;A</b>	<b>(255)</b>	<b>(280)</b>	<b>(313)</b>	<b>(360)</b>	<b>(384)</b>	<b>(406)</b>	<b>(429)</b>	<b>(451)</b>	<b>(472)</b>
Italy	(235)	(253)	(313)	(352)	(368)	(390)	(413)	(435)	(456)
Brazil	(20)	(27)							
Sungrid				(8)	(16)	(16)	(16)	(16)	(16)
<b>EBIT</b>	<b>723</b>	<b>714</b>	<b>682</b>	<b>722</b>	<b>791</b>	<b>825</b>	<b>880</b>	<b>905</b>	<b>944</b>
Italy	613	577	682	709	761	795	850	875	913
Brazil	110	137							
Sungrid				14	30	30	30	30	30
Net financial charges	(117)	(180)	(160)	(182)	(206)	(222)	(241)	(255)	(260)
<b>Pre-tax profit</b>	<b>606</b>	<b>534</b>	<b>522</b>	<b>540</b>	<b>585</b>	<b>603</b>	<b>639</b>	<b>650</b>	<b>684</b>
Tax	(173)	(193)	(186)	(193)	(209)	(217)	(230)	(234)	(246)
Discontinued operations			410						
Minorities	(19)	(14)							
<b>Net profit</b>	<b>414</b>	<b>328</b>	<b>746</b>	<b>347</b>	<b>376</b>	<b>386</b>	<b>409</b>	<b>416</b>	<b>438</b>
Adjustments	(68)	(14)	(427)						
<b>Net profit adjusted</b>	<b>346</b>	<b>313</b>	<b>319</b>	<b>347</b>	<b>376</b>	<b>386</b>	<b>409</b>	<b>416</b>	<b>438</b>
% change YOY		-9.4%	1.8%	8.7%	8.2%	2.8%	6.0%	1.7%	5.1%

Source: Kepler Capital Markets

Table 4: Cash flow statement and net debt

(EURm)	2007	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E
<b>Operating cash flow</b>	<b>776</b>	<b>512</b>	<b>969</b>	<b>722</b>	<b>697</b>	<b>741</b>	<b>798</b>	<b>851</b>	<b>907</b>
Capex	(714)	(993)	(1,998)	(1,160)	(800)	(795)	(791)	(709)	(712)
<b>Free cash flow</b>	<b>62</b>	<b>(481)</b>	<b>(1,029)</b>	<b>(438)</b>	<b>(103)</b>	<b>(54)</b>	<b>7</b>	<b>142</b>	<b>195</b>
Dividends	(311)	(308)	(338)	(389)	(391)	(396)	(397)	(397)	(398)
Other	(118)	73	746	-	-	-	-	-	-
<b>Net debt decrease/(increase)</b>	<b>(367)</b>	<b>(716)</b>	<b>(621)</b>	<b>(827)</b>	<b>(494)</b>	<b>(450)</b>	<b>(390)</b>	<b>(255)</b>	<b>(202)</b>
<b>Net debt</b>	<b>2,650</b>	<b>3,366</b>	<b>3,986</b>	<b>4,813</b>	<b>5,307</b>	<b>5,757</b>	<b>6,146</b>	<b>6,401</b>	<b>6,604</b>
D/E (%)	123%	162%	160%	197%	219%	238%	253%	261%	265%
Net debt/EBITDA	2.7	3.4	4.0	4.4	4.5	4.7	4.7	4.7	4.7

Source: Kepler Capital Markets

## Key financials

### Company profile

Terna is the main Italian electricity transmission operator. It owns 39,400 Km (around 98%) of the national transmission grid.

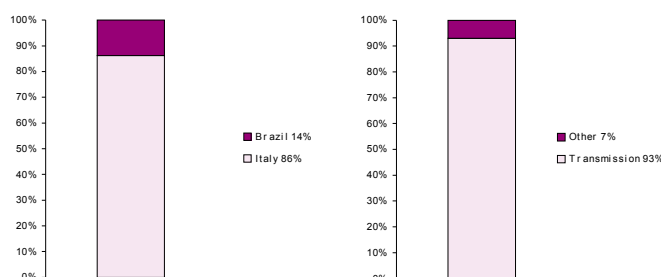
Top shareholders	Events calendar
CDP	30.0%
ENEL	5.1%

Income statement, 31 December (EURm)	2008	2009E	2010E	2011E
<b>Sales</b>	<b>1,395.2</b>	<b>1,343.0</b>	<b>1,456.3</b>	<b>1,552.9</b>
<b>EBITDA adjusted</b>	<b>994.7</b>	<b>995.1</b>	<b>1,082.6</b>	<b>1,175.4</b>
<b>EBITA adjusted</b>	<b>714.3</b>	<b>682.3</b>	<b>722.4</b>	<b>790.9</b>
<b>EBIT adjusted</b>	<b>714.3</b>	<b>682.3</b>	<b>722.4</b>	<b>790.9</b>
Net financial	-179.9	-160.0	-182.0	-206.0
Non recurring items	0.0	0.0	0.0	0.0
Associates	0.0	0.0	0.0	0.0
<b>PBT</b>	<b>534.4</b>	<b>522.3</b>	<b>540.4</b>	<b>584.9</b>
Income tax	-193.0	-185.9	-193.5	-209.4
Tax rate (%)	36.1%	35.6%	35.8%	35.8%
Others	0.0	410.0	0.0	0.0
Minorities	-13.9	0.0	0.0	0.0
<b>Reported net earnings</b>	<b>327.5</b>	<b>746.3</b>	<b>346.9</b>	<b>375.5</b>
Adjustments	-14.1	-427.2	0.0	0.0
<b>Adj. net earnings (group)</b>	<b>313.4</b>	<b>319.2</b>	<b>346.9</b>	<b>375.5</b>

Cash-flow statement (EURm)	2008	2009E	2010E	2011E
Net earnings	341.4	746.3	346.9	375.5
D&A	280.4	312.8	360.2	384.5
Change in TWC	-109.9	-90.5	15.0	-62.9
Other changes & non-cash	0.0	0.0	0.0	0.0
<b>Operating cash flow</b>	<b>511.9</b>	<b>968.6</b>	<b>722.1</b>	<b>697.1</b>
Capex	-993.0	-1,997.7	-1,160.0	-800.2
<b>Free cash-flow</b>	<b>-481.1</b>	<b>-1,029.0</b>	<b>-437.9</b>	<b>-103.1</b>
Disposals	0.0	307.0	0.0	0.0
Financial investments	0.0	0.0	0.0	0.0
Investing cash flow	-993.0	-1,690.7	-1,160.0	-800.2
Change in equity	0.2	0.0	0.0	0.0
Change in debt	1,379.1	629.9	836.3	503.3
Dividends	-308.4	-337.6	-389.0	-390.7
Others	73.2	439.0	0.0	0.0
Financing cash flow	1,144.1	731.3	447.3	112.6
Change in cash & equivalents	663.0	9.3	9.4	9.5
Change in net debt	716.1	620.6	826.9	493.8

Ratios	2008	2009E	2010E	2011E
Sales growth (%)	3.5%	-3.7%	8.4%	6.6%
EBITDA growth (%)	1.7%	0.0%	8.8%	8.6%
EBIT growth (%)	-1.2%	-4.5%	5.9%	9.5%
Net earnings growth (%)	-9.4%	1.8%	8.7%	8.2%
Gross margin (%)	0.0%	0.0%	0.0%	0.0%
EBITDA margin (%)	71.3%	74.1%	74.3%	75.7%
EBIT margin (%)	51.2%	50.8%	49.6%	50.9%
Net earnings margin (%)	22.5%	23.8%	23.8%	24.2%
Net debt/equity (%)	155.6%	155.0%	190.2%	211.0%
Net debt/EBITDA (%)	338.4%	400.6%	444.6%	451.5%
ROE (%)	14.8%	14.0%	14.1%	15.4%
ROCE (%)	12.1%	10.3%	9.6%	9.7%
Equity/total assets (%)	22.9%	24.7%	22.5%	21.5%
TWC/sales (%)	5.9%	6.2%	5.8%	5.4%
Operating CF/sales (%)	36.7%	72.1%	49.6%	44.9%
Capex/sales (%)	71.2%	148.8%	79.7%	51.5%
FCF/sales (%)	-34.5%	-76.6%	-30.1%	-6.6%
Capex/D&A (%)	354.1%	638.7%	322.0%	208.1%
Dividend pay out (%)	100.8%	119.2%	110.9%	103.7%

### 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
<b>Current assets</b>	<b>2,892.1</b>	<b>2,921.0</b>	<b>2,950.2</b>	<b>2,979.7</b>
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	6,980.2	7,780.0	8,195.7
Financial assets	38.2	38.2	38.2	38.2
<b>Fixed assets</b>	<b>6,562.7</b>	<b>7,501.6</b>	<b>8,301.4</b>	<b>8,717.1</b>
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	382.5	398.3	336.3
<b>Current liabilities</b>	<b>2,626.0</b>	<b>2,557.9</b>	<b>2,595.4</b>	<b>2,555.3</b>
Long-term debt	4,022.0	4,649.2	5,482.7	5,983.2
Pension provisions	153.9	157.0	160.1	163.3
Other long-term liabilities	489.2	486.1	483.0	479.8
<b>Long-term liabilities</b>	<b>4,665.1</b>	<b>5,292.3</b>	<b>6,125.8</b>	<b>6,626.3</b>
Shareholders' equity	2,076.8	2,485.5	2,443.4	2,428.2
Minority interest	86.9	86.9	86.9	86.9
<b>Total shareholders' equity</b>	<b>2,163.7</b>	<b>2,572.4</b>	<b>2,530.3</b>	<b>2,515.1</b>
<b>Net debt</b>	<b>3,365.8</b>	<b>3,986.4</b>	<b>4,813.4</b>	<b>5,307.2</b>
<b>Trade working capital</b>	<b>82.1</b>	<b>82.9</b>	<b>83.8</b>	<b>84.6</b>
<b>Capital employed</b>	<b>6,134.4</b>	<b>7,163.8</b>	<b>7,948.6</b>	<b>8,427.2</b>
<b>Total assets</b>	<b>9,454.8</b>	<b>10,422.6</b>	<b>11,251.6</b>	<b>11,696.8</b>

Per share (EUR)	2008	2009E	2010E	2011E
EPS adjusted	0.16	0.16	0.17	0.19
EPS reported	0.16	0.37	0.17	0.19
CFPS	0.31	0.53	0.35	0.38
BVPS	1.04	1.24	1.22	1.21
DPS	0.16	0.19	0.19	0.19
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	17.2	15.8	14.6
P/BV	2.6	2.2	2.2	2.3
P/CF	8.5	5.2	7.7	7.2
Dividend yield	5.9%	6.9%	7.0%	7.1%
FCF yield	-8.7%	-18.8%	-8.0%	-1.9%
EV/sales	6.5	7.1	7.2	7.0
EV/EBITDA	9.1	9.6	9.6	9.3
EV/EBITA	12.6	14.0	14.4	13.8
EV/EBIT	12.6	14.0	14.4	13.8
EV/capital employed	1.5	1.4	1.4	1.3

# Disclosures

## Disclosure checklist - Potential conflict of interests

Stock	ISIN	Disclosure (See Below)	Currency	Price
ENEL	IT0003128367	nothing to disclose	EUR	4.27
Terna	IT0003242622	nothing to disclose	EUR	2.74
Terna Participacoes	BRTRNACDAM14	nothing to disclose	BRL	36.85

Source: Factset closing prices of 11/11/2009

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### Rating History:

Kepler Capital Markets has not changed its rating on Terna in the past 12 months.

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

## Rating ratio Kepler Capital Markets Q3 2009

Rating breakdown	A	B
Buy	50.8%	0.0%
Hold	10.0%	0.0%
Reduce	36.9%	0.0%
Not Rated/Under Review/Accept Offer	2.3%	0.0%
Total	100.0%	0.0%

Source: Kepler Capital Markets

A: % of all research recommendations

B: % of issuers to which Investment Banking Services are supplied

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