Kepler Research

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Smart grid

Our fine-tuned capex forecast and DCF roll-forward drove our target price up from EUR3.03 to EUR3.20. The resulting upside to our target price combined with a great equity story supported by a low-risk operation portfolio, visible growth opportunities and a generous dividend policy all back our Buy.

Price	Target
EUR2.94	**EUR3.20**
Previous Buy	**Buy**

Italy **Utilities**

Terna

COMPANY UPDATE **12 January 2010**

Flash Note

Reuters TRN.MI
Bloomberg TRN IM
Index DJ Stoxx 600

In brief

- > **Visible capex**
- > **High-quality asset portfolio**
- > **Excellent dividend yields**
- > **Buy reiterated with TP raised from EUR3.03 to EUR3.2**

Latest financials

Market cap (EURbn)	5.9
Free float	65%
Shares outstanding (m)	2,000
Daily trade volume ('000)	13,373
YTD abs. performance	-2%
52-week high (EUR)	3
52-week low (EUR)	2.23
Enterprise value (EURm)	10,814
Net debt (EURm)	4,817

(EUR)	2008	2009E	2010E
Sales	1,395	1,343	1,456
EBITDA	995	995	1,083
EBIT	714	682	722
Pretax profit	534	522	540
Net profit (adj)	313	319	347
EPS (adj)	0.16	0.16	0.17
DPS	0.16	0.19	0.19
P/E	16.9	15.9	16.9
EV/sales	6.5	6.8	7.4
EV/EBITDA	9.1	9.2	10.0
EV/EBIT	12.6	13.5	15.0
Net div. yield	5.9%	7.5%	6.5%

Financial year end: 31 December

In detail

High visibility on capex opportunities

We have updated our capex projections, adding EUR270m in 2011-15 for the new 1,000 MW Italy-France connection line. Terna has recently presented the authorisation request to the Economic Development Ministry and the approval is expected in 2010. With this addition, we are now modelling EUR4.2bn transmission capex in 2009-13E and EUR4.1bn in 2010-14E. We are projecting 2014E tariff RAB to EUR10.6bn (5.7% CAGR). Asset base upgrades are attractively rewarded with returns up to 9.9%. In the longer run, visibility on capex chances on the Italian grid is enhanced by the provisions laid out in the 2009-18 National Development Plan.

Low-risk operations

M&A deals completed in 2009 clearly improved the risk profile of Terna's business portfolio. The almost fully regulated group's asset base is now entirely located in Italy, following the disposal of the interest in Terna Participaçoes and the acquisition of the EUR1.2bn high-voltage grid from ENEL. For many reasons, we expect Italian regulatory conditions to remain clear and stable (thus supportive) for a long period, granting excellent visibility to Terna's earnings profile.

Sustainable high dividend yields

The decision to allocate to the dividend payments a further EUR150m from the cash-in generated by the sale of the Brazilian assets has further enhanced an already generous dividend policy: the updated yields has now reached almost 7%, 60bp better than our previous expectations and about 100bp ahead of yields implied by previous guidance.

Interesting new investment pipeline

Another >EUR300m portion of the cash-in from Brazil's divestment is to be employed in a new and smart investment initiative: a start-up for developing new solar plants by exploiting and maximising the value of ancillary assets (unused lands near some of the group's substations). This enables to quickly allocate freed-up resources (expenditures in 2010) targeting double-digit returns (we modelled 10% IRR) to be likely monetised rather rapidly. In the meantime, we expect new investment chances to materialise (ie, Italy-Balkans interconnection lines).

Investment conclusion

Target price raised from EUR3.03 to EUR3.20

Capex forecast review and the DCF model roll-forward have raised our target price from EUR3.03 to EUR3.20. Our new target price implies a 14% premium to end-2009E RAB, justified by the NPV of capex incentives applied for another regulatory period and continued efficiency outperformance. The stock is a clear Buy.

Table 1: Profit and loss

(EURm)	2007	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Revenues	**1,348**	**1,395**	**1,343**	**1,456**	**1,554**	**1,609**	**1,694**	**1,748**	**1,817**
Grid fee - Italy	1,061	1,060	1,195	1,322	1,390	1,442	1,523	1,571	1,632
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	55	55	55	55	55
Operating costs	(370)	(401)	(348)	(374)	(377)	(377)	(380)	(382)	(385)
EBITDA	**978**	**995**	**995**	**1,083**	**1,176**	**1,232**	**1,314**	**1,366**	**1,431**
Italy	848	831	995	1,061	1,129	1,185	1,267	1,319	1,384
Brazil	130	164	-	-	-	-	-	-	-
Sungrid	-	-	-	22	47	47	47	47	47
Depreciations & provisions	**(255)**	**(280)**	**(313)**	**(360)**	**(386)**	**(409)**	**(434)**	**(458)**	**(481)**
Italy	(235)	(253)	(313)	(352)	(370)	(393)	(418)	(442)	(465)
Brazil	(20)	(27)	-	-	-	-	-	-	-
Sungrid	-	-	-	(8)	(16)	(16)	(16)	(16)	(16)
EBIT	**723**	**714**	**682**	**722**	**790**	**823**	**880**	**908**	**950**
Italy	613	577	682	709	759	792	849	877	919
Brazil	110	137	-	-	-	-	-	-	-
Sungrid	-	-	-	14	31	31	31	31	31
Net financial charges	(117)	(180)	(160)	(182)	(206)	(222)	(241)	(255)	(260)
Pre-tax profit	**606**	**534**	**522**	**540**	**584**	**601**	**639**	**653**	**690**
Tax	(173)	(193)	(186)	(193)	(209)	(216)	(230)	(235)	(248)
Discontinued operations			410						
Minorities	(19)	(14)	-	-	-	-	-	-	-
Net profit	**414**	**328**	**746**	**347**	**375**	**384**	**409**	**418**	**442**
Adjustments	(68)	(14)	(427)						
Net profit adjusted	**346**	**313**	**319**	**347**	**375**	**384**	**409**	**418**	**442**
% change YOY		-9.4%	1.8%	8.7%	8.1%	2.5%	6.3%	2.2%	5.7%

Source: Kepler Capital Markets

Table 2: Cash flow statement

(EURm)	2007	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Operating cash flow	**776**	**512**	**889**	**718**	**715**	**756**	**814**	**864**	**921**
Capex	(714)	(993)	(1,998)	(1,160)	(840)	(845)	(851)	(769)	(772)
Free cash flow	**62**	**(481)**	**(1,109)**	**(442)**	**(125)**	**(89)**	**(37)**	**95**	**149**
Dividends	(311)	(308)	(338)	(389)	(391)	(396)	(397)	(397)	(398)
Other	(118)	73	826	-	-	-	-	-	-
Net debt decrease (increase)	**(367)**	**(716)**	**(621)**	**(831)**	**(516)**	**(485)**	**(434)**	**(302)**	**(249)**
Net debt	**2,650**	**3,366**	**3,986**	**4,817**	**5,333**	**5,818**	**6,252**	**6,555**	**6,803**
D/E (%)	123%	162%	160%	197%	220%	241%	257%	268%	273%
Net debt/EBITDA	2.7	3.4	4.0	4.4	4.5	4.7	4.8	4.8	4.8

Source: Kepler Capital Markets

Table 3: Kepler European utilities universe: Sector-relative ranking based on yields only (our start-of-2010 set list)*

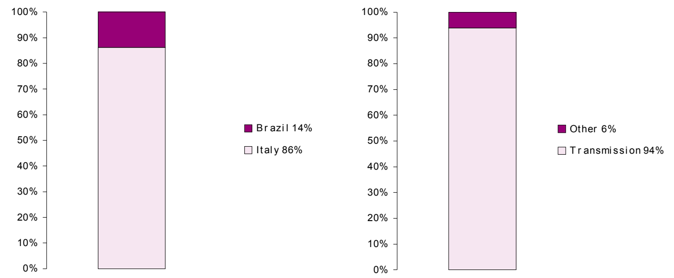
	Stock	Price	Dividend 2009	Dividend 2010	Dividend 2011	Yield 2009	Yield 2010	Yield 2011	Official target price	Absolute rating	Sector-relative view (yield-driven)	Analyst
1	A2A	1.42	0.10	0.10	0.11	6.8%	7.2%	7.5%	1.45	Reduce	Rel.Buy**	Roberto Mascarello
2	**Terna**	**2.94**	**0.19**	**0.19**	**0.19**	**6.5%**	**6.5%**	**6.6%**	**3.20**	**Buy**	**Strong rel. Buy**	**Roberto Mascarello**
3	ENEL	4.20	0.26	0.27	0.26	6.1%	6.4%	6.2%	4.00	Reduce	Strong rel. Buy	Roberto Mascarello
4	RWE	68.00	3.60	3.80	3.80	5.3%	5.6%	5.6%	55.00	Reduce	Strong rel. Buy	Ingo Becker
5	SNAM Rete Gas	3.41	0.18	0.18	0.19	5.3%	5.4%	5.5%	3.70	Buy	Strong rel. Buy	Roberto Mascarello
6	Fortum	19.03	1.00	1.00	1.00	5.3%	5.3%	5.3%	17.00	Reduce	Strong rel. Buy	Ingo Becker
7	E.ON	29.23	1.50	1.60	1.60	5.1%	5.5%	5.5%	25.00	Reduce	Rel.Buy	Ingo Becker
8	GDF Suez	30.38	1.54	1.69	1.69	5.1%	5.6%	5.6%	29.00	Reduce	Rel.Buy	Arnaud Joan
9	Iberdrola	6.68	0.33	0.33	0.33	4.9%	4.9%	4.9%	5.70	Reduce	Rel.Buy	Arnaud Joan
10	HERA	1.63	0.08	0.09	0.10	4.9%	5.4%	6.2%	2.00	Buy	Rel.Buy	Roberto Mascarello
11	Veolia Environnement	25.10	1.21	1.21	1.21	4.8%	4.8%	4.8%	21.00	Reduce	Rel.Buy	Arnaud Joan
12	Enagas	15.68	0.73	0.84	0.88	4.7%	5.4%	5.6%	16.10	Buy	Rel.Buy	Victor Acitores
13	Edison	1.14	0.05	0.06	0.06	4.6%	4.8%	5.1%	1.45	Buy	Rel.Buy	Roberto Mascarello
14	Sechilienne-Sidec	26.65	1.21	1.21	1.33	4.5%	4.5%	5.0%	34.00	Buy	Rel.Buy	Arnaud Joan
15	Centrica	275.00	0.13	0.13	0.14	4.5%	4.7%	4.8%	222.00	Reduce	Rel.Buy	Ingo Becker
16	Red Electrica	37.93	1.46	1.65	1.83	3.9%	4.3%	4.8%	46.10	Buy	Rel. Hold	Victor Acitores
17	Suez Environnement	17.07	0.65	0.65	0.65	3.8%	3.8%	3.8%	18.00	Buy	Rel. Hold	Arnaud Joan
18	Verbund	30.80	1.05	1.05	1.05	3.4%	3.4%	3.4%	27.00	Reduce	Rel. Reduce	Ingo Becker
19	MVV Energie	30.86	0.90	0.90	0.92	2.9%	2.9%	3.0%	20.00	Reduce	Rel. Reduce	Ingo Becker
20	EDF	42.14	1.20	1.20	1.38	2.8%	2.9%	3.3%	29.00	Reduce	Rel. Reduce	Ingo Becker
21	Séché Environnement	61.73	1.30	1.41	1.66	2.1%	2.3%	2.7%	59.00	Reduce	Rel. Reduce	Arnaud Joan
22	Iberdrola Renovables	3.43	0.03	0.03	0.04	0.8%	1.0%	1.1%	3.94	Buy	Rel. Reduce	Victor Acitores
23	EDP Renovaveis	7.01	0.00	0.04	0.04	0.0%	0.5%	0.6%	8.23	Buy	Rel. Reduce	Victor Acitores

*our fundamental assessment of each stock is shown by our (absolute) recommendation on each stock alongside its target price; we use yield levels to set our sector-relative hit list for Q1;
**A2A is not a strong relative pick for us, as we can't rule out a dividend cut (even not a strong one);
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.

Sales split – Geographical and divisional



Top shareholders	
CDP	30.0%
ENEL	5.1%

Events calendar	
FY-09 results	25/03/2010
AGM	30/04/2010
Q1-10 results	12/05/2010
H1-10 results	28/07/2010
Q3-10 results	10/11/2010

Income statement, 31 December (EURn	2008	2009E	2010E	2011E
Sales	**1,395**	**1,343**	**1,456**	**1,554**
EBITDA adjusted	**995**	**995**	**1,083**	**1,176**
EBITA adjusted	**714**	**682**	**722**	**790**
EBIT adjusted	**714**	**682**	**722**	**790**
Net financial	-180	-160	-182	-206
Non recurring items	0	0	0	0
Associates	0	0	0	0
PBT	**534**	**522**	**540**	**584**
Income tax	-193	-186	-193	-209
Tax rate (%)	36.1%	35.6%	35.8%	35.8%
Others	0	410	0	0
Minorities	-14	0	0	0
Reported net earnings	**328**	**746**	**347**	**375**
Adjustments	-14	-427	0	0
Adj. net earnings (group)	**313**	**319**	**347**	**375**

Balance sheet , 31 December (EURm)	2008	2009E	2010E	2011E
Cash and equivalents	929	939	948	958
Account receivables	1,945	1,964	1,984	2,004
Other current assets	18	18	18	18
Current assets	**2,892**	**2,921**	**2,950**	**2,980**
Goodwill	204	204	204	204
Other intangible assets	279	279	279	279
Property, plant & equipment	6,041	6,813	7,613	8,067
Financial assets	38	38	38	38
Fixed assets	**6,563**	**7,335**	**8,134**	**8,589**
Short-term debt	273	276	279	281
Accounts payable	1,881	1,899	1,918	1,938
Other current liabilities	472	303	314	269
Current liabilities	**2,626**	**2,478**	**2,511**	**2,488**
Long-term debt	4,022	4,649	5,487	6,010
Pension provisions	154	157	160	163
Other long-term liabilities	489	486	483	480
Long-term liabilities	**4,665**	**5,292**	**6,130**	**6,653**
Shareholders' equity	2,077	2,486	2,443	2,428
Minority interest	87	0	0	0
Total shareholders' equity	**2,164**	**2,486**	**2,443**	**2,428**
Net debt	**3,366**	**3,986**	**4,817**	**5,333**
Trade working capital	**82**	**83**	**84**	**85**
Capital employed	**6,134**	**7,077**	**7,866**	**8,366**
Total assets	**9,455**	**10,256**	**11,085**	**11,569**

Cash-flow statement (EURm)	2008	2009E	2010E	2011E
Net earnings	341	746	347	375
D&A	280	313	360	386
Change in TWC	-110	-170	11	-46
Other changes & non-cash	0	0	0	0
Operating cash flow	**512**	**889**	**718**	**715**
Capex	-993	-1,998	-1,160	-840
Free cash-flow	**-481**	**-1,109**	**-442**	**-125**
Disposals	0	387	0	0
Financial investments	0	0	0	0
Investing cash flow	-993	-1,611	-1,160	-840
Change in equity	0	0	0	0
Change in debt	1,379	630	840	526
Dividends	-308	-338	-389	-391
Others	73	439	0	0
Financing cash flow	1,144	731	451	135
Change in cash & equivalents	663	9	9	9
Change in net debt	716	621	831	516

Ratios	2008	2009E	2010E	2011E
Sales growth (%)	3.5%	-3.7%	8.4%	6.7%
EBITDA growth (%)	1.7%	0.0%	8.8%	8.6%
EBIT growth (%)	-1.2%	-4.5%	5.9%	9.4%
Net earnings growth (%)	-9.4%	1.8%	8.7%	8.1%
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%	24.1%
Net debt/equity (%)	155.6%	160.4%	197.2%	219.7%
Net debt/EBITDA (%)	338.4%	400.6%	445.0%	453.5%
ROE (%)	14.8%	14.0%	14.1%	15.4%
ROCE (%)	12.1%	10.3%	9.7%	9.7%
Equity/total assets (%)	22.9%	24.2%	22.0%	21.0%
TWC/sales (%)	5.9%	6.2%	5.8%	5.4%
Operating CF/sales (%)	36.7%	66.2%	49.3%	46.0%
Capex/sales (%)	71.2%	148.8%	79.7%	54.1%
FCF/sales (%)	-34.5%	-82.6%	-30.3%	-8.1%
Capex/D&A (%)	354.1%	638.7%	322.0%	217.8%
Dividend pay out (%)	100.8%	119.2%	110.9%	103.8%

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	15.9	16.9	15.7
P/BV	2.6	2.0	2.4	2.4
P/CF	8.5	4.8	8.3	7.7
Dividend yield	5.9%	7.5%	6.5%	6.6%
FCF yield	-8.7%	-21.9%	-7.5%	-2.1%
EV/sales	6.5	6.8	7.4	7.3
EV/EBITDA	9.1	9.2	10.0	9.6
EV/EBITA	12.6	13.5	15.0	14.3
EV/EBIT	12.6	13.5	15.0	14.3
EV/capital employed	1.5	1.4	1.4	1.4

Source: Kepler Capital Markets

Research ratings and important disclosures

Disclosure checklist - Potential conflict of interests

Stock	ISIN	Disclosure (See Below)	Currency	Price
A2A	IT0001233417	nothing to disclose	EUR	1.42
Centrica	GB00B033F229	nothing to disclose	GBP	279.50
E.ON	DE0007614406	nothing to disclose	EUR	29.23
EDF	FR0010242511	nothing to disclose	EUR	42.14
Edison	IT0003152417	nothing to disclose	EUR	1.14
EDP Renovaveis	ES0127797019	nothing to disclose	EUR	7.01
Enagas	ES0130960018	nothing to disclose	EUR	15.68
ENEL	IT0003128367	nothing to disclose	EUR	4.20
Fortum	FI0009007132	nothing to disclose	EUR	19.03
GDF Suez	FR0010208488	nothing to disclose	EUR	30.38
HERA	IT0001250932	nothing to disclose	EUR	1.63
Iberdrola	ES0144580018	nothing to disclose	EUR	6.68
Iberdrola Renovables	ES0147645016	nothing to disclose	EUR	3.43
MVV Energie	DE0007255903	nothing to disclose	EUR	30.86
Red Electrica	ES0173093115	nothing to disclose	EUR	37.93
RWE	DE0007037129	nothing to disclose	EUR	68.00
Sechilienne-Sidec	FR000060402	nothing to disclose	EUR	26.65
SNAM Rete Gas	IT0003153415	nothing to disclose	EUR	3.41
Suez Environnement	FR0010613471	nothing to disclose	EUR	17.07
Séché Environnement	FR0000039109	nothing to disclose	EUR	61.73
Terna	IT0003242622	nothing to disclose	EUR	2.94
Terna Participacoes	BRTRNACDAM14	nothing to disclose	BRL	37.40
Veolia Environnement	FR0000124141	nothing to disclose	EUR	25.10
Verbund	AT0000746409	nothing to disclose	EUR	30.80

Source: Factset closing prices of 08/01/2010
Stock prices**:** Prices are taken as of the previous day's close (to the date of this report) on the home market unless otherwise stated.

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Rating history:

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

We did not disclose the rating to the issuer before its publication and dissemination.

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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