

COMPANY UPDATE

Terna (TRN.MI)

Sell

Small changes to forecasts following 1Q10 results; retain Sell

What's changed

Terna reported 1Q10 results with EBITDA of €274 mn (up 19% yoy, vs. our €270 mn) and net income of €107 mn (up 36% yoy, vs. our €98 mn). The main difference compared to our forecasts was in financial charges, where the company benefitted from a 3% average cost of debt (we previously forecast a 3.5% cost of debt for the FY).

Implications

We have adjusted our forecasts for Terna, primarily to reflect a lower cost of debt, based on the company's updated guidance of 3.2%-3.3% for 2010 (we now assume 3.2%). As a result, our EPS forecast for 2010E has increased by 4%.

Valuation

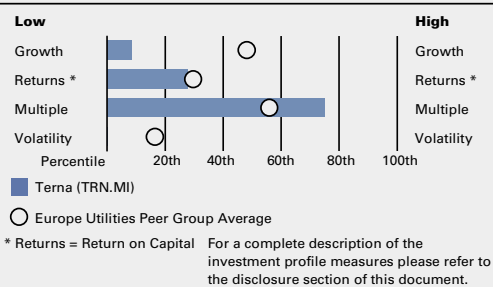
Our 12-month, RAB-based price target is unchanged at €3.3.

Terna is trading on a 2010E EV/EBITDA multiple of 9.5x, compared to the average for regulated utilities of 8.7x, and a 2010E P/E multiple of 14.8x, compared to an average of 11.9x. With less than 10% potential upside to our price target (compared to more than 30% average potential upside in the wider utilities sector), we retain a Sell rating on the stock.

Key risks

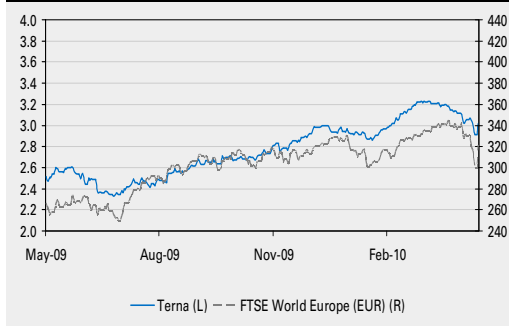
Key risks are potential regulatory changes and higher/lower interest rates.

Investment Profile



Key data	Current			
Price (€)	3.02			
12 month price target (€)	3.30			
Upside/(downside) (%)	9			
Market cap (€ mn)	6,032.7			
Enterprise value (€ mn)	10,619.0			
	12/09	12/10E	12/11E	12/12E
Revenue (€ mn) New	1,360.7	1,503.5	1,639.5	1,681.6
Revenue revision (%)	0.0	0.7	0.3	0.3
EBIT (€ mn) New	694.4	754.2	843.9	869.8
EBIT revision (%)	0.0	1.3	0.6	0.6
EPS (€) New	0.39	0.20	0.22	0.21
EPS (€) Old	0.39	0.19	0.22	0.21
EV/EBITDA (X)	9.0	9.5	9.1	9.2
P/E (X)	6.6	14.8	13.7	14.5
Dividend yield (%)	7.5	6.4	6.5	6.5
FCF yield (%)	(3.9)	(10.1)	(3.4)	(4.3)
CROCI (%)	6.5	6.4	6.6	6.3

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	5.1	8.6	19.8
Rel. to FTSE World Europe (EUR)	(0.4)	5.2	(0.9)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 5/10/2010 close.

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Terna: Summary Financials

Profit model (€ mn)	12/09	12/10E	12/11E	12/12E	Balance sheet (€ mn)	12/09	12/10E	12/11E	12/12E
Total revenue	1,360.7	1,503.5	1,639.5	1,681.6	Cash & equivalents	501.1	501.1	501.1	501.1
Operating costs	(357.5)	(390.5)	(400.4)	(405.1)	Accounts receivable	1,169.1	1,217.8	1,311.6	1,345.2
R&D	--	--	--	--	Inventory	11.7	11.7	11.7	11.7
Lease payments	0.0	0.0	0.0	0.0	Other current assets	18.4	28.9	32.6	33.7
Other operating profit/(expense)	0.0	0.0	0.0	0.0	Total current assets	1,700.3	1,759.5	1,856.9	1,891.7
EBITDA	1,003.2	1,113.0	1,239.1	1,276.4	Net PP&E	7,075.4	7,956.6	8,391.5	8,814.9
Depreciation & amortisation	(308.8)	(358.8)	(395.2)	(406.6)	Net intangibles	182.0	192.0	202.0	212.0
EBIT	694.4	754.2	843.9	869.8	Total investments	144.2	144.2	144.2	144.2
Net interest income/(expense)	(148.3)	(130.6)	(167.1)	(224.9)	Other long-term assets	217.8	217.8	217.8	217.8
Associates	0.0	0.0	0.0	0.0	Total assets	9,319.7	10,270.1	10,812.4	11,280.6
Profit/(loss) on disposals	0.0	0.0	0.0	0.0	Accounts payable	1,482.0	0.0	0.0	0.0
Others (recurring)	0.0	0.0	0.0	0.0	Short-term debt	99.7	0.0	0.0	0.0
Pretax profits	546.1	623.6	676.8	644.9	Other current liabilities	164.8	1,691.4	1,721.4	1,681.6
Income tax	(192.1)	(217.2)	(235.4)	(227.7)	Total current liabilities	1,746.5	1,691.4	1,721.4	1,681.6
Tax rate (%)	35.2	34.8	34.8	35.3	Long-term debt	4,199.2	5,179.6	5,658.5	6,162.7
Minorities	0.0	0.0	0.0	0.0	Other long-term liabilities	872.5	847.5	822.5	797.5
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	5,071.7	6,027.1	6,481.0	6,960.2
Net income (pre-exceptionals)	354.0	406.4	441.4	417.2	Total liabilities	6,818.2	7,718.5	8,202.4	8,641.8
Other non-recurring items post tax	417.0	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	771.0	406.4	441.4	417.2	Total common equity	2,501.5	2,551.6	2,610.0	2,638.8
EPS (underlying) (€)	0.18	0.20	0.22	0.21	Minority interest	0.0	0.0	0.0	0.0
EPS (basic, reported) (€)	0.39	0.20	0.22	0.21	Total liabilities & equity	9,319.7	10,270.1	10,812.4	11,280.6
Weighted shares outstanding (mn)	2,000.9	2,000.9	2,000.9	2,000.9	Capitalised leases	0.0	0.0	0.0	0.0
Common dividends declared	380.2	385.0	390.6	390.9	Capital employed	6,800.4	7,731.2	8,268.4	8,801.5
DPS (€)	0.19	0.19	0.20	0.20	Adj for unfunded pensions & GW	(274.5)	(269.5)	(264.5)	(259.5)
Dividend payout ratio (%)	107.4	94.7	88.5	93.7	Adj capital employed	6,525.9	7,461.7	8,003.9	8,542.0
Dividend cover (X)	0.9	1.1	1.1	1.1	Gross cash invested	12,287.0	13,561.6	14,479.0	15,403.7
Growth & margins (%)	12/09	12/10E	12/11E	12/12E	Ratios	12/09	12/10E	12/11E	12/12E
Revenue growth	(2.5)	10.5	9.0	2.6	CROCI (%)	6.5	6.4	6.6	6.3
EBITDA growth	0.9	10.9	11.3	3.0	CROCI/WACC (X)	1.1	1.1	1.2	1.1
EBIT growth	(2.8)	8.6	11.9	3.1	ROIC (%)	8.8	6.8	6.9	6.6
Net income growth	135.4	(47.3)	8.6	(5.5)	ROIC/WACC (X)	1.4	1.2	1.2	1.2
EPS growth	8.1	14.8	8.6	(5.5)	ROA (%)	3.8	4.1	4.2	3.8
DPS growth	20.3	1.3	1.5	0.1	WACC (%)	6.1	5.7	5.6	5.5
EBITDA margin	73.7	74.0	75.6	75.9	Inventory days	3.1	2.8	2.6	2.5
EBIT margin	51.0	50.2	51.5	51.7	Asset turnover (X)	0.2	0.2	0.2	0.2
Cash flow statement (€ mn)	12/09	12/10E	12/11E	12/12E	Net debt/equity (%)	151.8	183.4	197.6	214.6
Net income	354.0	406.4	441.4	417.2	EBITDA interest cover (X)	6.8	8.5	7.4	5.7
D&A add-back (incl. ESO)	308.8	358.8	395.2	406.6	Valuation	12/09	12/10E	12/11E	12/12E
Minority interest add-back	0.0	0.0	0.0	0.0	EV/sales (X)	6.5	6.9	6.8	6.9
Net (inc)/dec working capital	159.7	(14.6)	(67.4)	(74.7)	EV/EBITDAR (X)	8.8	9.3	8.9	9.1
Other operating cash flow	(25.0)	(25.0)	(25.0)	(25.0)	EV/EBITDA (X)	8.8	9.3	8.9	9.1
Cash flow from operations	797.5	725.6	744.2	724.1	EV/EBIT (X)	12.7	13.8	13.1	13.3
Capital expenditures	(878.0)	(1,250.0)	(840.0)	(840.0)	P/E (X)	14.3	14.8	13.7	14.5
Acquisitions	(1,212.1)	0.0	0.0	0.0	Dividend yield (%)	7.5	6.4	6.5	6.5
Divestitures	847.6	0.0	0.0	0.0	FCF yield (%)	(3.9)	(10.1)	(3.4)	(4.3)
Others	0.0	0.0	0.0	0.0	EV/GCI (X)	0.7	0.8	0.8	0.8
Cash flow from investing	(1,242.5)	(1,250.0)	(840.0)	(840.0)	EV/adj. capital employed (X)	1.5	1.5	1.5	1.5
Dividends paid (common & pref)	(337.8)	(356.3)	(383.0)	(388.4)	Price/book (X)	2.4	2.4	2.3	2.3
Inc/(dec) in debt	104.4	880.7	478.8	504.3	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.				
Cash flow from financing	(233.4)	524.4	95.8	115.9	Source: Company data, Goldman Sachs Research estimates.				
Total cash flow	(278.6)	0.0	0.0	0.0					
Capex/D&A (%)	284.3	348.4	212.6	206.6					
Reinvestment rate (%)	137.7	168.9	103.5	105.2					
Cash flow cover of dividends (X)	1.7	1.9	2.1	2.0					
Free cash flow cover of dividends (X)	(0.5)	(1.6)	(0.5)	(0.7)					

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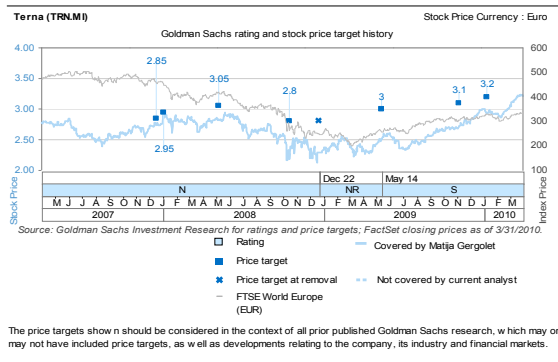
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