BANCA IMI

Equity Company Note

TerniEnergia

Turning into a Smart Energy Company

TerniEnergia - Key estimates and data

Y/E December		2016A	2017E	2018E	2019E
Revenues	EUR M	86.13	70.00	136.0	200.0
EBITDA	EUR M	17.32	12.32	21.02	30.00
EBIT	EUR M	7.87	-4.88	11.02	20.00
Net Income	EUR M	1.05	-8.04	4.03	9.87
Dividend ord.	EUR	0	0	0	0
Adj. EPS	EUR	0.02	-0.17	0.09	0.21
EV/EBITDA	x	8.1	9.6	5.8	3.9
Adj. P/E	x	43.4	Neg.	9.7	4.0

Neg.: negative; A: actual; E: estimates; Source: Company data and Intesa Sanpaolo Research

- **Riding the OT/IT convergence to enter smart business.** Leveraging on Operation Technology (OT) assets and know-how, and through the recent acquisition of ICT companies Softeco and Selesoft, TerniEnergia has now focused on becoming a smart energy company. Along with the transition from an EPC player to a provider of on-site technical services, TerniEnergia could be a first mover into smart/micro grids and smart trading. The micro grid market, according to Markets&Markets, should reach around USD 35Bn by 2022. In Italy, following the Delibera AEEGSI 300/2017/R/eel by the "Autorità per l'energia elettrica il gas e il sistema idrico" (the Electricity, Gas and Water Authority) of 5 May 2017, the electricity dispatching market will open, and a "digital utility" scenario is taking shape. TerniEnergia has the skills to monitor, model, analyse, forecast, manage risk, coordinate & control, to act as a balanced service provider, and be one of the first movers in Italian smart energy trading.
- **1H17 results.** 1H17A results were affected by a managerial discontinuity, following an interruption of the fiduciary relationship with the former CEO. Due to this discontinuity, TerniEnergia posted a 20.4% revenue contraction in 1H17A to EUR 40.2M, and an EBITDA margin decline of 180bps to 17%. EBIT was negative for EUR 6.2M (EUR 5.9M positive in 1H16A), dragged down by write-downs, largely attributable to the suspension of EPC activities, resulting from the choices made by the former CEO. The net loss was EUR 6.5M, vs. a EUR 1.1M profit in 1H16A. Net debt reduced by around 6.8% vs. FY16A, to EUR 87.5M.
- **Financials and valuation.** Reflecting 1H17 trends, we expect an 18.7% yoy revenue contraction in FY17E to EUR 70M and an EBITDA margin of 17.6%, slightly better than 1H17A. For 2018E-20E, we expect revenue from assets and smart solutions&services to increase slightly, and a strong growth of smart trading revenue, sustained by higher volumes in gas trading. The "smart" component should help to improve profitability, which we project at 15-15.8% in the 3-years. We also projected a strong de-leveraging, with a net debt to EBITDA which, after peaking at 6.4x in FY17E, should gradually decline to normalised values along the plan timeframe. Management has also stated that it will pursue actions to strengthen its balance sheet, which might involve current shareholders as well as potential investors and/or industrial partners. Considering that the company is in a transition phase, we limited our DCF calculation to 2018, to allow for a "sanity-check" on our 2018 projections based on the coming quarterly results. **We calculated a target price of EUR 1.15/share and rate the company BUY.**
- **Key risks.** In our view, TerniEnergia 's key risks are: 1) high level of working capital in EPC projects, an effect which should be softened in the new plan; 2) volatility in terms of revenue and margin in the trading business; 3) execution risk in the transition to a smart energy company; 4) deleveraging and reimbursing the EUR 25M bond expiring at the beginning of 2019, could be a risk, should the economic scenario become difficult.

See page 17 for full disclosures and analyst certification
Banca IMI is Specialist to TerniEnergia

5 October 2017: 15:30 CET
Date and time of production

BUY

Target Price: EUR 1.15

Italy/Multi-Utilities
Initiation of Coverage

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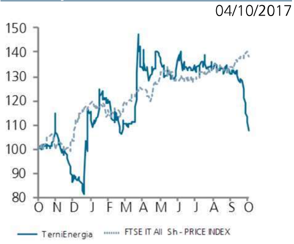
Price performance, -1Y



Source: FactSet

Date and time of first circulation:
6 October 2017: 8:00 CET

Priced at market close on 04.10.2017*	
Target price (€)	1.15
Target upside (%)	38.55
Market price (€)	0.83
52Wk range (€)	1.13/0.63
Market cap (€ M)	39.08
No. of shares	47.09
Free float (%)	44.9
Major shr	Italeaf
(%)	42.2
Reuters	TRNI.MI
Bloomberg	TER IM
FTSE IT All Sh	24799

Performance %

Absolute		Rel. to FTSE IT All	
-1M	-17.8	-1M	-20.3
-3M	-19.1	-3M	-24.3
-12M	7.8	-12M	-21.9

*unless otherwise indicated within report. Source: FactSet and Intesa Sanpaolo Research estimates

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Contents

Investment Summary

Positives

- **Strong and long-term relations with important customers in Italy and abroad**. Since the beginning of its activity, the company has finalised contracts with Italian energy players (Enel, Terna and other primary Italian utilities), but also with international partners, such as the Société Tunisienne de l'Electricité et du Gaz (S.T.E.G) within a government plan to build a total capacity of 1 GW with investments of USD 1Bn (Tunisia Solar Plan), and Juice Power to develop and build clean energy generation plants and energy management structures in India. Thanks to energy efficiency projects (co-working building of Copernico Torino), the list of customers expands with industrial/service players;

- **Integrating physical and virtual businesses**. The company has a solid and long track record in Operations Technology (OT), by building from the beginning of its activity 274 PV plants (aggregate capacity of approximately 425 MWp, of which13.2 MWp in full ownership and 30 MWp in joint venture), 2 biomass plants connected to the grid for a total of 1.5 MWe and 2 MWt, 2 treatment and recycling plants for end of life tires, 1 green bio-digestion and composting plant and 1 groundwater remediation plant. The recent acquisition of software companies Softeco and Selesoft has added ICT expertise, thus allowing TerniEnergia to play the entire energy value chain by leveraging its OT/IT convergence;

- **First mover into smart/micro grids….** We believe that smart grids will be able to meet the rising electricity demand and increase the reliability and quality of power supplies, to improve energy efficiency, and integrate low carbon energy sources into power networks. The micro grid architecture aims at balancing captive supply and demand resources to maintain stable service within a defined boundary, thus providing the final customer a power supply characterised by resilience, reliability, and sustainability. The potential market is huge, Boston Consulting Group estimates global investments in transmission, distribution and energy storage up to around USD 280Bn by 2030, according to Markets&Markets, the micro grid market should reach USD around 35Bn by 2022. Thanks to its OT/IT convergence, TerniEnergia can grab the "first mover advantage" in these new markets, as also shown by the partnership agreement signed in India with Juice Power to develop and build clean energy generation plants and energy management structures, which combine on-site and off-site generation and storage, and smart energy management systems (smart grids and smart mini grids);

- **… and in smart trading.** On-demand energy provision can effectively fill the gaps created by intermittent renewable generation. We believe TerniEnergia has the skills to monitor, model, analyse, forecast, manage risk, coordinate & control, in order to act as a balanced service provider. This may reduce customers' energy demand at peak hours providing to TSO/RTO a flexible power reserve through partnership with UVAC, and, in the future can also provide renewable energy supplies in targeted areas;

- **Open to external growth**. Management has indicated its intention to seize growth opportunities by external lines through M&A transactions with industrial targets (e.g. EPC and system integration companies in wind and hydro energy), aiming to integrate complementary geographic and technological coverage, enhancing overall capabilities, and allowing further expansion into new technologies and solutions. Management would also consider opening the capital to institutional investors and/or industrial partners, in the best interests of the company.

Negatives

- **Impact of EPC activity**. Large EPC projects may require a high level of working capital when panels are also provided, in 2016 the ratio of working capital to revenue in the technical service business line was around 19%. Moreover, having a limited scale, the end of a "giant" project may leave the IT/OT technicians "idle" for several quarters, while awaiting the start of new projects. Going forward this effect should be softened as in the new plan is entailed the transition from an EPC player to a provider of on-site engineering and operations services;

- **Volatility of the trading business**. Dual fuel marketing and trading activity for energy-intensive customers and consolidated re-sellers is volatile in volumes and margins. However, it offers a cross-selling opportunity for smart energy services and solutions, pricing strategies, remote control systems, development of innovative software to the thousands of customers served by dual fuel offers (large industrial groups, SMEs, government entities and apartment blocks to private housing agencies). Moreover, it may leverage renewable power generation for heavy industrial consumers;

- **Possible pressure on margins.** To support revenue growth and tap market opportunities, TerniEnergia needs to scale up its IT/OT structure and its commercial network, with an execution and financial sourcing risk, and to enter new lateral markets and/or geographic markets, with risks related to the national or international policies and regulation;

- **Financial constraints for TerniEnergia customers**. The smart/micro grid projects are usually implemented by private companies, which could suffer financial constraints thus limiting the adoption of smart energy systems, or requiring higher IRR from the implementation project, with a margin erosion for TerniEnergia;

- **High leverage and the 2019 bond**. TerniEnergia net debt to EBITDA ratio was 5.4x in FY16A, and we expect to increase to 6.4x in FY17E. Moreover, on 6 February 2019, a EUR 25M bond, with a 6.875% rate will expire. In the new FY18E-20E management expects an important de-leveraging and we project a net debt to EBITDA ratio of 1.8x in 2020E. Management also stated that it will pursue actions to strengthen its balance sheet, which might involve current shareholders as well as potential investors and/or industrial partners. However, should the economic scenario become difficult, the 2019 bond reimbursement could be a risk.

Valuation

TP at EUR 1.15/share; BUY rating

We value TerniEnergia using a DCF model with a 2.25% risk-free rate and a 5.5% equity risk premium, which points to a WACC of 6.0%.

TerniEnergia - WACC calculation

%	
Gross debt rate	6.9
Tax rate	28.5
Net debt rate	4.9
Beta levered* x	1.00
Gearing	62.0
Beta relevered	1.00
Risk-free rate	2.25
Equity risk premium	5.50
WACC	**6.0**

Source: Intesa Sanpaolo Research estimates and * Bloomberg

For the long term, we assumed 0% growth.

As usual, in the long term, capex equals depreciation.

Considering that the company is in a transition phase, we limited our DCF calculation to 2018, to allow for a "sanity-check" on our 2018 projections based on the coming quarters' results.

We calculated a target price of EUR 1.15/share and rate the company a BUY.

TerniEnergia - DCF calculation (2017E-18E)

EUR M	2017E	2018E	LT
EBIT	-4.9	11.0	11.0
Tax	0.0	-2.2	-2.2
Depreciation	17.2	10.0	
NOPAT	12.3	18.9	8.9
WC	4.3	-15.2	
Capex	-2.0	-2.0	
FCF	14.6	1.7	8.9
Discounted FCF	14.6	1.6	7.9
WACC (%)	6.0		
TV growth (%)	0.0		
Sum	16		
TV	131		
EV	148		
Debt 2016A	94		
Equity	54		
Shares (M)	47.1		
Target price (EUR/share)	**1.15**		

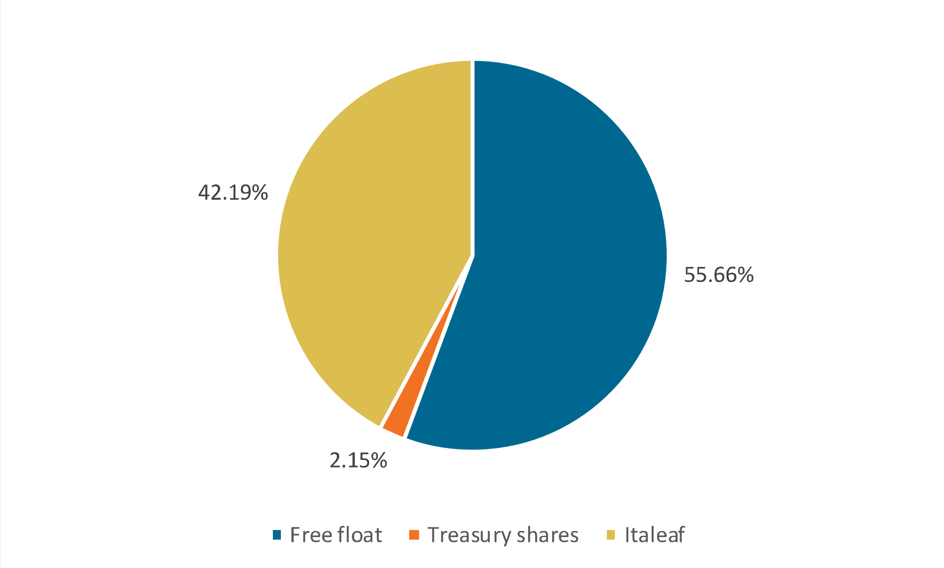
E: estimates; Source: Intesa Sanpaolo Research estimates

Shareholding Capital

TerniEnergia's share capital currently comprises 47,089,550 shares with no nominal value. The main shareholder is Italeaf, with a 42.19% stake.

The company owns a 2.15% stake of treasury shares.

Shareholders structure



Source: Company data

In March 2015, the General assembly approved the change of company bylaws to introduce the mechanism of increased voting rights.

This mechanism provides for the assignment of two votes to each ordinary share held by the same shareholder for a continuing period of not less than two years, effective as of the date of registration within a specific list created and maintained by TerniEnergia.

At the moment, 4,872,943 shares have obtained the increased voting rights. Italeaf owns 45.44% of voting rights.

Voting rights

	n. shares	n. voting right
Ordinary shares	42,216,607	42,216,607
Ordinary shares with increased voting rights	4,872,943	9,745,886
Total	47,089,550	51,962,493

Source: Company data

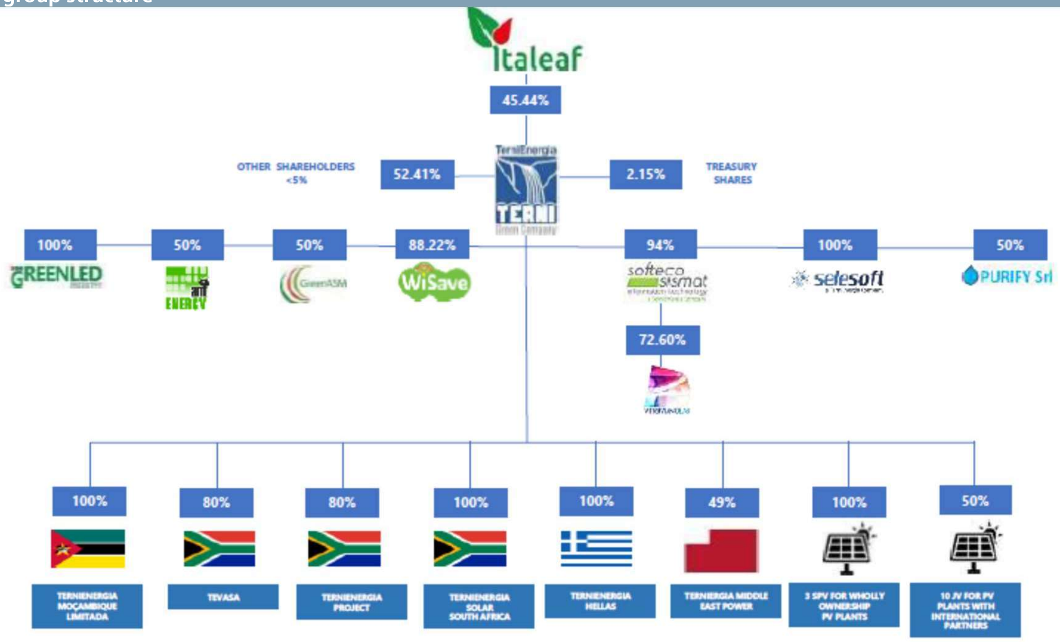
The General Assembly recently approved a 2017-19 stock grant entailing the issue of up to 2,354,478 shares (5% of existing capital) for top management on meeting some targets related to the share price value.

The Transition to a Smart Technology Enabler

TerniEnergia management, leveraging on its assets and know-how of the historical 4 business lines described below, and through the integration of the recent acquisition of digital companies Softeco and Selesoft, is now focused on becoming a smart technology enabler.

The new plan will entail the repositioning the group towards providing services and solutions with greater added value and high technology content, focusing on resource efficiency by developing and implementing solutions for power generation, energy saving, energy trading and sustainable mobility. In the chart below we show a simplified structure of TerniEnergia.

Simplified group structure

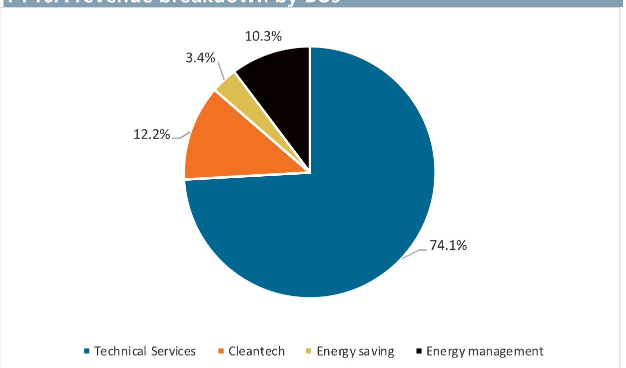


Source: Company data

At FY16A TerniEnergia revenues were broken down as follows:

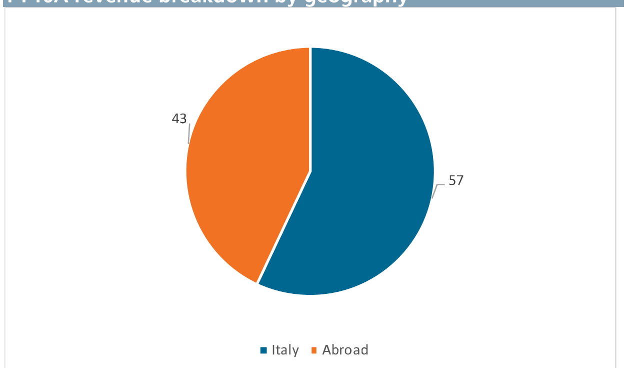
- **Technical services (74.1% of FY16A revenue)**: it includes, alone or in JV with primary national players, turn-key industrial photovoltaic plant as an EPC or system integrator. By using digital technologies, it supplies smart, mini and micro grids, providing remote control systems, cyber and physical security, and TLC services;

FY16A revenue breakdown by BUs



Source: Company data

FY16A revenue breakdown by geography



Source: Company data

- **Energy management (10.3% of FY16A revenue)**: it provides dual fuel (gas & power) marketing and trading for energy-intensive customers and re-sellers. It also provides smart energy services and solutions, pricing strategies, remote control systems, development of innovative software. After the deconsolidation of Free Energia in FY16A, the ongoing acquisition of Energetic aims to strengthen this business line, by integrating downstream the value chain of the gas and power management business;

- **Energy saving (3.4% of FY16A revenue)**: it develops energy efficiency systems both as EPC and as TPF (Third Party Financing);

- **Cleantech (12.2% of FY16A revenue)**: it operates in the recovery material from marginal resources (e.g. tyres), from waste to energy (bio-fuel power generation), in waste management (treatment of biodegradable waste), in water remediation. At FY16A, TerniEnergia revenue came principally from technical services (74.1% of total), which included EPC activities and the revenue from PV plants

As better explained in the section "The New Business Units", in the new vision of TerniEnergia, the assets within Technical services and Cleantech flow into the new "Assets" business unit, Energy management flow into the new "Smart trading" business unit and the other activities flow into the new "Smart solutions&services" business unit.

A demand of resource efficiency

The medium and long-term population and macroeconomic scenarios, the evolution of the energy sector and the expected digitalisation of electricity services and sustainable mobility are accelerating the demand for resource efficiency.

Among the global megatrends that will affect power generation, the economy and environment, thus accelerating the demand of resource efficiency, TerniEnergia management, in its new 2018-20 plan presentation, highlighted:

- 6Bn people in 2000 and 3Bn more in 2050;
- 60% of N2O and CO^2 pollution derives from agriculture;
- 40% soil degradation;
- Increasing logistical problems;
- Deregulation, liberalisation and privatisation taking place.

Power generation

A growing world population along with an increase of per capita food/energy consumption will probably determine a structural change in industry in terms of new technologies and prices, thus increasing the demand and new requirements on energy generation and saving.

Economy

Earnings will be strongly affected by digitalisation, as companies will have to face new "smart market" based on data.

An intensified global competition will affect the value-chain, by re-designing the borders between technology, providers and customer, in order to extract higher productivity and efficiency.

Environment

Some trends like growing pressure on ecosystems, increasingly severe consequences of climate change and environmental pollution will probably require a move towards a more urban world, where "smart" will allow simple and more efficient solutions to "green" requirements.

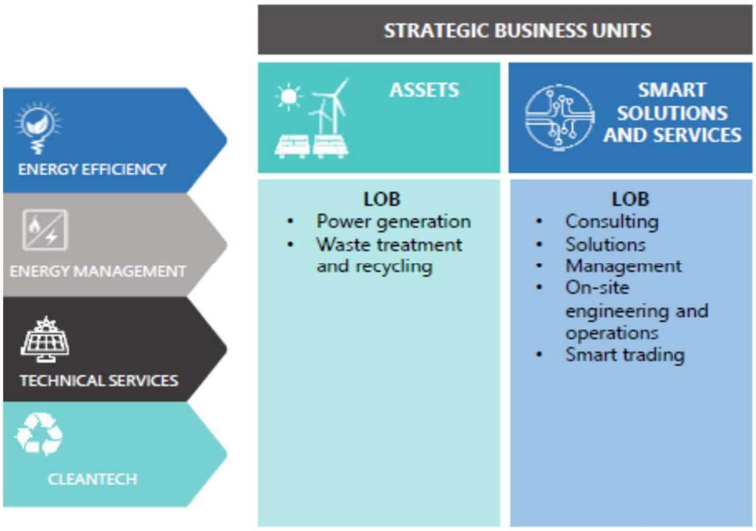
Repositioning in a new playing field

TerniEnergia believes that a new playing field is taking shape, into which they intend to reposition. The key pillars to become a smart tech enabler for the efficient use of energy and resources are:

- **Assets**: provide asset performance management for renewable energy and resource recovery plants (own and 3rd party);
- **Smart solutions & services**: leveraging on IT and ICT expertise for ecosystem management in energy, transport, utilities (oil, gas and water), industry, building;
- **Smart trading**: covering the segments of balancing the service market, active demand-response, aggregation of load/generation, active demand.

In order to make this repositioning happen, management has decided to reshape the 4 historical business units (energy efficiency, energy management, technical services and cleantech) into two new strategic business units, Assets and Smart solutions&services.

The new business units



Source: Company data

Through this reorganisation, in which research and innovation have a critical role, management aims to:

- Move from being an EPC player to a provider of onsite engineering and operations services;
- Leverage on O&M expertise (in PV and Cleantech) to become a leading asset performance manager;
- Implement truly innovative smart energy concepts, such as microgrids, demand response and capacity aggregation to virtual power plants (VPPs);
- Strengthening smart energy trading activities;
- Provide industry customers access to the latest technologies for energy efficiency (advanced BMS, software development, hardware supply, IoT);
- Provide consultancy services to international partners to develop innovative solutions across industrial sectors;
- Contribute to the development of smart mobility with digital, ITS and EV solutions.

As previously mentioned, research and innovation will have a critical role in enabling the repositioning, and in this regard the acquisition of Softeco and Selesoft made at the end of 2016 are strategic.

Softeco and Selesoft are leading national players in the provision of consultancy, solutions, services and products for energy, transport and industry. The key streams of ICT expertise are:

- **Energy and resource efficiency:** increase energy efficiency in industry, commercial, transport, buildings and beyond, including urban planning; digitally optimised water and waste management, oil & gas, etc.;
- **Carbon neutrality:** decrease carbon footprint of private and public real estate, feed distributed renewables into the grid, optimise traffic management, manage public lighting, etc.;
- **Cost-effectiveness:** achieve savings through reduced peak energy demand, to turn consumers into prosumers, to optimise logistics; reduce technical complexity in services, etc.;
- **Further emerging objectives:** cybersecurity, open data, interoperability, simulation, gamification, prediction, hybridisation, etc.

The New Business Units

As previously described, TerniEnergia is re-organising its industrial and know-how footprint into two new business units, Assets and Smart solutions&services. The following is a brief description of the new BUs.

Assets

The business unit assets comprise PV power generation and circular economy assets.

PV Power generation

TerniEnergia built and operated 45 PV plants in Italy, with 42 MW of total capacity, of which 12 MW in full ownership and 30 MWp in JV with funds, investors and industrial partners. The total power generation is equal to around 60.4 million kWh/year. The energy produced is sold to trading companies and the national energy services management company (GSE).

Circular economy

Current operations are:

- An end of life tyres recovery plant in Borgo Val di Taro (PR), with a capacity 24,600 t/y;
- A groundwater remediation plant in Nera Montoro (TR), with a capacity 438,000 mc/y;
- Anaerobic biodigestion and composting plants in Nera Montoro (TR), with a power generation of 740kWe and a capacity of 43,500 t/y organic waste.

A further two purification and newcoenergy plants are under construction:

- A liquid waste remediation plant in Nera Montoro (TR), with a capacity 58,000 mc/y;
- An anaerobic biodigestion and composting plant in Calimera (LE), with biomethane of 270S mc/h and a capacity 30,000t/y organic waste.

Lastly, the company has a project for an anaerobic biodigestion and composting plant (biomethane 270 Smc/h, capacity 30,000t/y organic waste) in Nera Montoro (TR), while a pyrogassifier of virgin wood plant of 850 kWe in Borgosesia (VC) is on stand-by.

Smart solutions&services

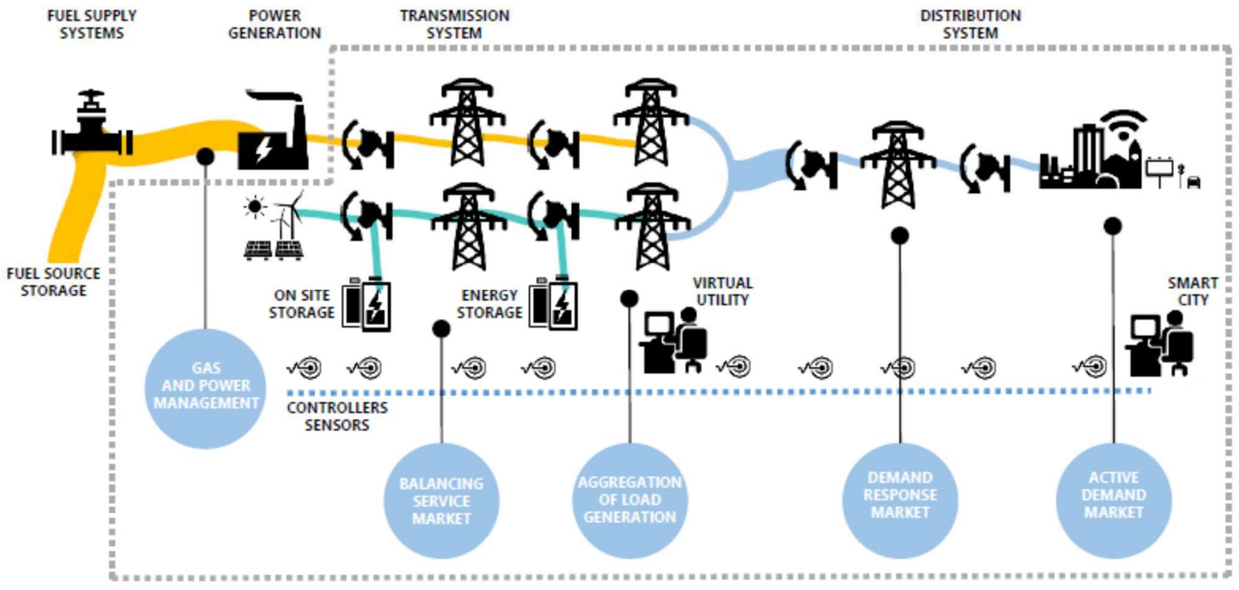
Within the Smart solutions&service management include:

- **Asset performance manager**: TerniEnergia has a long experience as an EPC contractor and a system integrator, having built over 420 MW of solar PV globally. Two further PV plants are currently being completed:10 MW PV plant in Tozeur, Tunisia and a 34 MW PV plant in Lusaka, Zambia. Solar PV remains an area of activity for TerniEnergia in this transitional phase from EPC player to provider of on-site engineering and operations services, which will ensure the final client maximised energy production, minimal downtime, reduced O&M costs and, ultimately, highly performing assets;
- **Microgrids**: Leveraging on its track record as a system integrator and the digital expertise of Softeco and Selesoft, TerniEnergia may have a prominent role in the emerging microgrid market, which requires:
    - Intelligent energy storage, based on special weather-related or process needs;
    - Full optimisation of combined heating and power (CHP);
    - Data analytics to drive microgrid operation based on the energy market predictions for both gas and electricity;

- Optimisation of heating, ventilation and air conditioning (HVAC) through advanced control strategies;
- Minimised pollution based on sophisticated algorithms that consider CHP and displaced emissions;
- Enhanced power quality;
- Support of the future grid through an array of ancillary services, such as voltage regulation and reserve power.

- **Smart trading**: The former Energy management traditional activity of gas trading will flow into the "Smart trading" business. Moreover, TerniEnergia is looking to the "digital utility" scenario, where a player is able to integrate several electric production and consumption units into a unique virtual unit. This is in line with the opening of the Italian electricity dispatching market, as per the Delibera AEEGSI 300/2017/R/eel by the "Autorità per l'energia elettrica il gas e il sistema idrico" of 5 May 2017, which entails, among other things, the creation of UVAC (Unità Virtuali Abilitate di Consumo, i.e. a virtual unit of consumption) and "balance service providers". This may reduce customers' energy demand at peak hours providing TSO/RTO with a flexible power reserve through a partnership with UVAC, and, in the future could also provide renewable energy supplies in targeted areas. This "digital utility" scenario is taking shape, with players like Entelios, which provides Demand Response and Virtual Power Systems in Germany, Actility, which is a technology and service provider operating in France, Belgium and the Netherlands, and Next Kraftwerke which is entering the Italian market as Virtual Power Plan (VPP). TerniEnergia has the skills to monitor, model, analyse, forecast, manage risk, coordinate & control, in order to act as a balanced service provider, and be one of the first movers in Italian smart energy trading.

TerniEnergia - A first mover in Italian smart energy trading



Source: Company data

Company Guidance and Earnings Outlook

Recent results

1H17A results were affected by a managerial discontinuity, following the interruption of the fiduciary relationship with the CEO Manzoni (appointed on 1 June 2017), due to an irremediable difference of view between himself and the BoD, regarding TerniEnergia's strategic vision, its prospective positioning as well as the administrative and organisational management.

In 1H17A TerniEnergia posted EUR 40.2M revenue, down by 20.4% yoy, due to a contraction in technical service revenues, for a difficult comparison with 1H16 (EPC activities in two giant projects in South Africa were terminated in 2Q16), but also for a voluntary stop of some activities in photovoltaic EPC as from June 2017, due to the strategic vision of the former CEO Manzoni, which will also affect 3Q17.

On the other hand, there was a positive contribution from the energy management activities and of the new plants based in Tunisia and Zambia, and from the revenues attributable to energy efficiency project of Copernico Torino. In detail:

- Technical service revenues were EUR 16.4M, -60% yoy;
- Cleantech revenues were EUR 7.2M, +58% yoy, mainly due to a capital gain from the disposal of a 50% of Purify, owner of groundwater and liquid waste treatment plants;
- Energy savings were EUR1.7M, almost doubling yoy, thanks to the consignment of the Copernico and Huntsman projects;
- Energy Management revenues were EUR 14.9M (EUR 2.7M in 1H16), thanks to higher volumes in gas trading.

TerniEnergia – 1H17 results

EUR M	1H16A	1H17A	chg %
Revenue	50.5	40.2	-20.4
EBITDA	9.5	6.8	-28.2
EBITDA margin %	18.8	17.0	
EBIT	5.9	-6.2	NM
Net income	1.1	-6.5	NM
Net debt	93.9*	87.5	-6.8

NM: not meaningful; Source: Company data * At FY16A

EBITDA was EUR 6.8M, -28.2% yoy, with a 17% margin (-180bps).

EBIT was negative for EUR 6.2M (EUR 5.9M positive in 1H16A), after depreciation, amortisation and write-downs of EUR 13M. The write-downs are largely attributable to the suspension of EPC activities, resulting from the choices made by previous management, as explained above, and partly to the alignment of the impairment of an asset.

The net loss was EUR 6.5M, vs. a EUR 1.1M profit in 1H16A.

Net debt reduced by around 6.8% vs. FY16A, to EUR 87.5M.

Company guidance

In the new 2018-20 plan, cost efficiencies will be pursued through activities, which aim to improve internal processes in relation to working capital, procurement, human resources and plant management. The previously described repositioning should not require significant investments. Management presented the following guidance for the new 2018-20 plan:

- Revenue should grow at a 19% 2018-20 CAGR to around EUR 226M in 2020. The weighting of revenue from the Asset BU should reduce from 12% in 2018 to 9% in 2020. In the Smart solutions&service BU a strong growth is expected from smart trading, whose weighting on revenue should increase from 38% in 2018 to 53% in 2020;

- EBITDA should grow at a 20% 2018-20 CAGR to around EUR 35M in 2020, with a 16% margin. The weighting of EBITDA from the Asset BU should reduce from 28% in 2018 to 22% in 2020. In the Smart solutions&service BU a strong growth is expected from smart trading, whose weighting on EBITDA should increase from 10% in 2018 to 26% in 2020;
- EBIT should grow at a 33% 2018-20 CAGR to around EUR 26M in 2020.

TerniEnergia will also pursue actions to strengthen its balance sheet, which might involve current shareholders as well as potential investors and/or industrial partners.

Outlook

As previously described, TerniEnergia is in a phase of relaunching and reorganising value-added businesses in the smart services and solutions sector, which allows the efficient use of natural resources, in the fields of power generation, energy savings and sustainable mobility.

These businesses will be added to the evolution of the asset management activity for the production of energy from renewable sources, energy efficiency, recovery and transformation of raw materials into profitable resources within the environmental industry.

In the environmental sector, the group aims to complete the new liquid industrial waste treatment plant in Nera Montoro, which will allow it to intercept a substantial demand (58,000 cubic meters per year) in a high technological market segment, with high growth prospects.

Among the planned activities and, in part, already underway there are important commissions in Africa (Tunisia and Zambia) and the approach to new high potential growth markets (India) that will be the basis for managing the transition to a "technology enabler.

In July 2017, TerniEnergia signed an agreement with Appalti Tecnologie Progettazione Ambienti & Costruzioni Srl (A.T.P) for the disposal of 50% of Purify, owner of groundwater and liquid waste treatment plants. The transaction entailed a consideration of EUR 3.4M, of which around EUR 1.5M was paid in July, and the remaining part by 30 June 2019.

This repositioning will allow a better flexibility in managing fixed costs, through a more rational allocation, and at the same time preserve the company head-count and know-how to pitch for opportunities to become a smart technology enabler.

Earnings Outlook

Based on the 1H17A results, the 2017 outlook and 2018-20 company guidance, we made the following projections for FY17E-20E:

FY17E

- We expect revenue of EUR 70M (-18.7% yoy), due to a lower contribution from technical services due to the voluntary stop of some activities, as previously explained, which will affect 3Q17 and should partially be recovered in 4Q17;
- The positive contribution from energy management activities and the new plants based in Tunisia and Zambia should continue, and from the revenues attributable to the energy efficiency project;
- EBITDA should reach EUR 12.3M, with a 17.6% margin;
- Due to the write-offs posted in 1H17A, we expect an EBIT loss of EUR 4.9M;
- The net loss should amount to EUR 8.0M;

- Net debt should reach EUR 78.7M, also incorporating the first instalment of the sale of 50% of Purify.
- **FY18E**
- We assumed EUR 136M revenue, considering the full return to "look for opportunities" in technical services contracts, and the approach to new high potential growth markets (India), which should allow it to bring Smart solutions&service revenue to around EUR 70M. Revenue from existing assets should be EUR 16M. We also assumed that smart trading activity will generate around EUR 50M, mainly based on "traditional" trading (EUR 14.9M revenue posted in 1H17A);
- Based on the above mentioned revenue mix, we calculated an EBITDA margin of 15.5%, also considering the still limited contribution from "smart" solutions and trading, which are expected to have a higher profitability.

FY19E-20E

Our estimates are broadly aligned with company guidance, driven by:

- A slight increase in revenue from assets thanks to the operation of plants under construction, particularly in the circular economy segment;
- The component of "smart" solutions and trading should increase, also contributing to improve margins of the BUs;
- We project and EBITDA margin contraction in FY19E (-50bops vs. FY18E), mainly due to a higher weighting of Smart trading revenue on total (which have a lower profitability).

Net debt

In our assumptions, the net debt to EBITDA ratio, after peaking at 6.4x in FY17E, should gradually decline to normalised values along the plan timeframe.

TerniEnergia - FY17E-20E estimates

EUR M	FY16A	FY17E	FY18E	FY19E	FY20E
Revenue	86.1	70.0	136.0	200.0	225.0
of which: asset	NA	NA	16.0	20.0	20.3
SS&S	NA	NA	70.0	72.0	85.5
Smart trading	NA	NA	50.0	108.0	119.3
EBITDA	17.3	12.3	21.0	30.0	35.5
of which: asset	NA	NA	5.7	7.5	7.8
SS&S	NA	NA	13.3	15.0	18.5
Smart trading	NA	NA	2.0	7.5	9.2
EBITDA margin	20.1	17.6	15.5	15.0	15.8
of which: asset	NA	NA	35.7	37.5	38.6
SS&S	NA	NA	19.0	20.8	21.6
Smart trading	NA	NA	4.0	6.9	7.7
EBIT	7.9	-4.9	11.0	20.0	25.5
Net income	1.1	-8.0	4.0	9.9	13.8
Net debt	93.9	78.7	81.9	78.7	62.6
Net debt/EBITDA	5.4	6.4	3.9	2.6	1.8

NA: not available; A: actual; E: estimates; Source: Company data and Intesa Sanpaolo Research

TerniEnergia - Key data						
Rating	Target price (EUR/sh)	Mkt price (EUR/sh)	Sector		Free float (%)	Reuters Code
BUY	Ord 1.15	Ord 0.83	Multi-Utilities		44.9	TRNI.MI

Values per share (EUR)	2015A	2016A	2017E	2018E	2019E
No. ordinary shares (M)	47.09	47.09	47.09	47.09	47.09
No. NC saving/preferred shares (M)	0.00	0.00	0.00	0.00	0.00
Total no. of shares (M)	47.09	47.09	47.09	47.09	47.09
Market cap (EUR M)	79.73	45.66	39.08	39.08	39.08
Adj. EPS	0.08	0.02	-0.17	0.09	0.21
CFPS	0.23	0.22	0.19	0.30	0.42
BVPS	1.2	1.2	1.1	1.2	1.4
Dividend ord	0	0	0	0	0
Income statement (EUR M)	**2015A**	**2016A**	**2017E**	**2018E**	**2019E**
Revenues	368.7	86.13	70.00	136.0	200.0
EBITDA	25.24	17.32	12.32	21.02	30.00
EBIT	17.13	7.87	-4.88	11.02	20.00
Pre-tax income	6.11	2.47	-11.48	6.21	15.18
Net income	2.56	1.05	-8.04	4.03	9.87
Adj. net income	3.92	1.05	-8.04	4.03	9.87
Cash flow (EUR M)	**2015A**	**2016A**	**2017E**	**2018E**	**2019E**
Net income before minorities	2.6	1.1	-8.0	4.0	9.9
Depreciation and provisions	8.1	9.4	17.2	10.0	10.0
Others/Uses of funds	0	0	0	0	0
Change in working capital	11.8	2.8	4.3	-15.2	-14.7
Operating cash flow	22.4	13.3	13.5	-1.1	5.1
Capital expenditure	-7.2	-2.2	-2.0	-2.0	-2.0
Financial investments	0	0	0	0	0
Acquisitions and disposals	-8.5	0	0	0	0
Free cash flow	6.8	11.0	11.5	-3.1	3.1
Dividends	-2.9	-1.0	0	0	0
Equity changes & Other non-operating items	13.1	-31.8	-1.3	-3.5	-3.5
Net cash flow	17.0	-21.8	10.2	-6.6	-0.3
Balance sheet (EUR M)	**2015A**	**2016A**	**2017E**	**2018E**	**2019E**
Net capital employed	143.2	151.3	130.3	137.5	144.2
of which associates	0	0	0	0	0
Net debt/-cash	87.4	93.9	78.7	81.9	78.7
Minorities	0	0	0	0	0
Net equity	55.8	57.5	51.6	55.7	65.5
Minorities value	0	0	0	0	0
Enterprise value	167.1	139.5	117.8	120.9	117.8
Stock market ratios (x)	**2015A**	**2016A**	**2017E**	**2018E**	**2019E**
Adj. P/E	20.3	43.4	Neg.	9.7	4.0
P/CFPS	7.5	4.4	4.3	2.8	2.0
P/BVPS	1.4	0.79	0.76	0.70	0.60
Payout (%)	0	0	0	0	0
Dividend yield (% ord)	0	0	0	0	0
FCF yield (%)	236.0	1,172.3	1,662.1	-456.7	457.1
EV/sales	0.45	1.6	1.7	0.89	0.59
EV/EBITDA	6.6	8.1	9.6	5.8	3.9
EV/EBIT	9.8	17.7	Neg.	11.0	5.9
EV/CE	1.2	0.92	0.90	0.88	0.82
D/EBITDA	3.5	5.4	6.4	3.9	2.6
D/EBIT	5.1	11.9	Neg.	7.4	3.9
Profitability & financial ratios (%)	**2015A**	**2016A**	**2017E**	**2018E**	**2019E**
EBITDA margin	6.8	20.1	17.6	15.5	15.0
EBIT margin	4.6	9.1	-7.0	8.1	10.0
Tax rate	58.2	57.4	30.0	35.0	35.0
Net income margin	0.7	1.2	-11.5	3.0	4.9
ROCE	12.0	5.2	-3.7	8.0	13.9
ROE	4.0	1.9	-14.7	7.5	16.3
Interest cover	1.7	1.2	-0.7	2.3	4.2
Debt/equity ratio	156.6	163.3	152.4	147.0	120.1
Growth (%)		**2016A**	**2017E**	**2018E**	**2019E**
Sales		-76.6	-18.7	94.3	47.1
EBITDA		-31.4	-28.8	70.6	42.7
EBIT		-54.0	NM	NM	81.4
Pre-tax income		-59.6	NM	NM	NM
Net income		-58.8	NM	NM	NM
Adj. net income		-73.2	NM	NM	NM

NM: not meaningful; Neg.: negative; A: actual; E: estimates; Source: Company data and Intesa Sanpaolo Research

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Target price and market price trend (-1Y)

Initiation of Coverage

Historical recommendations and target price trend (-1Y)

Initiation of Coverage

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Equity rating key (short-term horizon: 3M)

Equity rating key (short-term horizon: 3M)	
Short-term rating	Definition
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