Tenaris S.A. (TS)

Updated November 10th, 2018 by Josh Arnold

Key Metrics

Current Price:	$30	**5 Year CAGR Estimate:**	8.5%	**Volatility Percentile:**	77.6%
Fair Value Price:	$24	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	42.5%
% Fair Value:	126%	**5 Year Valuation Multiple Estimate:**	-4.5%	**Growth Percentile:**	88.9%
Dividend Yield:	3.0%	**5 Year Price Target**	$38	**Valuation Percentile:**	19.2%
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Total Return Percentile:**	40.5%

Overview & Current Events

Tenaris S.A. is a global manufacturer of steel pipes and related services that is headquartered in Luxembourg and is a majority-owned subsidiary of the Techint Group. Tenaris has significant exposure to oil prices as the majority of its customers operate in the energy sector. Its common stock is traded on three international stock exchanges, but US investors can purchase it through ADRs that currently have a market capitalization of US$17.4 billion.

Tenaris reported Q3 earnings on 10/31/18 and results were strong, continuing a trend of good reports thus far in 2018. Revenue was up a staggering 46% from the year-ago quarter as Tenaris benefits from a couple of significant headwinds. First, recently-introduced tariffs in the US have boosted steel prices as producers have been able to pass those additional costs onto customers. Second, and more important, Tenaris is seeing robust demand from its oil-heavy customer base. Specifically, drilling activity has been strong this year throughout the globe as exploration companies attempt to capitalize on the recovery in oil prices in 2018. This means they need pipelines and Tenaris is poised to deliver. This strength led to higher EBITDA margins as well, rising from 17.3% of revenue in last year's Q3 to 20.3% in this quarter. In dollar terms, EBITDA was up 75% year-over-year as margins and revenue increased materially. Earnings-per-share rose 135% to 42 cents in this year's Q3, reflecting the strong recovery in Tenaris' markets.

Tenaris guided for a strong Q4 without providing specific numbers, stating it would continue to see robust shipment volume and margins similar to what was seen in Q3. There is some concern that overcapacity has been built in the steel industry in recent years, but Tenaris is leveraged heavily to the oil & gas market where competition is lighter than for coiled or rolled steel, for instance. While we'll certainly monitor this situation. Otherwise, Tenaris' outlook is bright.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$2.98	$2.00	$1.90	$2.26	$2.88	$2.62	$2.28	$1.08	$0.15	$0.77	***$1.40***	***$2.25***
DPS	$0.76	$0.86	$0.68	$0.68	$0.76	$0.86	$0.90	$0.90	$0.90	$0.82	***$0.82***	***$1.00***
Shares	590.27	590.27	590.27	590.27	590.27	590.27	590.27	590.27	590.27	590.27	***590.27***	***590.27***

Tenaris's growth over the last decade has been far from linear, but this is largely due to the prolonged downturn in oil prices that began in 2014. Since the majority of Tenaris' customers operate within the energy sector, this reduces demand for its products and services and causes a decline in its aggregate sales.

This year is seeing a strong rebound in Tenaris' earnings capacity. Beyond that, a continued rebound in oil prices should allow the steel pipe manufacturer to grow its earnings by around 10% per year over the next 5 years. Better pricing and strong demand from exploration companies should keep Tenaris growing for the years to come. However, oil prices are a key risk for Tenaris; should they decline significantly, they will take Tenaris' earnings meaningfully lower.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	14.9	14.6	21.6	18.1	13.3	16.6	18.5	25.2	N/A	40.3	***21.2***	***16.8***
Avg. Yld.	1.7%	2.9%	1.7%	1.7%	2.0%	2.0%	2.1%	3.3%	3.4%	2.6%	***3.0%***	***3.0%***

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Tenaris has traded at an average price-to-earnings ratio of 16.8 over the last decade if we exclude the years in which its price-to-earnings ratio was artificially elevated due to depressed earnings caused by the decline in oil prices. Today, shares trade for 21.2 times earnings, which compares unfavorably with our estimate of fair value of 16.8. We are therefore forecasting a 4.5% annual headwind to total returns from the valuation reverting to normalized levels.

For income investors, we note that the country of Luxembourg imposes a 15% withholding tax on Tenaris' dividend payments for international investors, which reduces its net yield to 2.6%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	35.0%	24.4%	20.6%	24.9%	26.3%	26.0%	24.2%	14.5%	8.1%	11.1%	***10.0%***	***20.0%***
Debt/A	42.4%	27.9%	26.6%	24.8%	27.9%	21.7%	22.4%	20.3%	18.5%	19.6%	***20.0%***	***20.0%***
Int. Cov.	13.7	12.3	48.3	74.1	63.9	32.3	N/A	63.6	N/A	N/A	***N/A***	***N/A***
Payout	26%	43%	36%	30%	26%	33%	40%	83%	600%	107%	***59%***	***44%***
Std. Dev.	68.7%	47.4%	29.8%	45.2%	28.7%	15.9%	27.1%	24.5%	31.2%	23.9%	***22.0%***	***22.0%***

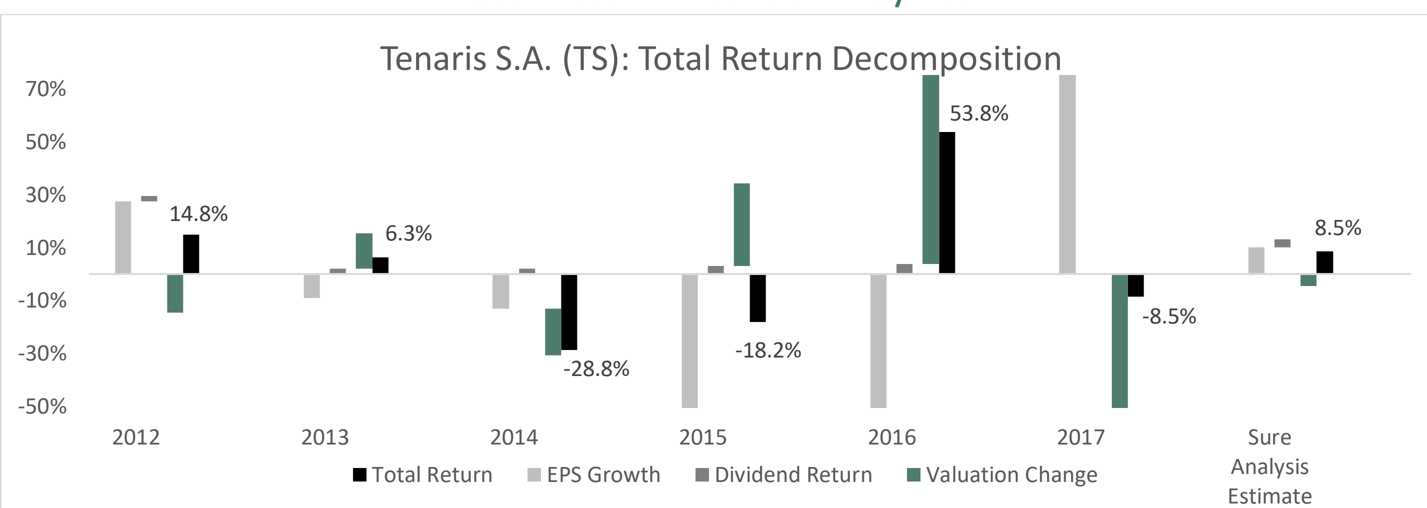
Tenaris' liabilities are almost entirely trade payables and not actual borrowings. Because of this, Tenaris' interest coverage is usually superb, which should allow the company to take full advantage of the rebound in the energy sector moving forward. Its margins have a long way to run higher compared to where they were when oil prices were strong, so we see that as a source of profit growth in the years to come should oil prices move higher.

Qualitatively, Tenaris' most compelling competitive advantage is its entrenched position in a technical segment of the energy sector that relies tremendously on strong customer-supplier relationships. As a large company with global operations, Tenaris' services are unlikely to be replaced by newer, smaller industry disruptors.

Final Thoughts & Recommendation

On the surface, Tenaris may be an unorthodox way to gain exposure to the continued rebound of the energy sector. With that said, the company is only priced to deliver 8.5% total returns at its current prices. Gains should accrue from the 3.0% yield, 10% earnings growth and a 4.5% headwind from the valuation. Given this and Tenaris' inherent risk from its oil market leverage, we rate the stock a hold at current prices. Its outlook is bright, but the valuation is pricing in too much today; we'd suggest investors wait for a better price before initiating a position.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	11988	8149	7712	9972	10834	10597	10141	6903	4294	5289
Gross Profit	5289	3284	2963	3699	4197	4140	4001	2155	1128	1603
Gross Margin	44.1%	40.3%	38.4%	37.1%	38.7%	39.1%	39.5%	31.2%	26.3%	30.3%
SG&A Exp.	1233	983	1170	1431	1412	1488	1510	1182	886	996
D&A Exp.	533	505	507	554	568	610	616	659	662	609
Operating Profit	3581	1900	1449	1842	2354	2181	2051	529	-96	328
Op. Margin	29.9%	23.3%	18.8%	18.5%	21.7%	20.6%	20.2%	7.7%	-2.2%	6.2%
Net Profit	2125	1162	1127	1332	1699	1551	1159	-80	55	545
Net Margin	17.7%	14.3%	14.6%	13.4%	15.7%	14.6%	11.4%	-1.2%	1.3%	10.3%
Free Cash Flow	1022	2603	24	421	1066	1624	955	1083	77	-580
Income Tax	1015	513	396	475	542	628	580	234	17	-17

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	15101	13483	14364	14864	15960	15931	16511	14887	14003	14398
Cash & Equivalents	1539	1543	844	824	828	615	418	287	400	330
Acc. Receivable	2123	1310	1422	1901	2071	1983	1963	1135	955	1214
Inventories	3091	1687	2460	2806	2986	2703	2780	1843	1564	2368
Goodwill & Int.	3827	3671	3582	3376	3200	3067	2758	2143	1863	1661
Total Liabilities	6399	3762	3814	3691	4460	3461	3704	3021	2590	2817
Accounts Payable	897	556	818	902	883	835	832	2259	557	751
Long-Term Debt	2976	1446	1244	931	1742	929	998	971	840	966
Total Equity	8177	9092	9902	10506	11328	12290	12654	11713	11287	11482
D/E Ratio	0.36	0.16	0.13	0.09	0.15	0.08	0.08	0.08	0.07	0.08

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	14.0%	8.1%	8.1%	9.1%	11.0%	9.7%	7.1%	-0.5%	0.4%	3.8%
Return on Equity	28.0%	13.5%	11.9%	13.0%	15.6%	13.1%	9.3%	-0.7%	0.5%	4.8%
ROIC	18.3%	10.2%	9.8%	11.1%	13.4%	11.6%	8.5%	-0.6%	0.4%	4.4%
Shares Out.	590.27	590.27	590.27	590.27	590.27	590.27	590.27	590.27	590.27	590.27
Revenue/Share	20.31	13.81	13.06	16.89	18.35	17.95	17.18	11.69	7.27	8.96
FCF/Share	1.73	4.41	0.04	0.71	1.81	2.75	1.62	1.84	0.13	-0.98

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.