Tenaris S.A. (TS)

Updated February 23rd, 2019 by Josh Arnold

Key Metrics

Current Price:	$27	**5 Year CAGR Estimate:**	13.0%	**Volatility Percentile:**	83.0%
Fair Value Price:	$27	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	13.8%
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	0.0%	**Growth Percentile:**	91.4%
Dividend Yield:	3.0%	**5 Year Price Target**	$44	**Valuation Percentile:**	49.6%
Dividend Risk Score:	F	**Retirement Suitability Score:**	D	**Total Return Percentile:**	84.7%

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 ADR shares. The company currently has a market capitalization of US$16.3 billion.

Tenaris reported Q4 earnings on 2/20/19 and results were quite strong. Total sales were up a staggering 32% year-over-year as the company's North America business performed extremely well, and it delivered on the second Zohr pipeline in the Eastern Mediterranean. Sales of seamless tubes were up 18% year-over-year in Q4 on broad-based strength from its various geographic reporting segments. Welded tubes, which is a much smaller segment, saw its revenue soar 45% from the year-ago period.

Thanks to much higher volumes and revenue, operating income rose 75% on an adjusted basis as operating leverage played a big part in the increase. Tenaris has significant fixed costs in its operating model so when revenue rises, it is able to leverage down those costs and significantly improve margins. To that end, selling, general and administrative costs fell from 22% of revenue in last year's Q4 to just 18% of revenue in this quarter. Tenaris reported a non-cash charge of $109 million in Q4 related to a 2006 acquisition, which we've excluded in reporting adjusted operating income.

In total, earnings-per-share came in at $0.38, which represents a 41% increase from the comparable period last year.

We're out with an initial estimate of $1.60 in earnings-per-share for this year as management is somewhat cautious on the North American market, but bullish on Latin America, as well as its operations in the Eastern Hemisphere. We see margins as stable for this year on another increase in annual revenue.

The board proposed an annual dividend of 82 cents per ADR, with is in line with the prior two years. Tenaris has an unusual dividend policy of paying two differently-sized dividends throughout the year, but the total should continue to add to 82 cents for 2019, pending approval by shareholders.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.00	$1.90	$2.26	$2.88	$2.62	$2.28	$1.08	$0.15	$0.77	$1.48	***$1.60***	***$2.58***
DPS	$0.86	$0.68	$0.68	$0.76	$0.86	$0.90	$0.90	$0.90	$0.82	$0.82	***$0.82***	***$1.00***
Shares	590	590	590	590	590	590	590	590	590	590	***590***	***590***

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.

Last year saw 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. The recent strength in oil prices certainly bodes well for Tenaris, at least in the near-term.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.6	21.6	18.1	13.3	16.6	18.5	25.2	N/A	40.3	22.6	***17.0***	***17.0***
Avg. Yld.	2.9%	1.7%	1.7%	2.0%	2.0%	2.1%	3.3%	3.4%	2.6%	2.5%	***3.0%***	***2.3%***

Tenaris has traded at an average price-to-earnings ratio of 17 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 17 times earnings, which means we expect no impact from the valuation as the stock is trading right at fair value. We note this is the first time in years that shares have traded at fair value.

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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	43%	36%	30%	26%	33%	40%	83%	600%	107%	55%	***51%***	***39%***

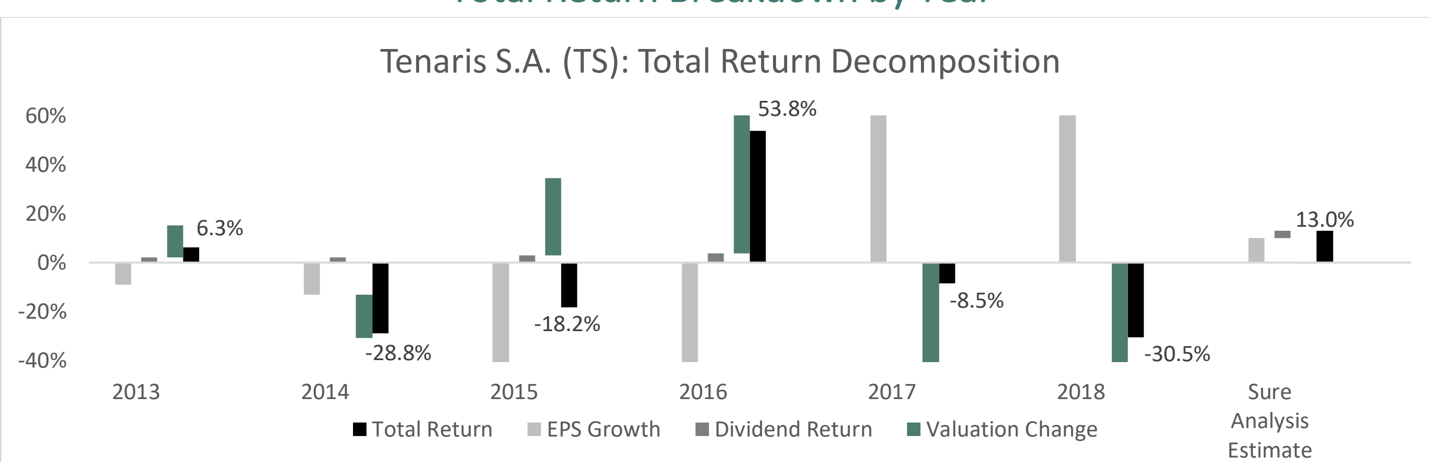
The current payout ratio is around half of earnings, and we expect that will drift lower over time. However, Tenaris has a variable dividend policy, so stronger or weaker than expected earnings can significantly impact how much the board wants to distribute.

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. Its leverage to the oil and gas markets has been an enormous source of strength in recent reporting periods as well.

Final Thoughts & Recommendation

On the surface, Tenaris may be an unorthodox way to gain exposure to the continued rebound of the energy sector. With the recent moderation in the valuation of the stock, Tenaris is poised to deliver 13% annual returns. Gains should accrue from the 3.0% yield, 10% earnings growth and no impact from the valuation. Given this, we've upgraded Tenaris from a hold to a buy as the total return picture has improved significantly since our last report. We note that Tenaris is a higher risk company than many others given its exposure to oil and gas prices, but the outlook and valuation collectively create a fairly compelling story.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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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.