Tenaris S.A. (TS)

Updated May 23rd, 2019 by Josh Arnold

Key Metrics

Current Price:	$27	**5 Year CAGR Estimate:**	13.4%	**Volatility Percentile:**	83.1%
Fair Value Price:	$27	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	9.7%
% Fair Value:	99%	**5 Year Valuation Multiple Estimate:**	0.3%	**Growth Percentile:**	91.1%
Dividend Yield:	3.1%	**5 Year Price Target**	$44	**Valuation Percentile:**	47.6%
Dividend Risk Score:	F	**Retirement Suitability Score:**	F	**Total Return Percentile:**	72.8%

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 produces nearly $8 billion in annual revenue and currently has a market capitalization of $16 billion.

Tenaris reported Q1 results on 5/2/19 and the report was somewhat mixed. Total revenue was essentially flat-year-over-year at $1.87 billion. Total volumes, however, fell markedly in Q1, declining by 12% to 824 thousand metric tons from 936 in the year-ago quarter. Seamless volume fell just 2% in Q1 and made up more than three-quarters of the company's total volume. Welded volume plummeted 35%, comprising most of the decline in volumes.

Weakness in revenue was due almost entirely to a lack of deliveries in the company's now-concluded offshore line pipe for East Mediterranean gas projects. This caused revenue in the Middle East & Africa segment to fall by a third in Q1, which was offset by gains in every other region in the world. North America gained 11%, South America was up 16%, Asia Pacific rose 23%, and Europe saw a smaller increase at +4%. The relatively weak revenue performance, given these factors, is understandable but does show Tenaris' susceptibility to cyclical revenue generation.

Earnings-per-share rose 3% year-over-year to $0.21 as operating income grew despite relatively weak revenue. We continue to expect $1.60 in earnings-per-share for this year on strength in margins.

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 constant, 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.

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	---	40.3	22.6	***16.8***	***17.0***
Avg. Yld.	2.9%	1.7%	1.7%	2.0%	2.0%	2.1%	3.3%	3.4%	2.6%	2.5%	***3.1%***	***2.3%***

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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 virtually no impact from the valuation as the stock is trading right at our estimate of fair value. We note that this is the first time in years that shares have traded at this level.

For income investors, we note that the country of Luxembourg imposes a 15% withholding tax on Tenaris's 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%***

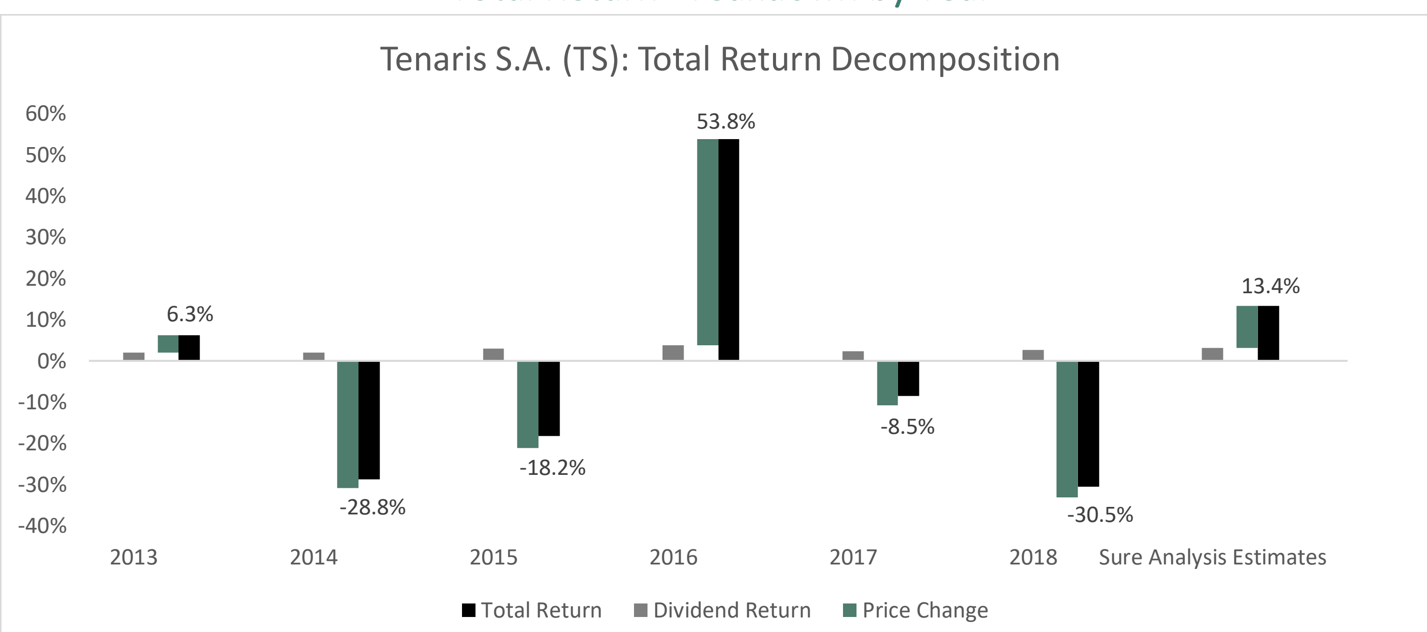
The current payout ratio is around half of earnings, and we expect that will drift lower over time. However, Tenaris has a variable dividend policy, so stronger or weaker than expected earnings can significantly impact how much the board decides to distribute.

Qualitatively, Tenaris's 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's 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. Tenaris is not susceptible to recessions so much as oil prices, so investors should focus on the latter, not the former, when assessing safety.

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 13.4% annual returns. Gains could accrue from the 3.1% yield, 10% earnings growth and a 0.3% tailwind from the valuation. Given this, we're reiterating Tenaris as a buy as the total return picture remains robust. 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	8149	7712	9972	10834	10597	10141	6903	4294	5289	7659
Gross Profit	3284	2963	3699	4197	4140	4001	2155	1128	1603	2379
Gross Margin	40.3%	38.4%	37.1%	38.7%	39.1%	39.5%	31.2%	26.3%	30.3%	31.1%
SG&A Exp.	983	1170	1431	1412	1483	1478	1151	853	994	1190
D&A Exp.	505	507	554	568	610	616	659	662	609	664
Operating Profit	1900	1449	1842	2354	2181	2083	560	-64	330	867
Op. Margin	23.3%	18.8%	18.5%	21.7%	20.6%	20.5%	8.1%	-1.5%	6.2%	11.3%
Net Profit	1162	1127	1332	1699	1551	1159	-80	55	545	876
Net Margin	14.3%	14.6%	13.4%	15.7%	14.6%	11.4%	-1.2%	1.3%	10.3%	11.4%
Free Cash Flow	2603	33	427	1074	1635	902	1094	100	-575	267
Income Tax	513	396	475	542	628	580	234	17	-17	229

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	13483	14364	14864	15960	15931	16511	14887	14003	14398	14251
Cash & Equivalents	1543	844	824	828	615	418	287	400	330	428
Acc. Receivable	1310	1422	1912	2077	2005	2003	1216	1026	1241	1779
Inventories	1687	2460	2806	2986	2703	2780	1843	1564	2368	2524
Goodwill & Int.	3671	3582	3376	3200	3067	2758	2143	1863	1661	1466
Total Liabilities	3762	3814	3691	4460	3461	3704	3021	2590	2817	2376
Accounts Payable	556	818	902	883	835	832	504	557	751	694
Long-Term Debt	1446	1244	931	1742	929	998	971	840	966	539
Total Equity	9092	9902	10506	11328	12290	12654	11713	11287	11482	11783
D/E Ratio	0.16	0.13	0.09	0.15	0.08	0.08	0.08	0.07	0.08	0.05

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	8.1%	8.1%	9.1%	11.0%	9.7%	7.1%	-0.5%	0.4%	3.8%	6.1%
Return on Equity	13.5%	11.9%	13.0%	15.6%	13.1%	9.3%	-0.7%	0.5%	4.8%	7.5%
ROIC	10.2%	9.8%	11.1%	13.4%	11.6%	8.5%	-0.6%	0.4%	4.4%	7.0%
Shares Out.	590	590	590	590	590	590	590	590	590	590
Revenue/Share	13.81	13.06	16.89	18.35	17.95	17.18	11.69	7.27	8.96	12.97
FCF/Share	4.41	0.06	0.72	1.82	2.77	1.53	1.85	0.17	-0.97	0.45

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