Tenaris SA (TS)

Updated August 14th, 2019 by Josh Arnold

Key Metrics

Current Price:	$22	**5 Year CAGR Estimate:**	14.6%	**Volatility Percentile:**	84.5%
Fair Value Price:	$26	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	9.0%
% Fair Value:	87%	**5 Year Valuation Multiple Estimate:**	2.9%	**Growth Percentile:**	77.3%
Dividend Yield:	3.7%	**5 Year Price Target**	$37	**Valuation Percentile:**	78.2%
Dividend Risk Score:	F	**Retirement Suitability Score:**	D	**Total Return Percentile:**	83.9%

Overview & Current Events

Tenaris SA 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 U.S. investors can purchase it through ADR shares. The company produces nearly $8 billion in annual revenue and currently has a market capitalization of $13 billion.

Tenaris reported Q2 earnings on 7/31/19 and results beat lowered expectations. Total revenue rose 2% over Q1 as higher sales in Mexico and certain Eastern Hemisphere markets offset seasonal weakness in Canada. Operating income declined 9% against Q1 as that quarter saw a $15 million tariff recovery that is nonrecurring. In addition, higher maintenance costs in Mexico weighed on operating margins.

Tenaris said drilling activity in the U.S. has slowed and likely will remain weak with present oil and gas prices. Due to subdued commodity prices, Tenaris expects its customers to maintain a disciplined approach to capital expenditures. The same is true in Canada and the company expects no recovery before the end of the year.

In Latin America, drilling activity is expected to remain at current levels given uncertainty around elections in Argentina, as well as the financial position of Mexican concrete giant Pemex. On the bright side, Eastern Hemisphere drilling activity continues to improve, led by new gas developments in the Middle East.

Tenaris says Q3 sales will be affected by lower average selling prices, seasonal factors, and the impact of major maintenance stoppages, but that Q4 will see improvement. Overall EBITDA margin should be similar to last year.

Due to lower volume and selling prices, which also slightly reduced margins in the first half, we've taken a dime out of our earnings-per-share estimate for this year and now expect $1.50.

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	***$1.50***	***$2.20***
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[1]	590	590	590	590	590	590	590	590	590	590	***590***	***590***

Tenaris' 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 8% per year over the next 5 years. Note that this is a reduction from our prior target of 10% growth thanks to the volume and pricing issues mentioned. Oil prices remain a key risk for Tenaris; should they decline significantly, they will take Tenaris' earnings meaningfully lower. Tenaris is beholden to capital expenditures of oil and gas producers, which was a headwind in Q2.

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[1] Share count in millions

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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	---	40.3	22.6	***14.7***	***17.0***
Avg. Yld.	2.9%	1.7%	1.7%	2.0%	2.0%	2.1%	3.3%	3.4%	2.6%	2.5%	***3.7%***	***2.7%***

Tenaris has traded at an average price-to-earnings ratio (P/E) of 17 over the last decade, if we exclude the years in which its P/E ratio was artificially elevated due to depressed earnings caused by the decline in oil prices. Today, shares trade for 14.7 times earnings, which means we expect a 2.9% tailwind from the valuation as the multiple reverts to our fair value P/E estimate of 17 over time. Indeed, the stock is as cheap today as it has been in the past decade by this measure.

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 ~3.1%. Today's yield is also the highest it has been in the past decade as Tenaris' shares are languishing.

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%	***55%***	***45%***

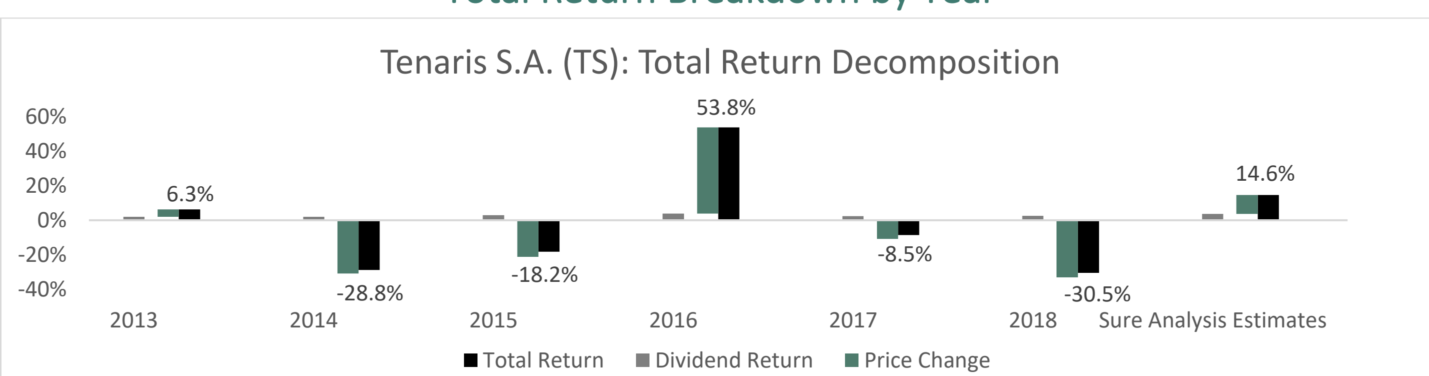
The current payout ratio is around half of earnings, and we expect that will drift lower over time. However, Tenaris has a variable dividend policy, so stronger or weaker than expected earnings can significantly impact how much the board decides to distribute.

Qualitatively, Tenaris' 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 both a blessing and a curse in recent quarters. 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 14.6% annual returns, even with the lower earnings estimate for this year and lower growth estimate. Gains could accrue from the 3.7% yield, 8% earnings growth and a 2.9% 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, yield, and valuation collectively create a fairly compelling story.

Total Return Breakdown by Year



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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.