Tenaris SA (TS)

Updated February 24th, 2020 by Josh Arnold

Key Metrics

Current Price:	$19	**5 Year CAGR Estimate:**	5.8%	**Market Cap:**	$11.4B
Fair Value Price:	$16	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	05/18/20
% Fair Value:	120%	**5 Year Valuation Multiple Estimate:**	-3.6%	**Dividend Payment Date:**	05/20/20
Dividend Yield:	4.2%	**5 Year Price Target**	$22	**Years Of Dividend Growth:**	0
Dividend Risk Score:	F	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	N/A

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 initiate a stake in the business through ADR shares. The company produces nearly $8 billion in annual revenue and currently has a market capitalization of $11.4 billion.

Tenaris reported Q4 and full-year earnings on February 19th and results were weak, missing expectations on the top and bottom lines. For 2019, total sales declined 5% year-over-year, reflecting lower drilling activity in Canada and the US, as well as lower sales in the Middle East and Africa markets, respectively. Aramco, the world's largest company, went through inventory destocking, and Tenaris suffered from its East Mediterranean market producing lower sales than the record achieved in 2018.

Operating income was down 5% as well, in line with revenue. Gross margins were impacted slightly by lower volumes and higher maintenance costs, the company saw an offsetting decline in amortization costs. Cash flow from operating activities came to $1.53 billion in 2019, amounting to free cash flow margin of 16% of revenue. Tenaris made $484 million in dividend payments in 2019, spent $350 million on capital expenditures, invested $133 million in Saudi Steel Pipe, and still grew its net cash position from $495 million to $980 million year-over-year.

Earnings-per-share declined 15% year-over-year, falling from $1.48 to $1.26. We see continued weakness in oil prices, as well as the beginnings of economic slowdowns in certain parts of the globe, as crimping earnings once again this year. As a result, our initial estimate is for $1.15 in earnings-per-share for 2020. We do note, however, that Tenaris has very volatile earnings from year-to-year, so investors must take this volatility into account.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.90	$2.26	$2.88	$2.62	$2.28	$1.08	$0.15	$0.77	$1.48	$1.26	***$1.15***	***$1.54***
DPS	$0.68	$0.68	$0.76	$0.86	$0.90	$0.90	$0.90	$0.82	$0.82	$0.82	***$0.82***	***$0.82***
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. However, 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 generally decline when oil prices remain low for long periods of time, as we're seeing now. We've lowered our estimate of long-term growth from 8% to 6% as it has become clear Tenaris has meaningful

[1] Share count in millions

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.

volume and pricing issues to work through. Should coronavirus fears be prolonged, oil prices would almost certainly suffer, and with that, Tenaris' earnings.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	21.6	18.1	13.3	16.6	18.5	25.2	---	40.3	22.6	19.3	***16.8***	***14.0***
Avg. Yld.	1.7%	1.7%	2.0%	2.0%	2.1%	3.3%	3.4%	2.6%	2.5%	3.4%	***4.2%***	***3.8%***

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. We recently lowered our estimate of fair value from 17 times earnings to 14 given the significant operating issues Tenaris is facing. Today, shares trade for 16.8 times earnings, which means we expect a -3.6% headwind from the valuation if the multiple were to revert to our fair value P/E estimate of 14 over time.

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 ~3.6%. 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	36%	30%	26%	33%	40%	83%	600%	107%	55%	65%	***71%***	***53%***

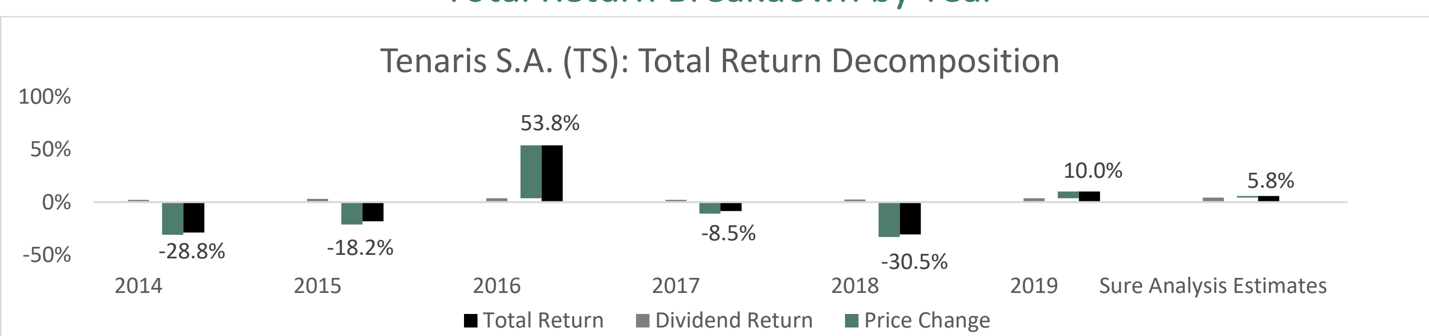
The current payout ratio is around two-thirds of earnings, and we expect that will drift lower over time. However, Tenaris has a variable dividend policy, so stronger or weaker than expected earnings can significantly impact how much the board decides to distribute. We expect the dividend to remain flat at $0.82 per share annually for the foreseeable future.

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 another downward revision in earnings and fair value, Tenaris may produce just 5.8% total annual returns. Given this, as well as the inherent volatility in the company's earnings, we are reiterating Tenaris at a sell recommendation.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	7712	9972	10834	10597	10141	6903	4294	5289	7659	7294
Gross Profit	2963	3699	4197	4140	4001	2155	1128	1603	2379	2187
Gross Margin	38.4%	37.1%	38.7%	39.1%	39.5%	31.2%	26.3%	30.3%	31.1%	
SG&A Exp.	1170	1431	1412	1483	1478	1151	853	994	1190	1167
D&A Exp.	507	554	568	610	616	659	662	609	664	540
Operating Profit	1449	1842	2354	2181	2083	560	-64	330	867	827
Op. Margin	18.8%	18.5%	21.7%	20.6%	20.5%	8.1%	-1.5%	6.2%	11.3%	
Net Profit	1127	1332	1699	1551	1159	-80	55	545	876	743
Net Margin	14.6%	13.4%	15.7%	14.6%	11.4%	-1.2%	1.3%	10.3%	11.4%	
Free Cash Flow	33	427	1074	1635	902	1094	100	-575	267	1180
Income Tax	396	475	542	628	580	234	17	-17	229	202

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	14364	14864	15960	15931	16511	14887	14003	14398	14251	14843
Cash & Equivalents	844	824	828	615	418	287	400	330	428	1554
Acc. Receivable	1422	1912	2077	2005	2003	1216	1026	1241	1779	1348
Inventories	2460	2806	2986	2703	2780	1843	1564	2368	2524	2266
Goodwill & Int.	3582	3376	3200	3067	2758	2143	1863	1661	1466	1562
Total Liabilities	3814	3691	4460	3461	3704	3021	2590	2817	2376	2657
Accounts Payable	818	902	883	835	832	504	557	751	694	556
Long-Term Debt	1244	931	1742	929	998	971	840	966	539	822
Total Equity	9902	10506	11328	12290	12654	11713	11287	11482	11783	11989
D/E Ratio	0.13	0.09	0.15	0.08	0.08	0.08	0.07	0.08	0.05	0.07

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	8.1%	9.1%	11.0%	9.7%	7.1%	-0.5%	0.4%	3.8%	6.1%	5.1%
Return on Equity	11.9%	13.0%	15.6%	13.1%	9.3%	-0.7%	0.5%	4.8%	7.5%	6.2%
ROIC	9.8%	11.1%	13.4%	11.6%	8.5%	-0.6%	0.4%	4.4%	7.0%	5.8%
Shares Out.	590	590	590	590	590	590	590	590	590	590
Revenue/Share	13.06	16.89	18.35	17.95	17.18	11.69	7.27	8.96	12.97	12.36
FCF/Share	0.06	0.72	1.82	2.77	1.53	1.85	0.17	-0.97	0.45	2.00

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