Tenaris SA (TS)

Updated April 30th, 2020 by Josh Arnold

Key Metrics

Current Price:	$14	**5 Year CAGR Estimate:**	5.4%	**Market Cap:**	$8.2B
Fair Value Price:	$14	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	N/A
% Fair Value:	103%	**5 Year Valuation Multiple Estimate:**	-0.5%	**Dividend Payment Date:**	N/A
Dividend Yield:	0.0%	**5 Year Price Target**	$19	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	F	**Retirement Suitability Score:**	D	**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 under normal conditions and currently has a market capitalization of $8.2 billion.

Tenaris reported first quarter earnings on April 29th and results were quite weak. Total revenue declined nearly -6% year-over-year to $1.76 billion, and the company reported a loss of -$1.12 per ADS. However, that number includes a $622 million impairment charge related to various businesses in the US, including the former IPSCO business. Without this non-cash charge, adjusted earnings would have been close to breakeven. Indeed, EBITDA came in at $280 million in Q1, down -28% from $390 million in the year-ago period, but positive nonetheless.

Margins declined precipitously as volumes fell sharply in Q1, with EBITDA margin falling from 20.9% in the year-ago period to just 15.9% this year.

The company said it would layoff more than 900 workers in the US on weakness in oil and gas markets, and indefinitely shutter its US operations due to COVID-19 fears.

We've cut our earnings-per-share estimate for this year from $1.15 to just $0.40 as Tenaris suffers from sharp weakness in oil and gas markets, as well as shutdowns from COVID-19. The dividend was also eliminated.

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	***$0.40***	***$1.34***
DPS	$0.68	$0.68	$0.76	$0.86	$0.90	$0.90	$0.90	$0.82	$0.82	$0.82	***---***	***$0.40***
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; much lower oil and gas prices have significantly impaired the company's ability to produce earnings in 2020. 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 volume and pricing issues to work through. Should coronavirus fears be prolonged, oil prices would almost certainly suffer, and with that, Tenaris' earnings.

We're using a normalized earnings power value of $1.00 per share for our fair value and valuation calculations instead of actual earnings estimates for this year to help smooth this volatility for long-term holders.

[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.

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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	***14.4***	***14.0***
Avg. Yld.	1.7%	1.7%	2.0%	2.0%	2.1%	3.3%	3.4%	2.6%	2.5%	3.4%	***0.0%***	***2.1%***

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 14.4 times our earnings power estimate, which means we expect very little impact 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. We expect the payout to rise back to 30% of earnings by 2025, or $0.40 at current estimates. This is consistent with the company's dividend posture coming out of the Great Recession.

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%	---	***30%***

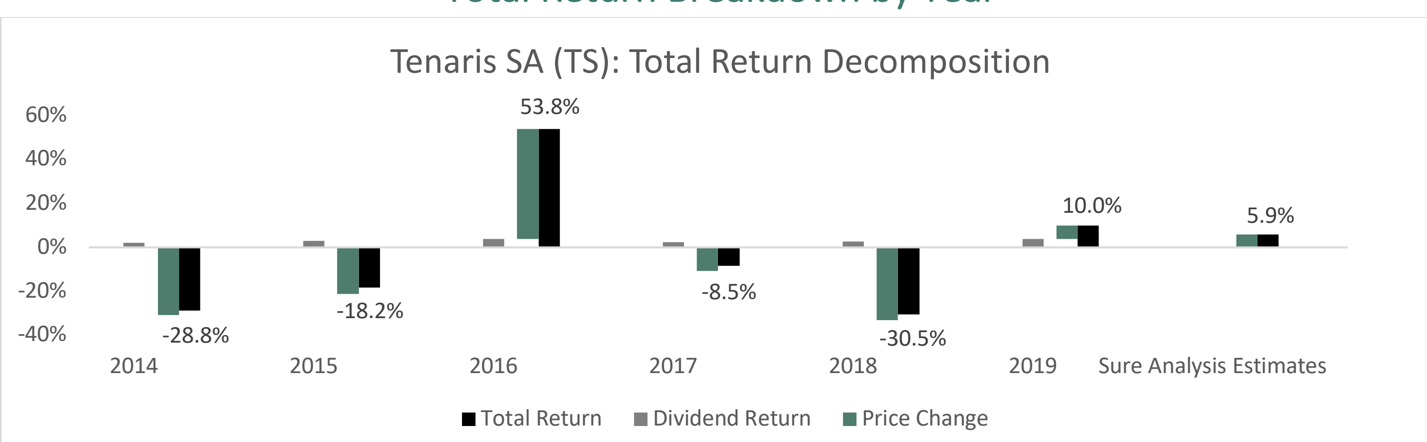
As mentioned, Tenaris eliminated the dividend for this year, as the November 2019 payment was the last payment made, and the previously proposed May dividend was retracted.

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 5.9% total annual returns, based mostly upon an expected rebound in earnings coming out of this crisis. Given this, as well as the inherent volatility in the company's earnings, and the elimination of the dividend, Tenaris earns a sell rating.

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%	30.0%
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%	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%	10.2%
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.