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Selecting opportunities as Active Dividend investor. The Technip Energies case

Selecting the right stocks for your dividend fund is a more complicated process than simply picking the company with the highest dividend. For the Kempen European High Dividend Fund and the Kempen Global High Dividend Fund, we use a thorough evaluation framework that focuses not only on valuation, but also on growth opportunities, business quality, management quality and capital allocation, among others.

Every company we invest in is expected to pay at least a 2% dividend yield, bringing the forward looking dividend yield of our portfolios to 5.1% and 4.8% for our European and Global High Dividend fund, respectively. However, dividend is only part of the total expected return, so in our valuation assessment we carefully consider the value from reinvestments in the business or earnings growth, buybacks, or a potential rerating of the shares.

Some parts of our framework, such as management quality, balance sheet strength and capital allocation can be applied to all investment cases. Because every industry is different our framework is further tailored to each specific sector. As an example, the energy sector needs to be adjusted for different commodity price scenarios. We need to have a view on the supply-demand fundamentals of oil, refining capacity, LNG capacity and pipeline capacity. We also want a company to be low on the cost curve, so it could survive in any downcycle. Equally important is the jurisdiction in which the company operates. It is hard to operate in a country where corruption is the norm, but nowadays it could be equally challenging to operate in a country that puts the entire cost of the energy transition on the petroleum industry.

As active investors, we try to be forward looking. We form an opinion on dividends in the next few years, rather than to just look on the past dividends. Especially for spin-offs or IPOs, where there is no readily available information in data terminals, this adds value. We also see the continuous improvement of our investment framework as a key driver of our added value. Most recently we have redefined our investable universe by focusing more on long-term potential and sustainability of dividends rather than current payouts.

We would like to illustrate our active dividend investing approach by introducing a recent addition to our dividend portfolios: Technip Energies.

Technip Energies

Technip Energies (TE) was spun-off in early 2021 from the French-American TechnipFMC. They are what is called an EPC contractor in the energy industry, or a company that does the Engineering, Procurement and Construction of energy infrastructure. Those projects include LNG terminals, (bio-)refineries and petrochemical plants. At the moment, 60%[1] of Technip Energies' projects is related to the energy transition, such as hydrogen plants, biorefining, carbon capture & storage or low carbon LNG terminals.

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While TechnipFMC will predominantly focus on the capital intensive offshore oil & gas market, Technip Energies will be a play on the downstream market and on other opportunities arising from the energy transition. Technip Energies is capital light: every dollar earned can either be returned to investors as a dividend, reinvested in the business, or used for M&A. Given the recent spin-off,

Technip has not paid out dividend yet, but the company has committed to paying out at least 30% of its earnings[2], which translated to a yield of around 4% at the time of our purchase.

Technip Energies has 3 years of revenues locked in through its backlog and has clear visibility on several other large projects. Its conservative balance sheet protects the downside. On a market cap of €2.2bn, Technip has a net cash position of €2.5bn[3]. To say that this is conservatively financed is an understatement. The caveat is that most of this cash comes from prepayments and that Technip has certain obligations towards its customers. It would therefore be irresponsible to pay out all of this cash to shareholders.
For reasons detailed below, TE trades at only 8x 2021 earnings, or a 12.5% yield. This is despite the underleveraged balance sheet and growth prospects related to the energy transition.

Even if we assume no growth and investors are content with an 8% return on equity, there is 50% upside to the current share price (12.5x P/E, or an 8% earnings yield). To trade in line with high quality peers such as Fluor and Jacobs (trade around 20x P/E), Technip Energies will need to rerate by 100-150%[4].

Competing on quality, not on price

The business of being an EPC contractor is risky. In projects where the contractor receives a lump sum payment and promises a turnkey solution, project delays and budget overruns come for the account of the contractor and can be very costly. Furthermore, the business is competitive and many players compete on price, adding to the risk.

At the same time, operational excellence, or being able to complete a project in time, can be of tremendous value to a client. An example is the Yamal LNG terminal in Northern Siberia which Technip built for Novatek and which was completed 1 year ahead of schedule. The value of being able to operate a $27bn facility a year earlier than expected – Yamal began exporting natural gas in early 2021, just in time to benefit from the current spike in natural gas prices – is more important than minor differences in price.

It comes as no surprise that Novatek's next LNG terminal, which is located only 40km east of Yamal, will also be built by Technip. This project, called Arctic LNG 2 provides a €6.5bn revenue opportunity for Technip[5]. We are confident that Technip, who has built more than 20% of the world's LNG facilities, won this contract based on its track record and expertise, not by undercutting competitors on price. The final investment decision for Arctic LNG 1, a project of similar size, will be taken next year, and we believe Technip Energies has an excellent chance to win this contract.

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Forced selling creates the opportunity

Before the spin-off of Technip Energies, the company was part of the S&P500 index, which automatically included the company in a lot of passive ETFs. After the split, the company was booted from the S&P 500. But there's more. TechnipFMC was both listed on the NYSE and on Euronext France. Technip Energies on the other hand, only applied for a listing in France. Many American shareholders were left with shares that in the US were traded over-the-counter, which isn't allowed within the mandate of many institutional investors. For both reasons, there was likely significant forced selling following this deal.

Normally, the market would have rebalanced by now – 7 months after the spin – if it wasn't for the fact that TechnipFMC retained around 50% of the shares, with the clear intention to sell those shares in the 12-18 months post spin. This overhang of new supply of shares has kept many investors at the sidelines. However, in the last couple of months, TechnipFMC has reduced its stake to 12% by selling big blocks through private placements to institutional investors. By participating in one of those

placements, at Kempen we have also been able to buy our shares it a significant discount to the then-prevailing market price. The remaining 12% held by TechnipFMC will most likely be sold following Technip's 3rd quarter results. Once this overhang is removed, we believe the company should rerate to a more reasonable valuation. Until then, we are happy earning the 12% earnings yield and 4% dividend yield.

1. Technip Energies Capital Markets Day Presentation
2. Technip Energies Prospectus
3. Technip Energies H1 2021 Results Release
4. Proprietary model, Kempen, as per September 1st 2021
5. Proprietary model, Kempen, as per September 1st 2021

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