Deutsche Bank
Markets Research

Rating
Buy

Europe
France
Luxembourg
Steel
Steel

Company
ArcelorMittal

Reuters	Bloomberg	Exchange	Ticker
MT.AS	MT NA	AEX	MT

Date
12 January 2018

Company Update

Price at 10 Jan 2018 (EUR)	29.83
Price Target (EUR)	36.00
52-week range (EUR)	29.83 - 17.84

Tailwinds getting (even) stronger – Lifting PT to E36, BUY

Valuation & Risks

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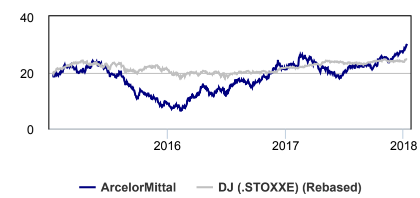
Price/price relative



Performance (%)	1m	3m	12m
Absolute	12.6	35.0	30.3
DJ (.STOXXE)	1.6	1.7	12.5

Source: Deutsche Bank

More upgrades + strong FCF remain underappreciated - Buy

European margins remain more robust than at any time post Lehman. Although this is not what the shares are priced for, we continue to see a scenario where this strength lasts or margins expand even further. Hence, we lift numbers again by 6-7% for 2018-19E (6-15% above Street EBITDA) but see another 20% upside potential if spot trends last and 45% upside potential for the equity in a more optimistic scenario (vs. 22% in our base case). MT´s shares have made money in H1 in each of the past 15 years and with strong cash generation (9-11% FCF yield in our base case scenario) and Street upgrades likely to crystallize over the coming quarters and 5.5x EV/EBITDA (vs. peers at 6.5x), we reiterate Buy.

Owning MT in H1 has usually been a good trade = timing favorable

H1 is usually the strong season in steel (seasonal demand, restocking, price dynamic) and this has been reflected in MT´ share price. On average, MT delivered 36% (median 26% vs. peers 16%) performance at some point in H1 over the past 15 years with H1 peaks usually being skewed into May/June. Supported by fundamental factors, we believe it is the right time to own the stock.

Strong fundamentals last and imply more upside potential to estimates

Given the fragility of past cycles, the market is wary on the sustainability of the strong spot margins in Europe. We believe spot EBITDA is close to USD11bn (vs. DB at USD9.0bn, Street at USD8.4bn in 2018E). Nevertheless, we see a few reasons why prices and margins may continue to move up: 1) Chinese production cuts stick and Chinese prices are at multi-year highs and above European levels (a situation rarely seen in the market), 2) demand leading indicators remain supportive and 3) European consolidation is underway and may support margins further. Additionally, the high-margin Brazilian market has just begun to stabilize post its recession and has scope to recover, and the US market could benefit from incremental demand stimulus and further trade restriction (section 232 suggestions are due Jan 15). We provide a detailed analysis on the upside.

FCF strength should crystallize over the next few quarters - Q4 preview included

While MT´s earnings delivery was strong in 2017 already, cash generation has lagged as underlying CF was absorbed by USD3.5bn WC build up (c.USD1.5bn of which to be released in Q4). However, this is a one-off driven by volume growth/ price inflation and won´t repeat unless steel prices continue to rise. With EBITDA run rates potentially north of USD2.5bn in H1, we believe this means MT may crystallize annualized FCF of USD4.4bn+ (implying c.14% FCF yield).

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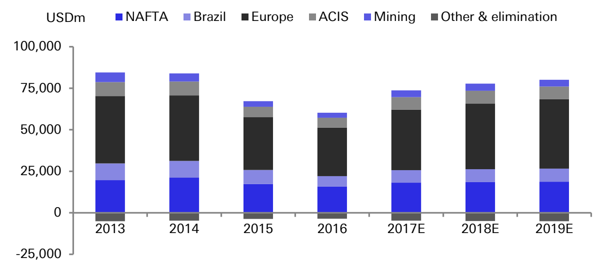
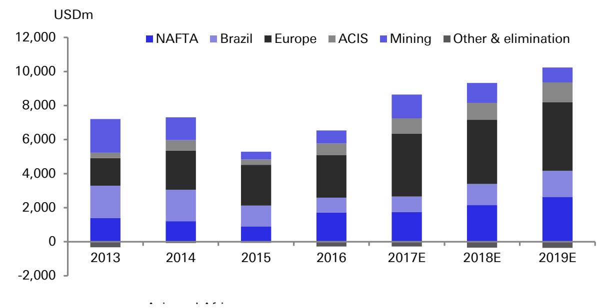
ArcelorMittal in a page

Figure 1: Sales by division



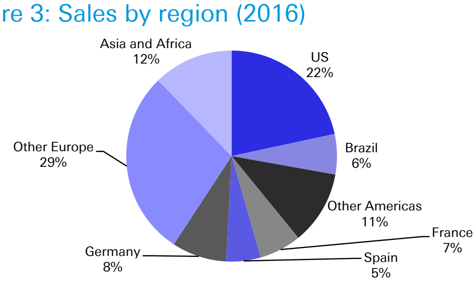
Source: Deutsche Bank estimates, Company data

Figure 2: EBITDA by division



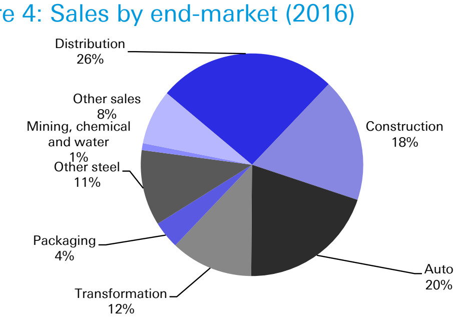
Source: Deutsche Bank estimates, Company data

Figure 3: Sales by region (2016)



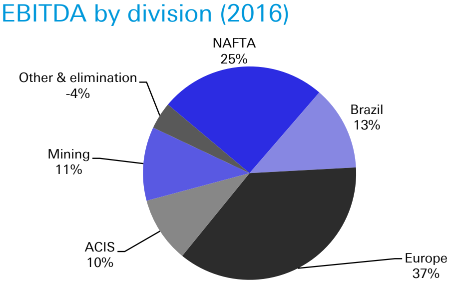
Source: Deutsche Bank, Company data

Figure 4: Sales by end-market (2016)



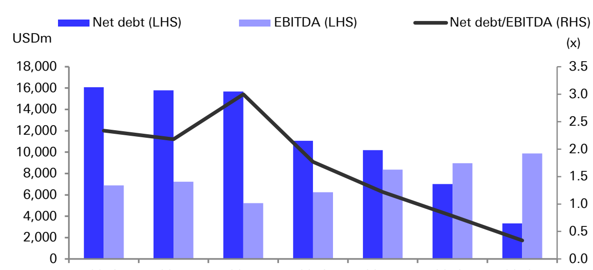
Source: Deutsche Bank, Company data

Figure 5: EBITDA by division (2016)



Source: Deutsche Bank, Company data

Figure 6: Net debt vs. EBITDA (USDm)



Source: Deutsche Bank estimates, Company data

Investment summary

Tailwinds accelerating - more upside potential ahead; Buy

Although the stock has performed well in the past two years, ArcelorMittal has the largest leverage to the current cyclical strength, which is not yet reflected at current share price levels, in our view. We lift numbers again by 6-7% for 2018-19E (6-15% above Street EBITDA) but see another 20% upside potential to our revised 2018E USD9bn EBITDA estimate if spot trends last. We see several reasons to own the stock now:

Catalysts:

- **Further rise in steel prices and upgrades to Street estimates**
- **Update on US trade regulation (possibly section 232 update on 15 January)**
- **Accelerating cash generation during the next three quarters and possible update on capital allocation**
- **Possible closure of ILVA acquisition post the European anti-trust review**

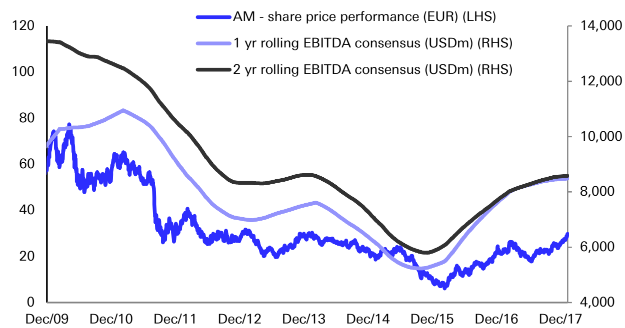
Operational tailwinds: Although current spot conditions would imply another 20% EBITDA upside to our above-Street estimates, this is before 1) any impact from the ongoing consolidation in Europe, 2) a volume recovery in the highly profitable Brazilian domestic market and 3) further impact of trade protection and adjustment of Western market prices to the current high Chinese spot price levels (which are above European prices) and means the stock comes with several free options for upside potential. Hence, we believe the stock offers another c45% upside potential in a more optimistic scenario (vs.22% in our base case).

Strong FCF is yet to crystallize: While MT´s operational performance was strong in 2017 already, cash generation has lagged as strong underlying CF was absorbed by USD3.5bn WC build up (c.USD1.5bn of which to be released in Q4). However, this is a one-off driven by volume growth and price inflation and should not repeat unless steel prices continue to rise. With EBITDA run rates potentially north of USD2.5bn in H1, we believe this means MT may crystallize annualized FCF of USD4.4bn+ (implying c.14% FCF yield). We also believe management could announce reinstatement of dividends and would expect a small dividend initially to allow for a speedy further deleveraging to make the company independent from debt market cyclicalities. Within 2-3 years, we believe strong cash generation could allow for a strong 5-10% direct shareholder return via dividends and share buybacks.

Timing is favorable: H1 is usually the strongest season in steel as: 1) seasonal demand kicks in, restocking supports and high apparent demand and commodity price inflation (driven out of China) often support price dynamics. This has been reflected in MT´s share price over the previous years. On average, MT has delivered 36% (median 26% vs. peers 16%) performance at some point in H1 over the past 15 years with H1 peaks usually being skewed into May/June. Supported by fundamental factors, we believe it is the right time to own the stock.

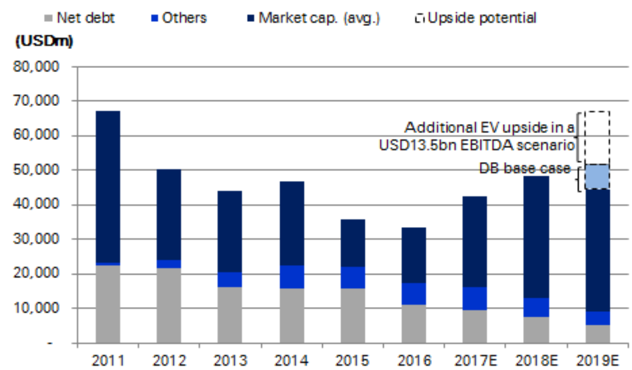
With a structurally improved BS (0.8x net debt/EBITDA 2018E) and strong FCF yield of 9-11% even in our base case scenario (22% in an optimistic scenario), we believe the stock will re-rate on a continuous debt to equity swap. We also believe this bodes well for direct shareholder returns (dividends and buybacks). At an attractive 5.5x EV/EBITDA 2018E vs. peers at 6.5x, we recommend Buy.

Figure 7: Expectations look well aligned, but shares are not reflecting the ongoing earnings recovery yet



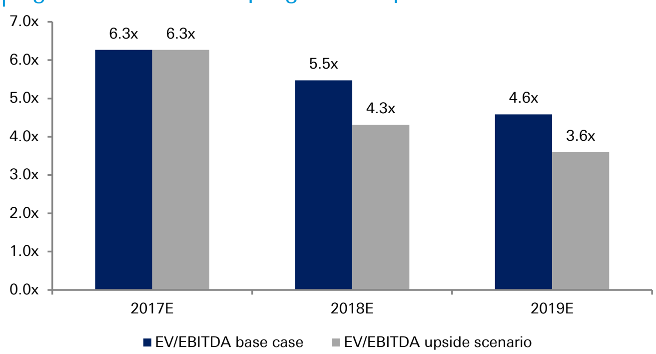
Source: Deutsche Bank, FactSet

Figure 8: Significant deleveraging provides scope for an even stronger re-rating



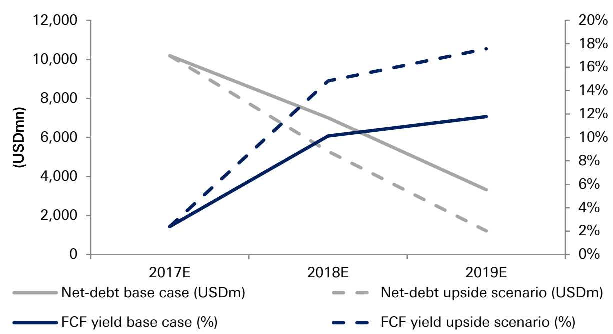
Source: Deutsche Bank estimates, Company data

Figure 9: EV/EBITDA progress in upside scenario



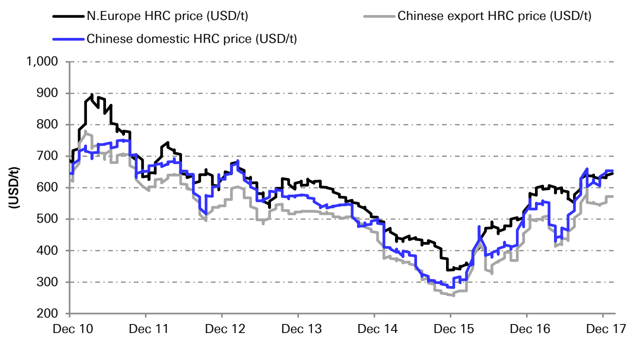
Source: Deutsche Bank estimates, Company data

Figure 10: Net-debt vs. FCF yield in upside scenario



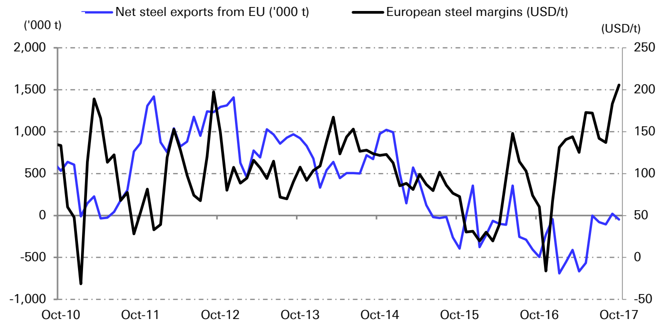
Source: Deutsche Bank estimates, Company data, FactSet

Figure 11: N. Europe, Chinese domestic and export HRC



Source: Deutsche Bank, SBB, TSI

Figure 12: European margins vs. net exports from EU



Source: Deutsche Bank, Eurofer

Figure 13: Changes in Deutsche Bank estimates

	New estimates			Old estimates			Change %		
Steel shipment ('000 t)	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**
NAFTA	22,105	22,994	23,693	22,105	22,994	23,693	0%	0%	0%
Brazil	10,666	10,983	11,271	10,610	10,822	11,001	1%	1%	2%
Europe	41,112	45,935	49,533	41,112	47,935	49,613	0%	-4%	0%
ACIS	13,079	13,471	13,875	12,959	13,347	13,748	1%	1%	1%
Inter-segment elimination	-1,645	-1,766	-1,860	-1,641	-1,799	-1,854	na	na	na
Total	**85,318**	**91,617**	**96,513**	**85,145**	**93,300**	**96,201**	**0%**	**-2%**	**0%**
-Iron Ore	58,813	63,325	64,591	59,086	60,149	61,352	0%	5%	5%
-Coal	6,424	6,424	6,424	6,424	6,424	6,424	0%	0%	0%
Sales (USDm)	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**
NAFTA	18,145	18,482	18,715	18,098	18,209	18,457	0%	2%	1%
Brazil	7,569	7,773	7,887	7,518	7,647	7,686	1%	2%	3%
Europe	36,417	39,623	41,739	36,139	40,301	40,138	1%	-2%	4%
ACIS	7,583	7,590	7,655	7,427	7,290	7,327	2%	4%	4%
Mining	4,053	4,337	4,102	4,047	3,993	3,885	0%	9%	6%
Other & elimination	-4,741	-4,911	-5,055	-4,706	-4,887	-4,891	1%	0%	3%
Total	**69,026**	**72,896**	**75,044**	**68,523**	**72,552**	**72,602**	**1%**	**0%**	**3%**
EBITDA (USDm)	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**
NAFTA	1,750	2,152	2,638	1,769	2,138	2,534	-1%	1%	4%
Brazil	907	1,246	1,524	897	1,196	1,427	1%	4%	7%
Europe	3,698	3,758	4,026	3,698	3,569	3,901	0%	5%	3%
ACIS	901	1,004	1,167	871	897	921	3%	12%	27%
Mining	1,393.2	1,162.8	875.9	1,376.0	978.4	862.2	1%	19%	2%
Other & elimination	-277.8	-349.8	-352.7	-277.5	-353.1	-344.2	0%	-1%	2%
Total	**8,372**	**8,973**	**9,878**	**8,333**	**8,425**	**9,301**	**0%**	**7%**	**6%**

Source: Deutsche Bank estimates

Figure 14: Deutsche Bank estimates vs. consensus

	DB new estimates			Consensus estimates			% Difference		
Company	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**
EBITDA	8,372	8,973	9,878	8,321	8,448	8,582	1%	6%	15%
EPS	4.10	3.65	4.40	4.06	3.44	3.74	1%	6%	18%

Source: Deutsche Bank estimates, FactSet

Figure 15: Sensitivity to USD10 steel price change

	Base Case		USD10 steel price increase		USD10 steel price decrease	
	2018E	2019E	2018E	2019E	2018E	2019E
EBITDA	8,973	9,878	9,889	10,843	8,057	8,913
EPS	3.65	4.40	4.33	5.13	2.96	3.67
Adj. FCF yield (%)	8.8%	11.2%	10.9%	13.4%	6.8%	9.0%

Source: Deutsche Bank estimates

Figure 16: Sensitivity to USD10 iron ore price change

	Base Case		USD10 iron ore price increase		USD10 iron ore price decrease	
	2018E	2019E	2018E	2019E	2018E	2019E
EBITDA	8,973	9,878	9,363	10,276	8,583	9,480
EPS	3.65	4.40	3.94	4.70	3.36	4.10
Adj. FCF yield (%)	8.8%	11.2%	9.7%	12.1%	7.9%	10.3%

Source: Deutsche Bank estimates

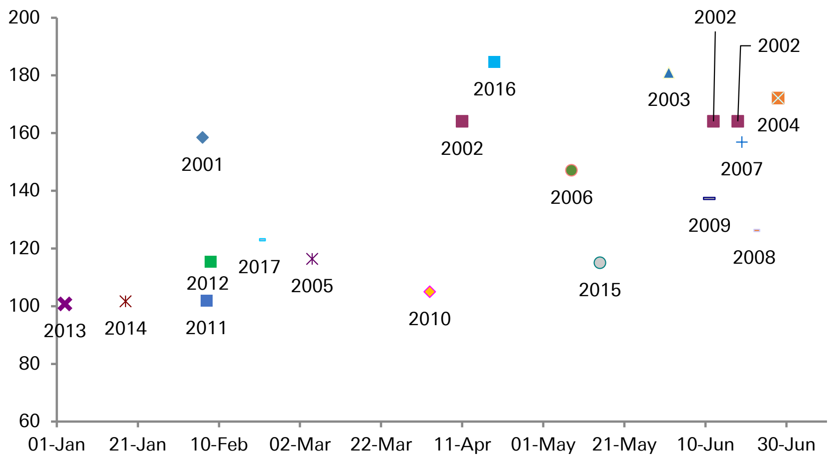
Not only are fundamentals strong, it is also the right time of the year to be long on the stock

We do believe that MT's shares will re-rate on fundamental reasons as expectations appear well-managed as the Street remains wary because of the fragility of past cycles, earnings momentum remains favorable and cash generation should increase the market's confidence. Nevertheless, we believe it is also the right time to own the stock.

H1 is usually the strongest season in steel due to a few reasons:

- Demand is seasonally strong in Western markets where industrial activity is the highest post the Christmas break in Q1 and in Q2 ahead of the summer holiday season and maintenance closures in Q3.
- After destocking in Q4 (to trim year-end cash balances to improve credit metrics), industrial clients and service centers are usually restocking in Q1 and Q2, which means apparent demand exceeds underlying demand.
- Often, prices used to strengthen in H1 due to a few reasons: firstly, higher apparent demand usually increases pricing power in the domestic market. Secondly, China often accelerates post the CNY, which often drives cost inflation of input factors (mostly iron ore and coal). This is passed on via higher steel prices and increases the amplitude of the price cycle.

Figure 17: ArcelorMittal H1 share price peak over the past 15 years



Source: Deutsche Bank, FactSet

This has been reflected in MT´s share price over the past years. We looked at MT's H1 share price performance over the past 15 years and the stock has usually delivered a good absolute performance in each of the years. In only four out of 15 years, MT delivered less than 15% absolute performance. Also, strong years were often followed by strong years (also as the shares sometimes see a H1 correction, which partially reverses the year after).

On average, MT has delivered 36% (median 26%) performance vs. peers 20% (median 16%) at some point in H1 over the past 15 years. H1 peaks have been usually skewed into May/June. Supported by fundamental factors, we believe it is the right time to own the stock.

Figure 18: ArcelorMittal vs. European steel peers performance

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Average	Median
MT peak return in H1	58.5%	64.1%	81.0%	72.1%	16.4%	47.1%	56.9%	26.2%	37.4%	5.0%	1.9%	15.4%	0.8%	1.7%	15.0%	84.7%	23.0%	35.7%	26.2%
Sector peak return in H1	16.4%	10.9%	6.6%	11.1%	12.1%	48.1%	28.2%	28.5%	30.4%	7.3%	0.0%	21.7%	0.0%	37.6%	26.3%	37.6%	11.6%	19.7%	16.4%
MT performance vs. peers	**42.2%**	**53.2%**	**74.4%**	**61.0%**	**4.3%**	**-1.0%**	**28.7%**	**-2.3%**	**7.0%**	**-2.3%**	**1.9%**	**-6.3%**	**0.8%**	**-35.9%**	**-11.3%**	**47.1%**	**11.4%**	**16.0%**	**4.3%**
MT return in Q1	15.6%	-5.1%	29.0%	24.7%	-11.9%	40.4%	26.1%	-1.1%	-18.7%	-2.7%	-7.2%	-5.6%	-25.6%	-8.7%	-2.7%	37.8%	10.7%	5.6%	-2.7%
Sector return in Q1	3.0%	8.2%	-6.5%	4.7%	5.7%	24.8%	8.3%	4.9%	-23.2%	3.4%	-7.2%	2.9%	-17.9%	12.8%	18.6%	17.5%	2.7%	3.7%	4.7%
MT performance vs. peers	**12.7%**	**-13.3%**	**35.5%**	**20.0%**	**-17.5%**	**15.6%**	**17.8%**	**-6.0%**	**4.6%**	**-6.1%**	**0.0%**	**-8.5%**	**-7.7%**	**-21.5%**	**-21.3%**	**20.3%**	**8.0%**	**1.9%**	**0.0%**
MT return in H1	41.8%	61.0%	53.8%	72.1%	-29.0%	7.5%	47.6%	19.7%	24.5%	-33.0%	-12.7%	-20.2%	-36.5%	-15.4%	-3.2%	41.8%	-7.1%	12.5%	7.5%
Sector return in H1	7.2%	5.3%	5.0%	9.7%	5.1%	35.5%	26.5%	4.9%	14.9%	-18.7%	-10.9%	-21.5%	-25.8%	34.1%	11.0%	16.1%	-1.5%	5.7%	5.3%
MT performance vs. peers	**34.6%**	**55.7%**	**48.8%**	**62.3%**	**-34.1%**	**-28.0%**	**21.2%**	**14.9%**	**9.6%**	**-14.4%**	**-1.8%**	**1.3%**	**-10.7%**	**-49.5%**	**-14.1%**	**25.7%**	**-5.6%**	**6.8%**	**1.3%**

Source: Deutsche Bank, FactSet

Ultimately, we believe earnings performance and earnings expectations will be the key drivers for the stock, and the shares have started to react to consensus upgrades and higher conviction by the Street that 2018E could see an incremental earnings step-up vs. 2017. We believe that expectation could potentially move up to c.USD13.5bn EBITDA in a more optimistic, yet not a blue sky scenario (annualized peak EBITDA has been USD34bn in Q3 2008 which shows MT´s substantial earnings leverage). As we believe MT should trade at c. 5.0-6.5x EV/ EBITDA, this would imply an EV of USD68-88bn. As we argue that USD13.5bn EBITDA would be seen as an upper-cycle number in the context of recent years, we would find a 5.0x multiplier appropriate in such a scenario. With the benefit of having lowered net debt drastically, which means more of the re-rating will flow to the equity value, this would imply c45% upside potential to current share price levels (vs. 22% in our base case).

Cyclical tailwinds imply shares still have material upside potential

MT´s shares are now trading on just 5.0x EV/EBITDA 2018E on what we believe is a sufficiently conservative earnings scenario. Key building blocks for our assumptions are:

- a 2018 iron ore price of USD66/t (vs. 2017E average of USD71/t and below current spot of USD77/t),
- a US HRC benchmark price of USD755/t (below current spot at USD720/t with more price hikes underway),
- a significant decline in Northern European steel prices to USD568/t, down c.11% from current spot levels at around USD640-660/t (again with more price hikes likely near term).

Nevertheless, we believe these assumptions are sufficiently conservative and current spot conditions could provide significant upside potential to earnings. In our view, a mark to market EBITDA would likely be at c.USD10-11bn, c.11-22% above DBe of USD9.0bn and the Street at USD8.4bn. However, this is before: 1) any impact from the ongoing consolidation in Europe, 2) a volume recovery in the highly profitable Brazilian domestic market and 3) further impact of trade protection and adjustment of Western market prices to the current high Chinese spot price levels, which means the stock comes with several free options for upside potential.

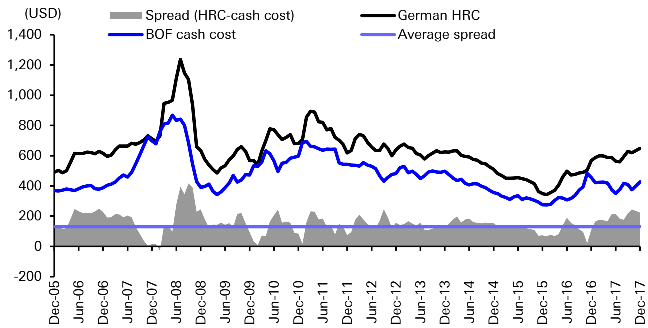
Cash flow leverage to multiples could accelerate rerating

Although we find the stock attractive on our base-case multiples and FCF yield of 9-11%, a more optimistic scenario could lift EBITDA to USD13.5bn and cash generation to FCF of 22% which would bring EV/EBITDA multiples down towards 3.4x within just two years. Hence, we believe the potential upside remains material and see potential c45% upside in a more optimistic scenario vs. our 22% base case.

We believe shares imply an USD8bn EBITDA scenario in 2018

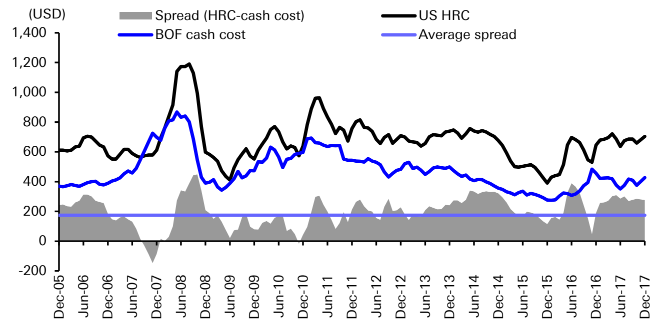
Given the restructured balance sheet and robust cash flow generation, we believe that 6x EV/EBITDA 2018E is a fair multiplier and therefore, the current share price suggests that the stock is priced for c.USD8bn EBITDA 2018. This would require steel margins to drop back to mid-cycle levels of c.USD70-75 EBITDA/t (vs. DBe 2018 of USD85/t and 2017E of USD82/t) against spot margins, which have been holding up well so far (see Figure 19 and Figure 20) and would imply EBITDA/t of c.USD100-110 (see Figure 21).

Figure 19: German HRC vs. BOF HRC cash costs



Source: Deutsche Bank, SBB

Figure 20: US HRC vs. BOF HRC cash costs

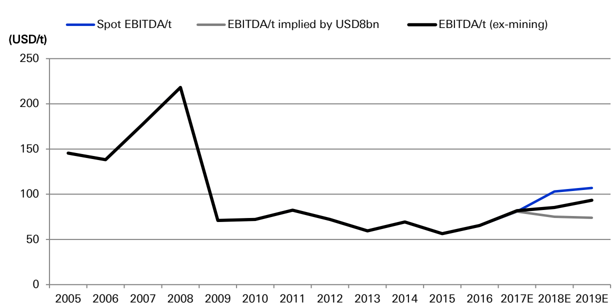


Source: Deutsche Bank, SBB

Although we are far from being in the outright bullish camp of "steel prices will never fall again", we do believe that particularly 2015 was special and unlikely to repeat. With exports out of China rising to a multi-year high and sending Western market steel prices into cash-burn territory, we believe 2015 was the perfect storm. Since then, however, China has started to cut capacity and thus domestic Chinese margins have begun to recover. Additionally, Western authorities have installed a continuously growing spectrum of AD duties, which should provide further support. Lastly, Italian Ilva and Tata´s European steel assets (number two and number four in Europe by installed capacity) were under significant financial pressure and hence desperate to defend market share at cash-negative margins. Post the pending takeover of Ilva by AM and the possible merger between TK and Tata Steel Europe, we believe this risk should no longer exist. Hence, a few structural changes have taken place and suggest downside risk has been removed and with Chinese margins at multi-year highs and Western market prices having scope to rise even further, we could be in a prolonged upcycle.

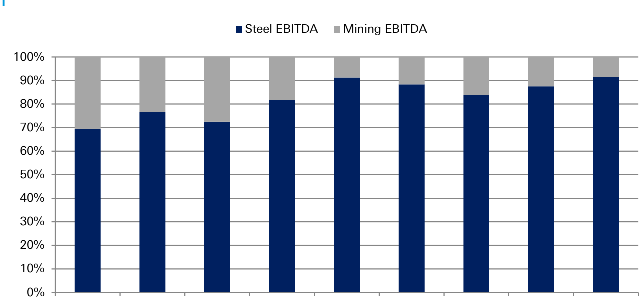
We also believe that downside risk from mining should be minimal vs. our assumptions. We use an iron ore price deck of USD66/t in 2018 and hence mining only accounts for USD1.2bn or 13% of total group EBITDA. This compares to the 2010-14 mining cycle, when mining contributed USD2bn EBITDA on average, accounting for c.27% of total earnings.

Figure 21: Steel EBITDA/t vs. spot and a USD6bn EBITDA scenario



Source: Deutsche Bank estimates, company data

Figure 22: Steel vs. mining EBITDA as percentage of total

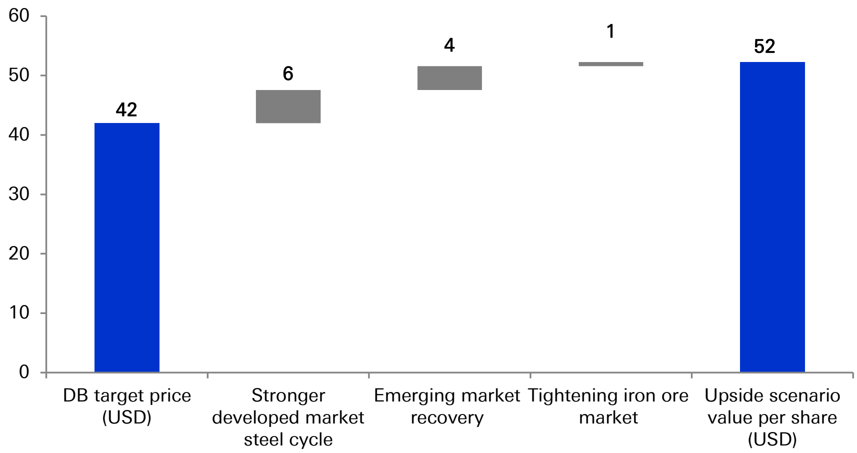


Source: Deutsche Bank estimates, company data

The stock comes with three free options

We identify three options for earnings upside, which are not reflected in MT´s share price, in our view. If they play out, this could take EBITDA to USD13.5bn (implying 22% FCF yield) and our price target to USD52.

Figure 23: Potential upside drivers beyond Deutsche Bank's base case scenario



Source: Deutsche Bank estimates

1. Stronger developed market recovery: Given the large volume exposure to the Europe and the US (MT sells 75% of its volumes in Europe and the NAFTA), any margin improvement in these markets continues to have the largest leverage to the company´s earnings line. We expect MT to ship c69mt into these two markets in 2018E and thus on our estimates, every USD10/t margin deviation moves EBITDA by USD0.7bn. We forecast a margin of USD86/t in our base case scenario but given the rising trade protection and robust domestic demand, we would not rule out that this could ultimately be closer to USD120/t (which is slightly ahead of spot and well below 2006-08 cycle levels). While we would view such margin levels as rather top of the cycle, we would lower our implied multiplier from 6x EV/EBITDA to 5.0x, which implies USD6 upside potential per share.

2. Brazil leaving the recession: Brazil has historically been MT´s most profitable market given the strong trade protection as well as consolidated domestic competitive landscape. This holds true today; however, domestic demand is down 31% vs 2013 levels and thus, local players are forced to increase the export share of their business. We forecast neither a strong volume, nor margin recovery and our 2018 margin forecast stands at USD113 EBITDA/t, well below previous levels north of USD200/t. Similarly, ACIS margins are still depressed, which has also been driven by low commodity prices and high import pressure, two trends which have started to reverse. We forecast EBITDA/t of USD75 in 2018E, well below previous highs around USD300/t.

Assuming margins around USD200/t in Brazil on a shipment level of c11mt and USD100/t in ACIS on a 13mt shipment level and applying a 6x EV/EBITDA multiplier on the business (high vs. the Western world, as this could be a recovered rather than a peak earnings level) would add USD4 upside per share to our base case scenario.

3. A tightening iron ore market: Our valuation is based on an iron ore price of USD66/t; however, recent price dynamics have taught us that commodity markets remain extremely volatile and could always surprise the market. We forecast 39mt of marketable iron ore shipments in 2018 and hence, every USD10/t surprise in iron ore prices could increase EBITDA by USD0.4bn. This is excluding any benefits from additional iron ore capacity being shipped at cost plus as well as strategic contracts (c.30mt) as our view is that some of MT´s mills benefitting from the integration are competing with peers which have similar cost advantages and may thus not be able to capture the full benefit. Hence, we estimate a USD80/t iron ore price scenario would lift EBITDA by USD0.5bn. However, as we would only apply 4.5x EV/EBITDA to numbers at a possibly unsustainable iron ore price level, this would only add USD1 of value to our base case scenario.

Figure 24: Deutsche Bank estimates

Products	Unit	Q4 17	Q1 18E	Q2 18E	Q3 18E	Q4 18E	2017	2018E	2019E	2020E
New Forecasts										
Hot rolled coil - Germany	USD/t	617	590	580	560	540	596	568	550	550
Hot rolled coil - Germany	EUR/t	526	500	492	475	458	531	481	466	466
Cold rolled coil - Germany	USD/t	733	720	710	690	670	716	698	680	680
Old Forecasts										
Hot rolled coil - Germany	USD/t	590	NA	NA	NA	NA	590	550	535	NA
Hot rolled coil - Germany	EUR/t	500	NA	NA	NA	NA	524	466	453	NA
Cold rolled coil - Germany	USD/t	720	NA	NA	NA	NA	713	680	665	NA

Source: Deutsche Bank estimates

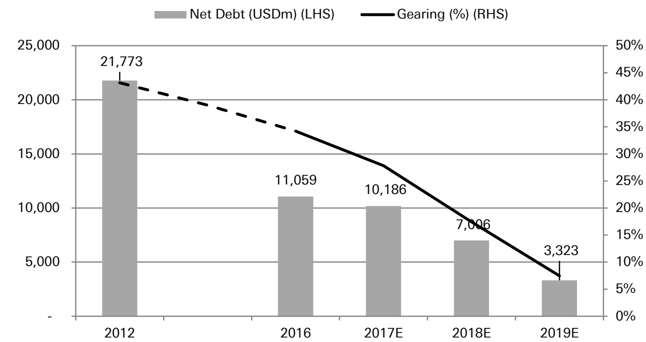
Strong 9-11% FCF yield, net debt to halve again

MT has gone through a phase of significant balance sheet restructuring and will have lowered net debt by more than 50% in 2017E vs. 2012. This has been supported by a number of non-core asset divestments as well as several equity measures (equity raise and convertible) and with net debt/EBITDA of 1.2x in 2017, we believe the balance sheet is now structurally de-risked.

Management has also done a good job in bringing down cash needs via debt refinancing, more stringent capex management and re-negotiation of pension schemes, and while cash needs have gone up modestly in 2017 (cUSD4.6bn) to finance small growth projects, MT has lowered the financial burden significantly and hence, should be able to cut cash needs down to USD4.0bn if necessary. We estimate that the ILVA transaction will likely lift cash needs by c.USD0.2-0.5bn in 2018-19E and also believe the stronger Euro will translate into a higher USD number for the Euro-denominated capex portion (DBe c40% of total) – management has recently announced to lift capex modestly to c.USD3.5bn. Nevertheless, cash generation remains strong and we expect underlying FCF yields of 9-11% until 2019E.

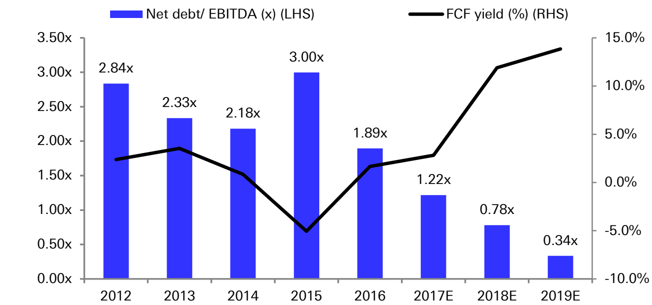
We believe the improved balance sheet and cash flow metrics clearly increase the likelihood of direct shareholder returns (both dividends and share buybacks). We recently got the sense that management is aiming for an even stronger debt reduction before starting to pay a larger dividend (we believe a small dividend payment could be reinstated for 2017). Nevertheless, we believe MT is a stock that could pay a mid-to-high dividend yield in the medium term.

Figure 25: Net debt has halved and is set to more than halve again



Source: Deutsche Bank estimates, company data

Figure 26: FCF yield vs. net debt/EBITDA



Source: Deutsche Bank estimates, FactSet

Three structural changes in favor of AM's core markets

We believe three structural changes are limiting the operational downside risk and may provide potential for a possibly material "second leg" recovery in MT's margins.

Structural change 1: European consolidation

Firstly, 2017 may have seen the largest M&A activity in Europe since 2006. Europe's market leader AM is in the process of taking over the fourth largest domestic player ILVA (Italy), and Thyssen and Tata (number two and number three by shipment) are reportedly in talks for a possible merger. Although the market concentration among the largest five European players would only increase by c5ppts to 45% of total capacity, the market concentration in several flat product categories should be significantly higher. Our base assumption is that pricing power will only change little (as the capacity tail in Europe remains more fragmented); however, we still believe this should support a more robust price environment in the flat steel segment and make price cycles possibly more pronounced.

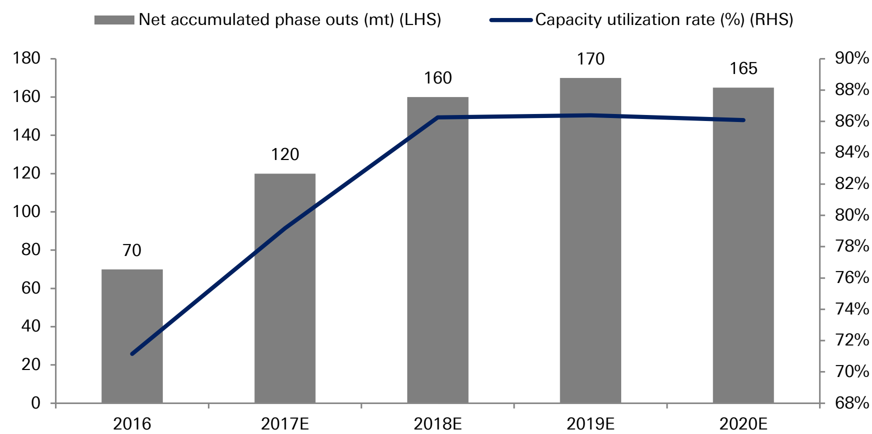
Structural change 2: Stricter trade policy

Secondly, trade policy in AM's European and US core markets has become stricter with various anti-dumping duties being introduced. Although imports keep coming in from countries that are not subject to anti-dumping duties and total imports remain close to record levels, the previously most aggressive market participant, China, has largely been excluded from the domestic European and US markets. Additionally, the results of the ongoing section 232 investigations in the US and a possible response by the European Commission could, depending on the outcome, drive a further market squeeze out. Although we believe such a scenario could result in an escalating trade war and impact growth of the wider economy negatively mid-term, it would likely shift the near-term pricing power further over to steel mills and thus allow for further margin recovery.

Structural change 3: Chinese supply side reform

Lastly, China has reportedly started to kick off on a 10-15% (100-150mt) capacity curtailment program in 2015 to rebalance its supply to domestic demand until 2020. Our Chinese team expects 73% of the program (110mt of net closures) to be finished by the end of 2017. We understand this is not including the closure of another 100-120mt black market induction furnace capacity in H1 2017, which likely has not been captured in any statistic (probably less than 50% has been operating as of late). Our Chinese team suggests that the accumulated closure for BF capacity will reach around 190 million metric tonnes per year by 2020, of which 25 million metric tonnes might restart production in response to favorable supply-demand dynamics. This should take the net removal to around 165 million metric tonnes per year. Taking the recently closed induction furnace capacity into account, the net removal should be around 285 million metric tonnes per year.

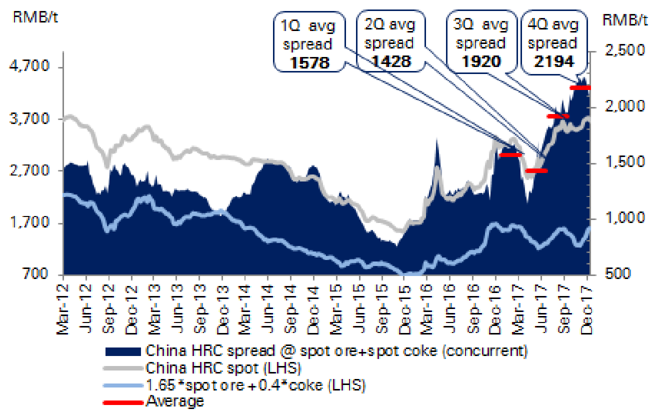
Figure 27: Expected Chinese capacity closures vs. implied utilization rate in a stable demand scenario



Source: Deutsche Bank estimates

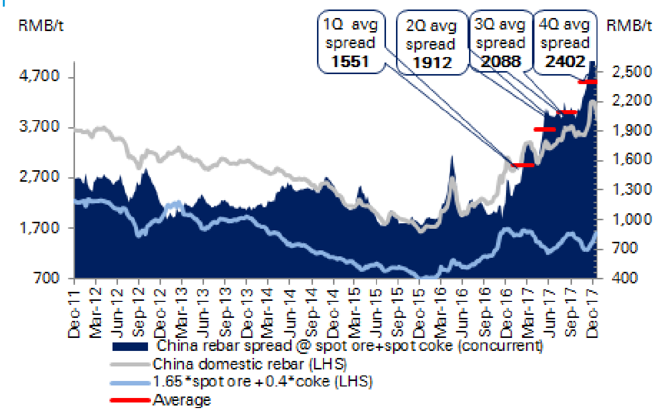
As China remains the largest global steel market and exporter, this could take further supply pressure off the global steel markets and support margins of Western World producers. Although data points continue to be controversial (i.e. reported Chinese production numbers remain around record levels), both DB´s Chinese steel team as well as companies support the view that capacity closures are actually happening (MT had to close 15% of BOF capacity at its JV China Oriental). We also note that Chinese margins have been strong since the measures have been initiated and saw good support even in the recent market correction. Although we prefer a certain degree of skepticism on the Chinese data points, we believe this could be the first evidence that structural changes are underway.

Figure 28: Price-cost spread for Chinese domestic HRC



Source: Deutsche Bank, Bloomberg Finance LP

Figure 29: Deutsche Bank, Bloomberg Finance LP, sx coal



Source: Deutsche Bank, Bloomberg Finance LP

Q4 preview

Q4 17 results due in February

AM is due to report its Q4 results, and we forecast Q4 EBITDA of USD2.1bn (vs. Q3 17's USD1.9bn), largely driven by strong numbers from Europe, Brazil and ACIS while NAFTA and Mining are expected to remain softer on lower volumes and prices. We expect steel shipments of 21.1mt, implying EBITDA/t ex. mining of USD88 (vs. Q3 17's USD73 and Q4 16's USD68). While Europe should be up due to higher prices as well as slightly higher volumes, Brazil should post better numbers on higher prices despite slightly lower volumes (-2% qoq). ACIS should benefit from solid volumes and a significant price recovery in the Black Sea region while Africa should benefit from AD duties. We expect NAFTA volumes to decline by 4% qoq and the mining business to decline on lower average iron ore prices (Deutsche Bank estimate: Q4 17 EBITDA USD253m), down 26% qoq and 15% yoy. This translates into net income of USD729m and EPS of USD0.71 on higher financial charges. We flag a margin for error due to the coke battery incident in Belgium in November and on possible revaluation of deferred tax assets liabilities post the US tax reform (which we believe may be a non-cash negative while the lower cash tax will benefit medium term). We expect net debt to decrease to USD10.2bn vs. Q3 17's level of USD12bn on solid cash generation despite some FX headwinds. Given the current strong fundamentals, we expect a confident outlook into Q1 and 2018.

Figure 30: Q2 preview

(USD m)	4Q 16A	3Q 17A	4Q 17E	yoy (%)	qoq (%)
Sales (external)	14,126	17,639	18,057	28%	2%
Reported EBITDA	1,661	1,924	2,104	27%	9%
Reported EBIT	809	1,234	1,339	66%	8%
EBIT margin (%)	5.7%	7.0%	7.4%		
Exceptional items	0	0	0	nm	nm
EBIT (clean)	965	1,234	1,339	39%	8%
PBT (reported)	324	1,278	976	201%	-24%
PBT (clean)	324	1,278	976	201%	-24%
PBT margin (%)	2.3%	7.2%	5.4%	136%	-25%
Tax	13	-71	-234	nm	nm
Tax rate	4.0%	-5.6%	-24.0%		
Net income (continuing operations)	403	1,205	729	81%	-40%
EPS (Basic, continuing operations)	0.40	1.18	0.71	81%	-40%
Sales/t	705	813	857	22%	5%
EBITDA/t	83	89	100	21%	13%
Cash cost/t	622	724	757	22%	5%
Reported EBIT/t	40	57	64	57%	12%
Clean EBIT/t	48	57	64	32%	12%
Sales/t (excluding mining division)	660	765	810	23%	6%
EBITDA/t (excluding mining division)	68	73	88	29%	20%
Cash cost/t (excluding mining division)	592	692	723	22%	4%
Steel Shipments	20,046	21,705	21,072	5%	-3%

Source: Deutsche Bank estimates, Company data

Figure 31: Q2 EBITDA by segment

EBITDA	4Q 16A	3Q 17A	4Q 17E	yoy (%)	qoq (%)
NAFTA	301	381	339	13%	-11%
BRAZIL	213	202	258	21%	27%
EUROPE	698	848	1,000	43%	18%
ACIS	142	239	297	109%	24%
Mining	297	341	253	-15%	-26%
Other & elimination	9	-87	-42	nm	nm
Total	**1,661**	**1,924**	**2,104**	**27%**	**9%**

Source: Deutsche Bank estimates, company data

Model updated: 09 January 2018

Running the numbers

Europe

Luxembourg

Steel

ArcelorMittal

Reuters: MT.AS Bloomberg: MT NA

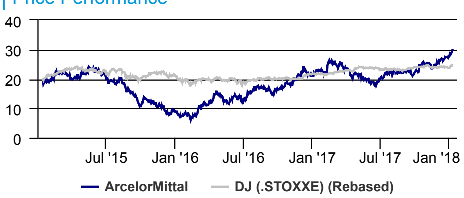
Buy

Price (10 Jan 18)	EUR 29.83
Target Price	EUR 36.00
52 Week range	EUR 17.84 - 29.83
Market cap (m)	EURm 30,763 USDm 37,054

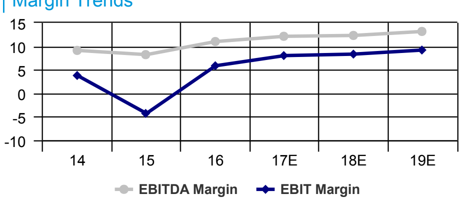
Company Profile

ArcelorMittal is the global steel leader, with production in five continents. Its product exposure spans both flat and long steels, and the company has a strong position in value-added and attractive markets, such as automotive. MT owns and operates iron ore mines in Kazakhstan, Ukraine, Africa, Latin America, and North America which, along with strategic contracts, supply ~50% of its iron ore requirements. The company has significant leverage

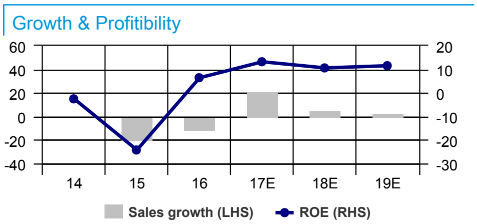
Price Performance



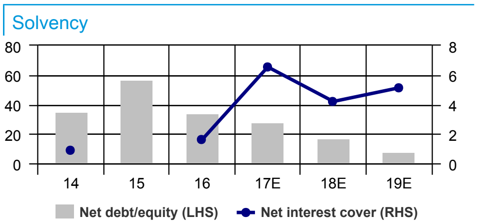
Margin Trends



Growth & Profitability



Solvency



Bastian Synagowitz
+41 44 227-3377 bastian.synagowitz@db.com

Fiscal year end 31-Dec	2014	2015	2016	2017E	2018E	2019E
Financial Summary						
DB EPS (USD)	-1.78	-10.41	0.99	4.06	3.65	4.40
Reported EPS (USD)	-1.88	-13.06	1.86	4.06	3.65	4.40
DPS (USD)	0.60	0.00	0.00	0.30	0.40	1.00
BVPS (USD)	70.5	42.2	31.6	33.7	37.2	41.3
Weighted average shares (m)	597	598	953	1,020	1,020	1,020
Average market cap (USDm)	19,808	11,686	15,334	37,054	37,054	37,054
Enterprise value (USDm)	42,904	33,973	32,583	53,080	49,728	45,889
Valuation Metrics						
P/E (DB) (x)	nm	nm	16.2	9.0	10.0	8.3
P/E (Reported) (x)	nm	nm	8.6	9.0	10.0	8.3
P/BV (x)	0.36	0.23	0.70	1.07	0.98	0.88
FCF Yield (%)	4.0	nm	1.7	2.4	9.9	11.6
Dividend Yield (%)	1.8	0.0	0.0	0.8	1.1	2.8
EV/Sales (x)	0.5	0.5	0.6	0.8	0.7	0.6
EV/EBITDA (x)	5.9	6.5	5.2	6.3	5.5	4.6
EV/EBIT (x)	14.3	nm	9.8	9.6	8.2	6.6
Income Statement (USDm)						
Sales revenue	79,283	63,578	56,791	69,026	72,896	75,044
Gross profit	9,978	1,192	9,014	10,916	11,709	12,694
EBITDA	7,237	5,231	6,255	8,372	8,973	9,878
Depreciation	4,233	7,956	2,927	2,832	2,897	2,972
Amortisation	0	0	0	0	0	0
EBIT	3,004	-2,725	3,328	5,539	6,076	6,907
Net interest income(expense)	-3,382	-2,858	-2,056	-846	-1,446	-1,346
Associates/affiliates	-172	-502	615	380	250	250
Exceptionals/extraordinaries	-60	-1,661	832	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0	0
Profit before tax	-610	-7,746	2,719	5,073	4,880	5,811
Income tax expense	454	902	986	785	976	1,104
Minorities	112	-477	-45	30	78	94
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	-1,176	-8,171	1,778	4,258	3,826	4,612
DB adjustments (including dilution)	60	1,661	-832	0	0	0
DB Net profit	-1,116	-6,510	946	4,258	3,826	4,612
Cash Flow (USDm)						
Cash flow from operations	3,870	1,995	2,709	3,773	7,287	7,891
Net Capex	-3,077	-2,170	-2,444	-2,900	-3,600	-3,600
Free cash flow	793	-175	265	873	3,687	4,291
Equity raised/(bought back)	0	0	3,115	0	0	0
Dividends paid	-458	-416	-61	0	-307	-409
Net inc/(dec) in borrowings	-1,553	808	-6,007	-303	-303	-303
Other investing/financing cash flows	-961	-264	-113	0	-200	-200
Net cash flow	-2,179	-47	-2,801	571	2,878	3,380
Change in working capital	368	-31	-1,023	-2,484	541	289
Balance Sheet (USDm)						
Cash and other liquid assets	4,016	4,102	2,615	3,186	6,063	9,443
Tangible fixed assets	46,593	35,780	34,831	34,899	35,802	36,630
Goodwill/intangible assets	8,104	5,592	5,651	5,651	5,651	5,651
Associates/investments	5,833	4,911	4,297	4,677	4,927	5,177
Other assets	34,633	26,461	27,748	29,643	29,722	29,777
Total assets	99,179	76,846	75,142	78,055	82,165	86,678
Interest bearing debt	19,797	19,786	13,674	13,371	13,069	12,766
Other liabilities	34,222	29,490	29,143	28,071	28,886	29,404
Total liabilities	54,019	49,276	42,817	41,442	41,954	42,170
Shareholders' equity	42,086	25,272	30,135	34,393	37,913	42,116
Minorities	3,074	2,298	2,190	2,220	2,298	2,392
Total shareholders' equity	45,160	27,570	32,325	36,613	40,211	44,508
Net debt	15,781	15,684	11,059	10,186	7,006	3,323
Key Company Metrics						
Sales growth (%)	-0.2	-19.8	-10.7	21.5	5.6	2.9
DB EPS growth (%)	46.5	-483.3	na	309.6	-10.1	20.5
EBITDA Margin (%)	9.1	8.2	11.0	12.1	12.3	13.2
EBIT Margin (%)	3.8	-4.3	5.9	8.0	8.3	9.2
Payout ratio (%)	nm	nm	0.0	7.2	10.7	22.1
ROE (%)	-2.6	-24.3	6.4	13.2	10.6	11.5
Capex/sales (%)	4.6	4.3	4.3	4.2	4.9	4.8
Capex/depreciation (x)	0.9	0.3	0.8	1.0	1.2	1.2
Net debt/equity (%)	34.9	56.9	34.2	27.8	17.4	7.5
Net interest cover (x)	0.9	nm	1.6	6.5	4.2	5.1

Source: Company data, Deutsche Securities estimates

Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
ArcelorMittal	MT.AS	30.16 (EUR) 11 Jan 2018	7, 8, 14

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors . Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr. Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

Important Disclosures Required by U.S. Regulators

Disclosures marked with an asterisk may also be required by at least one jurisdiction in addition to the United States.See Important Disclosures Required by Non-US Regulators and Explanatory Notes.

7. Deutsche Bank and/or its affiliate(s) has received compensation from this company for the provision of investment banking or financial advisory services within the past year.
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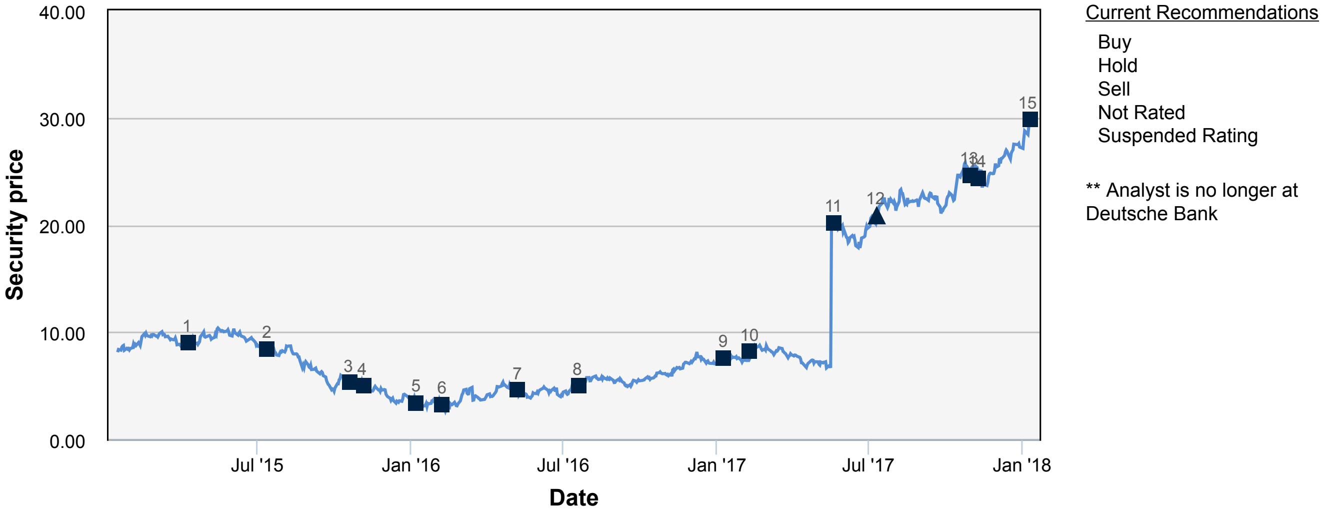
Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Bastian Synagowitz

Historical recommendations and target price. ArcelorMittal (MT.AS)

(as of 01/11/2018)



1.	04/10/2015	Hold, Target Price Change EUR 10,00 Bastian Synagowitz
2.	07/14/2015	Hold, Target Price Change EUR 9,50 Bastian Synagowitz
3.	10/20/2015	Hold, Target Price Change EUR 7,00 Bastian Synagowitz
4.	11/06/2015	Hold, Target Price Change EUR 6,00 Bastian Synagowitz
5.	01/08/2016	Hold, Target Price Change EUR 4,50 Bastian Synagowitz
6.	02/08/2016	Hold, Target Price Change EUR 4,00 Bastian Synagowitz
7.	05/08/2016	Hold, Target Price Change EUR 4,50 Bastian Synagowitz
8.	07/20/2016	Hold, Target Price Change EUR 5,50 Bastian Synagowitz
9.	01/10/2017	Hold, Target Price Change EUR 7,50 Bastian Synagowitz
10.	02/10/2017	Hold, Target Price Change EUR 8,00 Bastian Synagowitz
11.	05/22/2017	Hold, Target Price Change EUR 23,00 Bastian Synagowitz
12.	07/12/2017	Upgraded to Buy, Target Price Change EUR 28,00 Bastian Synagowitz
13.	11/01/2017	Buy, Target Price Change EUR 31,00 Bastian Synagowitz
14.	11/10/2017	Buy, Target Price Change EUR 33,00 Bastian Synagowitz
15.	01/11/2018	Buy, Target Price Change EUR 36,00 Bastian Synagowitz

Equity Rating Key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.
Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

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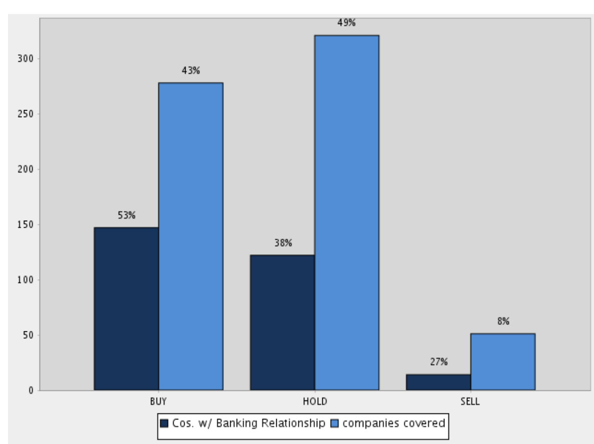
Equity rating dispersion and banking relationships



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