

ArcelorMittal: Making Hay While The Sun Shines, Trading At 1.5X EBITDA

Dec. 04, 2021 11:35 AM ET [ArcelorMittal \(MT\)](#) 25 Comments 9 Likes

Summary

- ArcelorMittal is rapidly improving its balance sheet and could soon reach a zero net debt position.
- Meanwhile, the company is spending billions on share buybacks and will reduce its share count by over 20% in just over a year.
- Although 2021 will likely be a peak year, the much stronger balance sheet makes Arcelor still interesting at the current levels.

Introduction

It has been a while since [I last discussed](#) ArcelorMittal (NYSE:[MT](#)) here on Seeking Alpha and although the stock was sold from the Nest Egg Portfolio at 24 EUR earlier this year, I'm still keeping an eye on this steel giant. The steel sector is enjoying massive tailwinds and after looking back at Algoma Steel (NASDAQ:[ASTL](#)) in this [recent article](#), it only makes sense to have a look at how ArcelorMittal is doing these days.



YCharts

The Q3 free cash flow result was phenomenal

Arcelor actually posted the best quarter since 2008 and despite shipping about 9% less steel, the EBITDA increased by approximately 20% to [in excess of \\$6B](#) while the net income came in at \$4.6B, which also is the highest quarterly performance since 2008.

The total revenue exceeded \$20B, and the operating income of \$5.35B indicated an operating margin of in excess of 26%. Much higher than in the preceding quarter where the operating margin was 'just' 22.9% (which is obviously still good), despite recording about \$123M in exceptional items in the third

quarter of the current financial year.

In millions of U.S. dollars unless otherwise shown	Three months ended			Nine months ended	
	Sept 30, 2021	Jun 30, 2021	Sept 30, 2020	Sept 30, 2021	Sept 30, 2020
Sales	20,229	19,343	13,266	55,765	39,086
Depreciation (B)	(590)	(620)	(739)	(1,811)	(2,249)
Impairment items (B)	—	—	556	—	464
Exceptional items (B)	(123)	—	—	(123)	(678)
Operating income (A)	5,345	4,432	718	12,418	112
Operating margin %	26.4 %	22.9 %	5.4 %	22.3 %	0.3 %
Income from associates, joint ventures and other investments	778	590	100	1,821	227
Net interest expense	(62)	(76)	(106)	(229)	(333)
Foreign exchange and other net financing loss	(339)	(233)	(150)	(766)	(565)
Income / (loss) before taxes and non-controlling interests	5,722	4,713	562	13,244	(559)
Current tax expense	(938)	(768)	(204)	(2,275)	(466)
Deferred tax benefit / (expense)	56	226	(580)	447	(842)
Income tax expense	(882)	(542)	(784)	(1,828)	(1,308)
Income / (loss) including non-controlling interests	4,840	4,171	(222)	11,416	(1,867)
Non-controlling interests income	(219)	(166)	(39)	(505)	(73)
Net income / (loss) attributable to equity holders of the parent	4,621	4,005	(261)	10,911	(1,940)
Basic earnings / (loss) per common share (\$)	4.17	3.47	(0.21)	9.52	(1.73)
Diluted earnings / (loss) per common share (\$)	4.16	3.46	(0.21)	9.49	(1.73)

Source: [financial statements](#)

On top of that, Arcelor saw its income from associates and joint ventures increase as well (which does make sense as the tailwinds are an industry-wide thing and it's obviously not just Arcelor benefiting from them) while the net interest expenses continue to decrease as Arcelor is rapidly reducing its net and gross debt while refinancing existing debt at lower interest rates. The bottom line shows a net income of \$4.84B (including an \$882M tax expense) of which approximately \$4.62B is attributable to the shareholders of ArcelorMittal. This represents an EPS of approximately \$4.17 based on the 1.11B shares outstanding on an average basis. However, ArcelorMittal is continuously buying back its own shares on a very aggressive basis and investors could expect the share count to continue to drop which will further fuel the per-share performance.

On November 17th, Arcelor announced a fifth buyback program for a total of \$1B as the company wants to make sure it enhances the value for its shareholders by using its very strong free cash flows by reducing the share count. The \$1B additional buyback program should be completed within three months and considering the steel industry remains pretty strong I don't think we should be surprised if we'd see additional buyback plans. In the period of November 17 to November 26, ArcelorMittal [already spent \\$380M on the share buybacks](#) as it repurchased 12.7M shares. I wouldn't be surprised if the additional buyback would be completed before the end of this year. Expect the share count to drop to less than one billion shares throughout 2022 and that would be about 20% fewer shares outstanding compared to Q3 2020.

Demonstrating consistent returns to shareholders

Surplus cash being returned through dividends and share buybacks since Sept'20

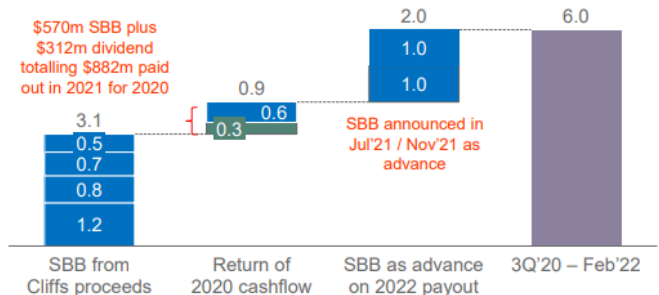
Clearly defined capital return policy:

- Base dividend plus 50% of surplus FCF (returned to shareholders)

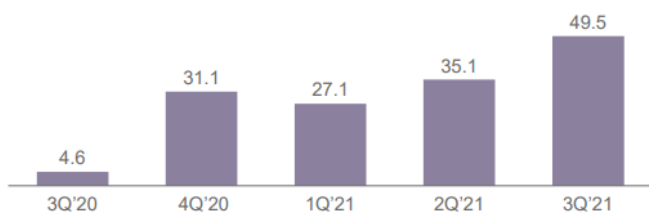
Driving consistent returns:

- 147m shares bought back since Sept'20 (13% shares issued**)
- Based on the strong 3Q'21 cashflow, the share buyback has been increased by a further \$1bn

Share buybacks* and dividends since Sept 2020 (\$bn)



Shares bought back since Sept 2020 (million)



- 983m shares in issue as of September 30, 2021
- Further \$1.8bn share value to be repurchased by Feb'22
- At maturity (May 18, 2023) MCN converts to minimum 93m and maximum 109m shares

Page 18

SBB refers to share buy back; * \$750m SBB completed on July 7, 2021, with cash outflow of \$427m in 2Q'21 (and remaining balance paid in early July 2021); As of September 30, 2021, ArcelorMittal had repurchased 42,299,224 shares for a total value of approximately \$1.4 billion out of the total \$2.2 billion share buyback program that was announced in 2Q 2021 for approximate value of at an approximate average price per share of €28.35; ** issued as of September 30, 2020 of 1,103m shares



Source: [company presentation](#)

As Arcelor is spending a lot of cash on these buybacks, we have to make sure the company's cash flow performance is sufficient to actually fund these buybacks. We obviously saw the net income of ArcelorMittal is excellent, so I had high hopes for the free cash flow result as well.

As you can see in the image below, Arcelor reported an operating cash flow of \$2.44B, but this includes a \$2.9B investment in the working capital position, but excludes the \$46M in lease payments and the \$157M in dividends paid to minority shareholders. Adjusting the result for these elements, the adjusted operating cash flow in the third quarter was approximately \$5.15B.

In millions of U.S. dollars	Three months ended			Nine months ended	
	Sept 30, 2021	Jun 30, 2021	Sept 30, 2020	Sept 30, 2021	Sept 30, 2020
Operating activities:					
Income /(loss) attributable to equity holders of the parent	4,621	4,005	(261)	10,911	(1,940)
Adjustments to reconcile net income/ (loss) to net cash provided by operations:					
Non-controlling interests income	219	166	39	505	73
Depreciation and impairment items	590	620	183	1,811	1,785
Exceptional items	123	—	—	123	678
Income from associates, joint ventures and other investments	(778)	(590)	(100)	(1,821)	(227)
Deferred tax (benefit) / expense	(56)	(226)	580	(447)	842
Change in working capital	(2,896)	(1,901)	1,072	(6,431)	571
Other operating activities (net)	619	238	257	1,100	884
Net cash provided by operating activities (A)	2,442	2,312	1,770	5,751	2,666
Investing activities:					
Purchase of property, plant and equipment and intangibles (B)	(675)	(569)	(520)	(1,863)	(1,771)
Other investing activities (net)	1,184	687	34	2,758	166
Net cash provided by / (used in) investing activities	509	118	(486)	895	(1,605)
Financing activities:					
Net payments relating to payable to banks and long-term debt	(806)	(2,232)	(270)	(3,662)	(889)
Dividends paid to ArcelorMittal shareholders	(28)	(284)	—	(312)	—
Dividends paid to minorities (C)	(157)	(17)	(55)	(239)	(165)
Share buyback	(1,703)	(997)	(13)	(3,350)	(13)
Common share offering	—	—	—	—	740
Proceeds from Mandatorily Convertible Notes	—	—	—	—	1,237
Lease payments and other financing activities (net)	(46)	(250)	(63)	(345)	(181)
Net cash (used in) / provided by financing activities	(2,740)	(3,780)	(401)	(7,908)	729

Source: financial statements

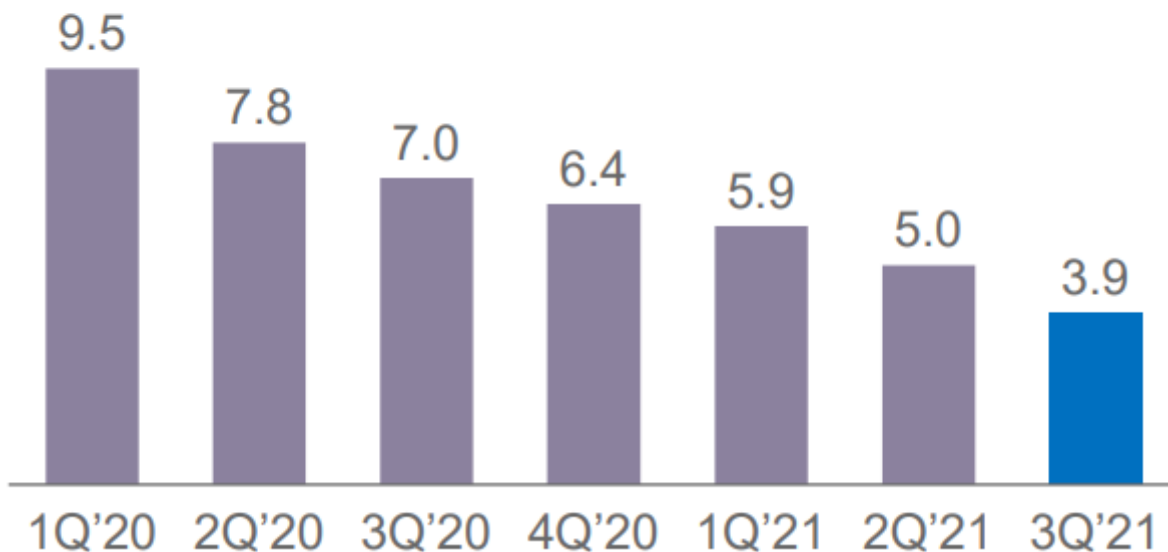
As you can see above, the total capex was just \$675M, resulting in a free cash flow result of just under \$4.5B. This indeed confirms the company's net free cash flow is pretty similar to the reported net income and the small difference is caused by a slightly higher capex versus depreciation expenses.

The balance sheet is now rapidly improving

So while ArcelorMittal is aggressively buying back stock (\$1.7B in Q3 and about \$3.4B in the first nine months of the year), this doesn't go at the expense of the balance sheet. In fact, the net debt is continuously being reduced by ArcelorMittal.

Segment	Site / unit	Project	Capacity / details	Key date / forecast completion
NAFTA	Mexico	New Hot strip mill	Production capacity of 2.5Mt/year	2021 ^(a)
NAFTA	ArcelorMittal Dofasco (Canada)	Hot strip mill modernization	Replace existing three end of life coilers with two state of the art coilers and new runout tables	1H 2022 ^(b)
NAFTA	ArcelorMittal Dofasco (Canada)	#5 CGL conversion to AluSi®	Addition of up to 160kt/year Aluminum Silicon (AluSi®) coating capability to #5 Hot-Dip Galvanizing Line for the production of Usibor® steels	2H 2022 ^(c)
Brazil	ArcelorMittal Vega Do Sul	Expansion project	Increase hot dipped / cold rolled coil capacity and construction of a new 700kt continuous annealing line (CAL) and continuous galvanising line (CGL) combiline	4Q 2023 ^(d)
Mining	Liberia mine	Phase 2 premium product expansion project	Increase production capacity to 15Mt/year	4Q 2023 ^(e)
Mexico	Las Truchas mine	Revamping and capacity increase to 2.3MT	Revamping project with 1Mtpa pellet feed capacity increase (to 2.3 Mt/year) with DRI concentrate grade capability	2H 2023 ^(f)
Brazil	Serra Azul mine	4.5Mtpa direct reduction pellet feed plant	Facilities to produce 4.5Mt/year DRI quality pellet feed by exploiting compact itabirite iron ore	2H 2023 ^(g)
Brazil	Monlevade	Sinter plant, blast furnace and melt shop	Increase in liquid steel capacity by 1.0Mt/year; Sinter feed capacity of 2.3Mt/year	2H 2024 ^(h)
Brazil	Juiz de Fora	Melt shop expansion	Increase in melt shop capacity by 0.2Mt/year	On hold ⁽ⁱ⁾

Net debt (\$bn)



Source: company presentation

In fact, the current debt ratio (net debt versus the trailing twelve month EBITDA) is less than 0.25, a massive improvement compared to the 1.5 ratio as of the end of last year (although we should obviously be mindful the weak performance in the first few quarters of 2020 weighed on the full-year EBITDA result).

This means that there's absolutely no issue for ArcelorMittal to continue to spend its cash on shareholder rewards and additional decarbonization and expansion programs.

Source: quarterly report

Investment thesis

I currently don't have a position in ArcelorMittal anymore, but it's impossible to deny the company's 2021 performance will be absolutely stellar. The adjusted free cash flows will remain strong in Q4 and likely in Q1 as well, and as Arcelor is expecting a working capital release, the net debt will continue to fall off a cliff and could soon reach zero. As the company continues to buy back stock, I think it's very likely ArcelorMittal will end the year at an enterprise value of less than \$30B.

That makes the stock extremely cheap right now, at just around 1.5 times the annualized EBITDA. Of course, we are now likely getting close to the peak of the current cycle and I expect the EBITDA and free cash flow to show a gradual decline from next year on (notwithstanding the higher infrastructure spending planned in some of Arcelor's main jurisdictions), but Arcelor took advantage of the tailwinds this year to rapidly reduce its net debt and prepare its balance sheet for some tougher times.

I may consider writing (out of the money) put options on ArcelorMittal again, but I haven't made a decision yet.

Consider joining [European Small-Cap Ideas](#) to gain exclusive access to actionable research on appealing Europe-focused investment opportunities, and to the real-time chat function to discuss ideas with similar-minded investors!