OVERVIEW:
Co. reported 2Q21 results.
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PRESENTATION
Operator
Good morning, everyone, and welcome to United States Steel Corporation’s Second Quarter 2021 Earnings Conference Call and Webcast. (Operator Instructions)

I’ll now hand the call over to Kevin Lewis, Vice President of Investor Relations and Corporate FP&A. Please go right ahead.

Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A
Okay. Thank you, Tommy. Good morning, and thank you for joining our second quarter call. As you read in our press release and saw in our supplemental materials yesterday, we had a very strong quarter. We look forward to discussing our results, the continued execution of our strategy and our bullish outlook with you this morning.

Joining me on today’s call is U.S. Steel President and CEO, Dave Burritt; Senior Vice President and CFO, Christie Breves; and Senior Vice President, Chief Strategy and Sustainability Officer, Rich Fruehauf.

This morning, we posted slides to accompany today’s prepared remarks. The link and slides for today’s call can be found on the U.S. Steel Investor page under the Events and Presentations section.

Before we start, let me remind you that some information provided during this call may include forward-looking statements that are based on certain assumptions and are subject to a number of risks and uncertainties as described in our SEC filings, and actual future results may vary materially.

Forward-looking statements in the press release that we issued yesterday, along with our remarks today, are made as of today, and we undertake no duty to update them as actual events unfold.
I would now like to turn the conference call over to U.S. Steel President and CEO, Dave Burritt, who will get us started on Slide 4.

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

Thank you, Kevin. Good morning, everyone, and thank you for being with us today and for your interest in U.S. Steel. Our second quarter performance was exceptional and is demonstrating the power of our strategy. Our footprint is positioned better than ever with the optionality to benefit from today's continued robust demand and strong operating performance. We remain optimistic about our future and have so many opportunities ahead.

We are delivering best in nearly every aspect of our business. We are delivering our best financial performance in 2021. We are delivering our best quality performance in 2021, and our employees are delivering their best and maintaining U.S. Steel's industry-leading safety performance. There are no joys in profits unless we keep our employees and our environment safe. So thank you to our employees for embodying our steel principles and for your continued focus on our #1 core value, safety. Safety is first at U.S. Steel.

Our record-setting performance so far this year demonstrates the power of our Best of Both strategy, a strategy that is rooted in product and process innovation so that we can continue to amaze and delight our customers. We can now truly say U.S. Steel, the original iconic Corporation, has its best days ahead. We can't get to the future fast enough. We are executing from a position of great strength, a foundation from which to continue to build and to transition to Best for All. We've made great progress, and I am pleased to provide another update this quarter on our steps forward.

Let's dig into the highlights on Slide 5. Our business is firing on all cylinders and the hard work we put into our business is producing exceptional results. We are safely delivering our best quality and best reliability for customers. Quality for North American Flat-Rolled segment is at record levels. Quality performance for U.S. Steel Europe is at record levels and quality performance for Big River Steel is at record levels.

We've also set new records on reliability and productivity at numerous assets in our portfolio, a portfolio that generated strong earnings, including best margin performance for the enterprise in the second quarter. Our second quarter EBITDA margin was 26%, the best EBITDA margin in our company's history and getting better. Our mini mill segment's 36% EBITDA margin was the best mini mill performance in the industry by far. The bold step we took to acquire Big River Steel faster is generating significant value today. The value of that bold action is further detailed on Slide 6.

When we purchased the remaining stake in Big River Steel, we knew we were buying the best mini mill in the country. But the performance of our Big River team has exceeded even our lofty expectations. Yet again, Big River is outperforming the competition. It’s 36% second quarter EBITDA margin far exceeds other domestic mini mills which further through cycle upside potential from our planned nongrain-oriented electrical steel line investment, which is expected to grow margins even more upon completion in 2023.

Big River is not only the clear financial leader, but it is the example of what best looks like when it comes to profitable steel solutions for people and planet. Big River is a leader in sustainability, a position that was recently validated by Daimler, who awarded Big River with their global sustainability recognition award earlier this month. It is clear that Best of Both is Best for All.

Moving to Slide 7. We've made a lot of improvements to our business with a high sense of urgency. Our goal has never been to be bigger. It’s always been to get better and never satisfied until best. That high sense of urgency to get better has positioned us extremely well to extract value from today's strong market.

You've heard me say we've been bullish for a long time about the potential of this market and my optimism for the future only continues to increase. Expectations for global growth continue to rise, ample fiscal stimulus, a recovering labor market, significant pent-up demand and a continued shift to domestic supply chain resiliency provide tailwinds for the market, along with an infrastructure bill that seems inevitable.

Steel fundamentals are booming, and we firmly believe our business will be stronger for longer. Demand from our customers continues and lead times remain extended. The industry, including here at U.S. Steel, has several planned outages in the second half of 2021. And low steel industry inventory levels suggest an extended restocking period still needs to take place, supporting steel consumption into the future.
The pace of change at U.S. Steel has allowed us to benefit from the sustained market strength we’ve seen over the past several quarters. While some competitive mini mills are adding capacity, we are building to better, not bigger and believe our unique competitive advantages provide opportunities to expand where the market is headed. In under a year, we’ve gone from 0 EAFs in our footprint to now 3 of the newest and most capable EAFs in the country. And in under a year, we’ve announced industry-leading goals that support a more sustainable future for all our stakeholders. Those goals continue to guide our future, a future that we can confidently say will be the Best for All.

Let’s turn to Slide 8. So what is best for all? Best for all is about the customer. Best for all is about the people who work in our facilities, live in our communities, benefit daily from the steels we produce and invest in our future and Best for All is about our most important customer the planet. Simply said, best for all is how U.S. Steel will provide customers with profitable steel solutions for people and planet. Together with our customers, employees, and partners we can contribute to a more sustainable future for all our stakeholders, and we’re already making great progress.

Before I turn it to Christie to discuss our second quarter performance and outlook, let me highlight the progress we’ve made since our last earnings call on Slide 9. We are investing to be a leader in non-grain oriented NGO electrical steel. In June, we announced a planned expansion of Big River Steel to include NGO electrical steels, an investment funded by the substantial free cash flow Big River Steel is generating. This investment is the very definition of best for all.

For our customers, we are meeting you where you are headed with the next most innovative and technologically advanced generation of NGO electrical steel. Our customers deserve a like-minded partner to support their growing fleet of electric vehicles. For our people, we are investing only after a few short months of full ownership of Big River into an asset that is highly differentiated and has strong strategic fit. For our planet, we plan to pursue additional LEED certification for our new NGO line, which will further expand our sustainable verdeX steel brand.

And we will do it profitably, delivering industry-leading technology that we expect to generate approximately $140 million of incremental run rate EBITDA by 2026. Permits are in place, and we are moving forward quickly to get to our future faster. We’ve been able to pull approximately $35 million of CapEx from the project into 2021 and now expect to spend approximately $85 million this year on the NGO line. Our expected total 2021 CapEx budget is now approximately $800 million.

Earlier this week, we closed on the sale of our Transtar short-line rail assets. The sale of Transtar delivers gross proceeds of approximately $640 million and generates immediate incremental value for stockholders. Lastly, we also recently furthered our commitment to sustainability by adding performance targets to our U.S. Steel and Big River Steel revolvers. This action reinforces our commitment to maintain our industry-leading safety performance, lower our GHG emissions and differentiate our operating footprint through responsible steel site certification. We know where we’re headed. And with today’s market conditions as a tailwind we’re getting to the future faster.

Let me hand it over to Christie now to highlight our financial performance. Christie?

Christine S. Breves - United States Steel Corporation - Senior VP & CFO

Thank you, Dave. I’ll begin on Slide 10. Our second quarter adjusted EBITDA was approximately $1.3 billion or 133% higher than our first quarter 2021 performance. This represents an all-time high quarterly EBITDA margin for the enterprise and demonstrates the quality of earnings that our strategy is delivering. We also continue to significantly improve the balance sheet.

As you will recall, we repaid approximately $1.2 billion of debt in the first quarter. In the second quarter, we reduced debt by another $300 million or so through open market repurchases and revolver paydowns. In mid-June, we also announced the redemption of approximately $718 million aggregate principal amount of the outstanding 2025 notes. And yesterday, we announced up to $1 billion of additional debt repayment over the next 12 months.

Year-to-date, we’ve completed or announced as much as $3.2 billion of deleveraging. Deleveraging is a no-regrets decision, and we can delever while also investing in projects that grow our earnings. It’s not either deleveraging or increasing earnings, it’s both.
In June, we were extremely excited to announce our investment in the NGO electrical line at Big River that Dave highlighted in his remarks. We remain focused on deploying capital to assets with existing competitive advantages where we can grow earnings organically. Longer term, we'll continue to align investments with our best for all future, a future where we will be less capital-intensive and less carbon intensive.

Our strategy is not about being bigger, it’s about being better, better for our customers, better for our employees, better for our communities, better for our environment and all of this translates to better results for our stockholders in pursuit of best.

Let me now talk about the second quarter before I wrap up with some comments about the third quarter. So first, in our Flat-Rolled segment. Our North America Flat-Rolled segment posted second quarter EBITDA of $703 million, a 164% increase versus the first quarter. Our strong operating performance enabled the segment to capitalize on today’s favorable demand environment, while keeping its cost profile largely unchanged. We expect the third quarter to be even stronger, both from an EBITDA generation and margin perspective.

In our mini mill segment, Big River Steel doubled its first quarter EBITDA performance from $162 million to $324 million. Higher average selling prices and increased volumes more than offset higher metallics costs. We expect continued strong financial performance in the third quarter.

Our European segment delivered strong financial performance as well. Second quarter EBITDA was $232 million, up 78% from the first quarter as the flow-through of higher selling prices and effective order book management more than offset higher costs from iron ore. We expect similar dynamics to play out in the third quarter, higher selling prices to provide additional EBITDA uplift only partially offset by higher raw material costs.

In Tubular, higher selling prices from growing oil and gas demand was the primary driver to $11 million of EBITDA in the quarter. We expect continued improvement in the third quarter. In the third quarter, we currently expect adjusted EBITDA to set a new quarterly record for the enterprise.

I'll hand it back to Dave for closing comments. Dave?
Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A

Okay. Thank you, Dave. (Operator Instructions) Tommy, can you please queue the line for questions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll get to our first question on the line from Karl Blunden with Goldman Sachs.

Karl Blunden - Goldman Sachs Group, Inc., Research Division - Senior Analyst

I think you've done tremendous work derisking the balance sheet over the last year or so. Good to hear about the $1 billion debt reduction target. When you think about where you could focus that reduction across both the U.S. Steel and Big River Steel bond complex, would be interested in if there's any color you can share about that? I know you do have some callable debt in both structures?

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

Well, thanks for that question, Karl. You can imagine we're thinking a lot about those kind of things. And maybe just recap here a little bit, just to make sure everybody is clear. The no regrets decision is deleveraging and we're also pursuing organic profitable growth from best capability. But if you think about the way we think about this business, I think it's important that you understand, it's about our business priorities to deliver profitable solutions. And we are clearly operating from a position of strength. The market is exceptionally strong. We're operating exceptionally well. And we're continuing to deepen exceptional relationships with customers.

And we've made a lot of progress, and that's why I'm convinced there is so much more that we can do. We can make our business less capital and carbon intensive. We can move more quickly than our competitors. And we know they're not standing still. The pace of change only continues to accelerate, and that's why you keep hearing us say, we want to get to the future faster. And it's the customer relationships that we have. It's all about the customers with the high capability steels that we make, the value-added solutions and it all has to be sustainable. So that's the path we're on and then how do we get there?

Again, thinking about the priority, where we're headed as a company and where we are in terms of our competitive advantages. It's about our iron ore assets, which are the best in the industry. It's about our best-in-class finishing assets and it's about our research, innovation and deep customer relationship, and it's about our newest competitive advantage, the mini mill model at Big River. So that's why we say that deleveraging is no regrets. And you can look at the tiers of debt when it's due and see what those possibilities are.

But for us, the future is about deleveraging and also building the capabilities like the NGO line with Big River Steel and pursuing this best type of possibilities in accelerating ourselves to that. So I want to make sure you understand that context where we are with the strong market, the deleveraging and also the organic profitable growth that we are pursuing, more specifically, getting back to your question on the deleveraging, I'll turn it over to Christie.

Christine S. Breves - United States Steel Corporation - Senior VP & CFO

Okay. Thank you, Dave. I think you said it very well. This is the strategic path that informs our capital allocation priorities. Clearly, we know where we're headed, and we have the opportunity to confidently move forward. To talk more about our capital allocation priorities, in the near term, we're going to continue to delever. As Dave said, that's a no regrets decision. In the medium term, we're pursuing organic growth.
And longer term, we're moving towards our best for all. And we've made progress on each of these areas. In the near term, this $3.2 billion of debt reduction has been announced or completed so far. And we also have announced the state-of-the-art NGO electrical line that's underway at Big River Steel. And we're also producing -- pursuing even more opportunities to get to our best for all faster.

To think about some of the criteria that we use to guide our decision-making, we're looking to lower our capital intensity, our -- lower our carbon intensity. We're looking to expand the competitive advantages that Dave went through. We also are looking to create synergies between these competitive advantages. So we're working to unlock value, so we can be best. And as Dave explained, that's best for our customers, our employees, communities, our investors and best for the planet. And we think when we do all these things that we're talking about here, we will have delivered enduring value for all of our stakeholders.

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

And Karl, and again, getting back to the debt profile, you can see that we don't have any significant debt due until 2025. And I think after that, it's 2029. I think Kevin, you wanted to add?

Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A

Yes. So Karl, I think you touched on it in your question. I think we have flexibility across the entire capital structure as we think about the next $1 billion of deleveraging opportunity. And we're going to apply some pretty simple, I think, practical priorities to identify where we may pursue to delever. We'll look at kind of prepayment costs associated with the debt, what those frictional costs look like. As Dave mentioned, we'll look at the maturity profile and the absolute cost of debt. And those will really be kind of the guiding principles we use. And we're pretty confident that there's about $1 billion of opportunity that we can move quickly on.

Karl Blunden - Goldman Sachs Group, Inc., Research Division - Senior Analyst

Yes. That's very helpful. And you have set it up with some flexibility in terms of the coal prices. Just one quick follow-up. I didn't hear much discussion about M&A and capital allocation plans. I mean it sounds like you have a lot of different things to do organically. Just wanted to get a sense of M&A.

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

No, just let me repeat here because it's deleveraging and organic profitable growth. We're going to be developing profitable solutions for people and planet. So it's about organic growth. We're building capabilities, low on the cost curve, high on the capability curve for our customers.

Operator

We'll proceed to our next question on the line from the line of David Gagliano with BMO Capital Markets.

David Francis Gagliano - BMO Capital Markets Equity Research - Co-Head of Metals & Mining Research and Metals & Mining Analyst

Okay. Obviously, phenomenal numbers in the second quarter and this conversion to a hybrid producer has obviously been very impressive. Clearly, record high prices also helping. So my question is, as far as your strategy in terms of the capital allocation commentary, $1 billion is nice. That's basically the free cash you generated this quarter. What specifically do you plan to do with what's probably going to be $4 billion of cash over the next 12 months? If you can be a little more specific? And if you could read in some commentary regarding where shareholder returns fits into the equation?
David Boyd Burritt - United States Steel Corporation - President, CEO & Director

Well, thanks for that. Again, I'll just reiterate, deleveraging, no regrets. And then the organic profitable growth moving forward here and building the capabilities. So you think about what it is that U.S. Steel is best at, as I mentioned in my remarks, and we believe we have the best mini mill as measured by its performance, especially its EBITDA margin. So you can see us continuing to pursue opportunities with the NGO line that we have at Big River Steel and other possibilities in that space.

Finishing lines are something that we're really good at as well. The PRO-TEC facility that we have partnership with Kobe. We have what we believe is the best finishing line possibly in the world. It's certainly the largest and that is completed and moving forward, and we're getting qualified on new grades of steel there as well. So there's finishing line opportunity. And of course, we also have our world-class mining assets that -- we don't just provide iron ore assets to U.S. Steel blast furnaces, but we also pretty much own the seaborne market and have customers outside of U.S. Steel because of our low-cost position, low-cost curve.

So those are our competitive advantages, and that's where we want to grow. And that's where we're going to grow profit. That's where we want to have the capability.

And so as I look at those 3 areas that you almost feel like a checklist here. Organic growth in those areas that we have the competitive advantages.

David Francis Gagliano - BMO Capital Markets Equity Research - Co-Head of Metals & Mining Research and Metals & Mining Analyst

Okay. And then just as the follow-up. Did you -- are you going to -- are you thinking -- are you considering adding steel making capacity as part of that organic growth? I didn't hear that part, which is I want to clarify steelmaking is part of that?

And then secondly, can you talk about shareholder returns?

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

Well, we -- first on shareholder returns, we believe when we execute well, we perform well, we believe it will be rewarded in our share price. We're focused on, again, making sure that we have the best for all and that doesn't mean getting bigger, that's capability. And so we want to make sure that our best assets are the winner, winners, and that's where we're going to put our money to transition to those things that perform the best for the company. And so don't be looking for us to add a bunch of capacity, look for us to build capability for profitable growth. This business is in transition, best of both becomes best for all.

Emily Christine Chieng - Goldman Sachs Group, Inc., Research Division - Associate

I wanted to touch a little bit on Big River Steel and the raw material strategy here. Can you remind us again or provide a little rough guidance as to how much is being sourced internally within your sort of iron ore business? And how much you have to purchase in the open market?

Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A

Sure. Sure, Emily. This is Kevin. I'm happy to address that. So we've talked about in the past kind of some of those initial value capture opportunities that we've identified now that we are 100% owners of Big River Steel. And that's really manifested itself in the optimization of scrap within the U.S. steel footprint. So that's really where we've been primarily focused is optimizing the flow of home scrap, internally generated prime scrap to our
Big River facility in order to displace some of their more expensive outside purchases. Now that doesn't eliminate their need for outside purchased scrap. It just helps optimize really the cost structure there.

On the iron ore front, I mean, none of the metallics that Big River is consuming are currently being sourced from U.S. Steel, so they're procuring their HBI, pig iron, things like that from the outside market. But as Dave touched upon, core to the strategy is investing in those competitive advantages, looking at our iron ore assets and saying, as we grow the footprint of electric arc furnaces now having 3 in the U.S. Steel footprint, how do we use those iron ore assets to benefit the EAF, and that's certainly an area of opportunity, as Dave highlighted, to extract incremental value across the enterprise.

Emily Christine Chieng - Goldman Sachs Group, Inc., Research Division - Associate

And one follow-up, if I may. Given where steel prices are in sort of the healthier outlook for the broader U.S. steel industry, maybe give us some color around the updated outlook for blast furnace at Granite City. Should we anticipate this to be more or less indefinitely idled or is there a certain price environment or demand environment where you would reconsider sort of the operational status of blast furnace A there?

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

It will be indefinitely idled.

Operator

We'll get to our next question on the line from the line of Sathish Kasinathan from Deutsche Bank.

Sathish Kasinathan - Deutsche Bank AG, Research Division - Research Analyst

My first question is on the annual automotive contracts, GEN3/automotive OEMs and what's your expectation for 2022? I understand it's still early stages, but would appreciate any color given the significant move in the underlying spot pricing?

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

Well, thanks for that. And our discussions with our customers are ongoing. These aren't events. These are continuous dialogues and understanding of what their needs are. And I would say all of us have seen in this industry, everyone, a big pivot towards decarbonization. And that's certainly top of mind for them. So the types of steel that we're able to make, the advanced high-strength steel, the Generation 3 steels and most recently, the verdeX, the green steel that we've trademarked are definitely the kind of discussions that we're having. And we're not about out-negotiating our customers, we're about partnering with our customers. And they understand like we understand that the prices will ebb and flow and the prices are very high right now, and we'll work with them to the mutually beneficial solution that we can win together over the longer term.

If you think about the unique value proposition that we have for our customers, you think about Big River Steel, we had 3.3 million tons of low GHG emission steelmaking in our portfolio. So U.S. Steel is the only company producing Generation 3 advanced high-strength steel. So this is something that commands a premium and delivers on their decarbonization goals. And so while our negotiations are continuous and ongoing, we do, as we've said, stronger for longer, better days ahead. In fact, later it's going to be greater because the strength of this market is clearly enduring. Certainly, in the short term, we're going to have records. We expect records this next quarter, all-time records for the company. And each time people predict that the prices are going down, we see just the opposite. At some point in time, we do know that there will be more of a reversion to mean, but more likely than not, it's probably going to be reset at a higher number than in the past, given the fiscal stimulus, given the Fed's monetary policy, given that the infrastructure bill is inevitable and the strength of the comeback from this economy seems to be enduring.
And we’ve certainly seen that in every prediction about this cycle being short-lived has been debunked. It’s definitely in a good place and we expect prices to hold for quite some time.

Sathish Kasinathan - Deutsche Bank AG, Research Division - Research Analyst

Okay. That’s helpful color. Just one follow-up on the raw material strategy for Big River. Given the tightness in prime market -- prime scrap market, are you maybe looking at restarting one of the idle blast furnaces or converting the operating idle -- operating blast furnaces to supply pig iron to Big River? Is that something that is being considered?

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

Well, sometimes I wonder if you’re actually in the rooms that we’re discussing because this is certainly a hot topic for everybody that’s got a mini mill. Let’s face it. The thing that keeps mini mills up at night is their metallic strategy and where are they going to get the scrap and the iron ore longer term. The good news for us is being vertically integrated and having this world-class mine site. We have the opportunity to create a pig machine. We have several locations that it’s possible to do that with. And that’s certainly something that’s under discussion as we transition towards Best for All.

Operator

We’ll take our next question on the line from Carlos De Alba from Morgan Stanley.

Carlos De Alba - Morgan Stanley, Research Division - Equity Analyst

So the question I have is if you could be -- maybe give us more color on when do you -- how do you see dividends in your capital allocation policy? And at what stage in your deleveraging, which has obviously been quite strong and will continue to be? And given the fact that you are well funded in your pensions, at what stage would you consider maybe returning more money directly to shareholders yes either dividends or share buybacks?

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

Well, I think there’s no doubt that longer term, those are things that are going to be on the table. But for the current situation where we are right now, we think that the deleveraging is no risk and then also investing in organic growth, organic expansion of EBITDA is the right solution that will give the best returns to our stockholders, especially the longer-term stockholders.

Carlos De Alba - Morgan Stanley, Research Division - Equity Analyst

And on the sort of CapEx but away from organic growth, how do you see in the coming years, the level of maintenance CapEx or sustaining CapEx that you need to deploy to keep your assets in good shape or to sort of maybe take them up a notch?

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

Well, that’s another really good question because a couple of the challenges that this industry has is on decarbonization and reducing capital intensity. That’s certainly something that’s front and center for us as we pursue best of both and make the transition to best for all because we do believe that we’re on that path to become a lot less capital intensity -- intensive as we focus on those high competitive advantages that we have as a company. So the business is definitely in transition. The business is definitely in a really good place to deploy capital on those assets that perform the best for our stockholders. And that’s because they’re the ones that perform the best for our customers. It’s a green world. It’s a sustainable world that we have to go after.
And so long as our customers are demanding that we go green and we have to help them hit their targets. We're all in on that, and we'll invest in those assets that will get us there faster. And that means just by the very nature of what our customers are demanding, we are going to be less capital intensive.

Christine S. Breves - United States Steel Corporation - Senior VP & CFO

Dave, I'd just add, when you look at sustaining capital, we really like the mini mill model. Sustaining capital, for example, this year is going to be about $20 million at Big River Steel compared to about $460 million for us for the legacy U.S. steel plants. I mean tremendous difference. So we really like what we're seeing there. And we will be moving more in that direction.

Operator

We'll proceed to our next question on the line. It's from the line of Andreas Bokkenheuser from UBS.

Andreas Bokkenheuser - UBS Investment Bank, Research Division - Executive Director, Head of LatAm Mining & Basic Materials and Research Analyst

A quick question on your near medium-term production outlook of volume growth potential. Looking at your financials, I think you reported raw steel, flat-rolled capacity utilization at about 59%, which by my count includes the idle capacity at Great Lakes and Granite City in the denominator. So correct me if I'm wrong, if we kind of take that out, it looks like flat-rolled capacity utilization was more like 85%. And that makes me kind of wonder, do you have the ability -- assuming my math is correct here, but do you have the ability to go from 85% closer to like mid-90s, late 90s percent over the next 12 months and then get more volumes into the market?

Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A

Sure. Thanks, Andreas, this is Kevin. Your math is indeed correct. For everybody's benefit, the idled capacity we have in our footprint is included in the denominator of that calculation. So if you were to adjust for those 3 furnaces being off-line, in addition to the outage that we took in the second quarter at the Mon Valley, our utilization of our kind of operations in North American flat-rolled was closer to the mid-80s, 90% range. As a blast furnace producer, the 90% range is a very, very good level of utilization for our assets.

So there could be some incremental maybe shipment volume as we look into Q3, but it's not going to be a lot. And we think we can probably push shipments a little bit higher in our mini mill segment as well. So I'd expect that there'll still be some kind of quarterly volume growth here in the U.S. across both our integrated footprint as well as in the mini mill segment.

Andreas Bokkenheuser - UBS Investment Bank, Research Division - Executive Director, Head of LatAm Mining & Basic Materials and Research Analyst

That's very clear. And maybe one follow-up, if I may. Just going back to the pig iron question. If you could kindly remind me Big River, whether Big River consumes prime scrap? And if so, if the mill does, do you have the ability to reduce or completely remove prime scrap in the furnace and replace it with pig, given all the talk about the prime scrap market being tight in years to come, do you have that ability to replace? Or do you need some prime in the furnace there?

Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A

Yes. Yes. Thanks. So the metallic mix that we're currently seeing at our Big River operation is really about 65% scrap, 35% scrap substitute, so other virgin metallics. And obviously, as our metallic strategy continues to evolve, there's going to be some level of optimization that's going to occur. So whether that's the continued transfer of internally produced prime scrap to Big River or becoming more self-sufficient on some of the Virgin
Metallic units. I think those are all things that we will continue to look at that will only enhance I think the burden on the furnaces down at our Big River operations and could unlock some additional raw material cost savings moving forward.

**Andreas Bokkenheuser** - UBS Investment Bank, Research Division - Executive Director, Head of LatAm Mining & Basic Materials and Research Analyst

Okay. So it's really -- is it fair to say it's more of a profit maximization strategy that depends on whether you consume pig versus prime? I mean, there's no technological obstacles from reducing prime in the furnace, is that the correct way to think about it?

**Kevin Lewis** - United States Steel Corporation - General VP of IR and Corporate FP&A

I think it's certainly -- you're always -- the customer is everything. So you're going to make sure you produce the right chemistries and products and make sure you have the right inputs to get there. But it's certainly cost, productivity become key considerations when you think about how you burden the furnace moving forward. So I think we have some options to certainly continue to improve. And metallics is going to be, I think, a big value driver moving forward as the footprint of EAF grows and we continue to optimize what we have in our Tubular segment as well as the 2 furnaces there at Big River.

**Operator**

We'll get to our next question on the line from Tristan Gresser with Exane BNP Paribas.

**Tristan Gresser** - Exane BNP Paribas, Research Division - Research Analyst

Just one, please. Yesterday, one of your peers in the decarbonization CapEx figure and -- he also asked you to reduction target and decarbonization strategy. Have you already estimated the timeline with any CapEx associated with those targets? And more specifically in Europe, where probably you feel more the pressure of carbon costs at the moment, would you consider switching to a DRI/EAF production method?

**David Boyd Burritt** - United States Steel Corporation - President, CEO & Director

Yes. Thanks for that question. And I would think the answer would be, of course, when you decarbonize, it's going to take a planet to make the improvement. So we get approached frequently for partners to find ways, creative ways to decarbonize. And our Slovakian operation, we've been there for a very long time. It's a large operation with over 9,000 employees, and we work closely with the government. We work closely with our suppliers and we're looking at possibilities for us to partner together to create an enduring future that means everybody comes together to make the facilities become more green. And that's the beauty of this BHAG, the big hairy audacious goal for 2050.

It's going to take companies and counties and countries and all coming together in a unified way to get the advantages and yes that's another reason why steel prices will be stronger for longer because there will be additional expenses that will come and those additional expenses are things that we will be collaborating on and building partnerships in order to get to this wonderful greener future that saves the planet. So we're pretty pumped up and excited about how we're working well together, whether it be in Slovakia or even more recently, we're encouraged by the work that's happening right here in Allegheny County. There's a higher degree of interest in decarbonization. There's a higher degree of interest in what it takes to keep a strong manufacturing base in the United States.

We're thrilled, frankly, with build back better with Biden on this because the -- I think the future with this infrastructure bill is going to be breakthrough for manufacturing in the United States. We'll have to see how it plays out, but it's going to be a collaborative effort. And when people work together, again, countries and companies and counties, we end up in a much better place. So we're excited about the potential for our industry and also for the planet.
Go to our next question on line is now a follow-up question from the line of David Gagliano from BMO.

David Francis Gagliano - BMO Capital Markets Equity Research - Co-Head of Metals & Mining Research and Metals & Mining Analyst

I just wanted to ask a quick follow-up on the commentary around Slovakia. Can you talk a little bit about the capital spending needs there to make it a greener operation? And then also just unrelated. If you could just talk a little bit about demand destruction risk or if you’re seeing anything like that with regards to steel prices being this high in any of your key end markets?

Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A

I can certainly address the demand question, David, and then maybe I’ll ask Rich to comment kind of on USSK and how we think about decarbonization from there. But on the demand side, we’ll be honest, we’re not seeing really any weakness in the order book. I think we continue to have really robust order books, continued strength in consumer-driven end markets like appliance, construction. And we think that obviously, the automotive supply chain has been disrupted a bit here in the near term, which only means that there is some pent-up demand that will eventually be unlocked as the supply chain resiliency works its way up. But everything we’re seeing, our lead times remain extended, we’re seeing continued positive momentum in the order book with really no weaknesses to be found.

But maybe, Rich, I’ll hand it over to you to talk a little bit about USSK.

Richard L. Fruehauf - United States Steel Corporation - Senior VP and Chief Strategy & Sustainability Officer

Yes. Sure. Thanks, Kevin. So I think it’s interesting to think first in Europe, you’ve got basically 2/3 blast furnace, 1/3 EAF, which is the reverse here of what we’ve got in North America. When we think about decarbonization in Slovakia, as Dave said, we have a great partnership with the Slovak government because of the role USSK plays in the Slovak economy. Looking at the opportunities there, the Europeans are, I’d say, further ahead than the United States in terms of public-private partnerships. You look at what’s going on in Sweden with hybrid and SSAB and Vattenfall and the iron ore partner of that group LKAB and the Swedish government, the EU.

So when we think about decarbonization of USSK, it’s going to be probably need to be a public private partnership. And there are opportunities there when you look at electric arc furnace technology. You’ve got to assume that you’ll get DRI and scrap in sufficient quantity and the right electricity rates. But there’s a lot of opportunity there just from any potential switch over to EAFs, which are roughly 25% of the carbon emissions, the GHG emissions from an EAF versus a blast furnace. So you look at that, and you’re going to have to figure out how to get that partnership with the Slovak government if we’re going to decarbonize USSK.

David Francis Gagliano - BMO Capital Markets Equity Research - Co-Head of Metals & Mining Research and Metals & Mining Analyst

Is there a timeline around that decarbonization initiative and potential EAF swap in Slovakia?

Richard L. Fruehauf - United States Steel Corporation - Senior VP and Chief Strategy & Sustainability Officer

I wouldn’t say there’s a timeline. Obviously, with the efforts in the EU to accelerate their EU-wide decarbonization goals, things are accelerating in Europe. So we have to think about that as we plan for the future of USSK.
Carlos De Alba - Morgan Stanley, Research Division - Equity Analyst

I just wanted to follow up on the assumptions for the EBITDA generation of the NGO investment. Is there any way you can provide color behind the realized price that you're assuming for the EBITDA generation? And is it fair to assume that also the ramp-up that you provided on your EBITDA is the sort of ramp-up that you expect on volumes?

Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A

Yes. Thanks, Carlos. This is Kevin. So on the ramp-up of volumes, I think one of the really attractive things about this project and why we're really excited, this is a growing market, right? So the EBITDA ramp-up that you see not only is a portion of how is the asset itself going to ramp up from a productivity perspective, but also how are we going to be able to participate in that growth with our customers, right? So that's driving a bit of the ramp-up, in addition to the assumed utilization of the facility.

From a pricing perspective, what we did to drive -- to determine the incremental EBITDA as we looked at through-cycle HRC prices and what's the normal spread between a value-added product like NGO to an HRC price, and that's what’s really driving the incremental $140 million of improvement. So it's kind of the mix effect of elevating the value add of the NGO that's generating our assumptions around run rate EBITDA.

Matthew Wyatt Fields - BofA Securities, Research Division - Director

I wanted a quick one about your ABL. I noticed that you amended it to include some sustainability targets, but you also shrunk it to $1.75 billion. You've gotten bigger with the acquisition of Big River Steel. I understand there's a lot of seasonality in the business and you use this facility. Like I was just wondering why you wanted to shrink the ABL instead of keeping more financial flexibility on that thing? I know you're deleveraging. I know you can invest in both and everything's going great, but why a smaller one?

Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A

Yes. Thanks, Matt. So I mean, we really looked at what's the efficiency of that ABL, which is our kind of legacy ABL. So Big River has its own credit facility, which was extended for an additional 5 years. So when we looked at our domestic kind of legacy revolver, we were solving for efficiency and also making sure that we had full access to it throughout all points of the industry cycle. So what you've seen in the past is we've entered something that was below through cycle. We've lost some access to the ABL. So in our mind, it didn't make sense to have the bigger one given the downside access to liquidity was more limited. So we solved for efficiency, and we think this is the right size to fit the footprint we have now.

Matthew Wyatt Fields - BofA Securities, Research Division - Director

Does the new ABL -- haven't seen a credit agreement yet. Does the new ABL not have that covenant where you lose kind of 10% access below a certain coverage ratio?
Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A

So I think that based on the footprint that we have losing that downside protection is less like -- downside access is less likely now that it's a smaller facility.

Matthew Wyatt Fields - BofA Securities, Research Division - Director

Okay. And then there's been a lot of talk about the raw material investment on the mini mill side. Now that you do have 3 EAFs, 1 million tons of iron substitute is a lot. Is it more than just a pigging machine? Is it some kind of investment in HBI or DRI or a recycling infrastructure that you need across your footprint now that you sort of have EAF as a more substantial part of your footprint?

Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A

Yes. It's a good question, Matt. And obviously, the mini mill footprint has become a more integral part of U.S. Steel. It's certainly an important consideration. I think we are uniquely positioned to target very purposefully all sorts of different metallic strategies. So if you think about a pig iron strategy, it's leveraging existing blast furnaces in the footprint. It doesn't require as much upfront capital in order to execute.

So it can certainly be something we move more quickly on in the near term. When you think about longer term, you're talking about HBI, DRI, it's not something that we're going to certainly roll out. I think it could be an important part of U.S. Steel moving forward, but I would think about them almost potentially sequentially with pig iron maybe be the more near-term opportunity at the right time.

Matthew Wyatt Fields - BofA Securities, Research Division - Director

And then any kind of recycling operation, either you purchased or you kind of build from scratch. What's the outlook on that?

Kevin Lewis - United States Steel Corporation - General VP of IR and Corporate FP&A

Yes. I think we're -- yes, I think we're mostly focused, Matt, on as Dave talked about in his remarks, is investing in existing competitive advantages. Iron ore is the existing competitive advantage, and that's where we'd look to allocate capital. I think more so than starting something new.

Operator

I'll now turn the call back to U.S. Steel's CEO, Dave Burritt, for any closing comments.

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

Well, thanks, everyone, for joining us this morning. These are exciting times for U.S. Steel. And I want to conclude by thanking our customers and employees. So to our customers, thank you. Thank you for your partnership and trust, and thank you for the opportunity to provide the sustainable steel that turns your visions into reality. We look forward to what we can achieve together.

And to our employees, thank you for delivering record performance in the second quarter. Stay focused on what you can control, working safely and producing quality products that delight our customers time and time again. Your commitment to your fellow coworker and the customer is what makes U.S. Steel the best. Now let's get back to work safely.
Operator

Thank you. And that does conclude the conference call for today. We thank you for your participation, ask you to disconnect your lines. Have a good day, everyone.