Cleveland-Cliffs, Inc.
Second Quarter 2021 Earnings
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Presenters
Lourenco Goncalves, Chairman, President, & Chief Executive Officer
Keith Koci, Executive Vice President & Chief Financial Officer

Q&A Participants
Phil Gibbs - KeyBanc Capital Markets
Lucas Pipes - B. Riley Securities
Tristan Gresser - Exane BNP Paribas
Matthew Fields - Bank of America
Karl Blunden - Goldman Sachs
Sean Wondrack - Deutsche Bank

Operator
Good morning, ladies and gentlemen. My name is Diego, and I am your conference facilitator, today.

I would like to welcome everyone to Cleveland-Cliffs Second Quarter, 2021, Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question-and-answer session.

The company reminds you that certain comments made on today's call will include predictive statements that are intended to be made as forward-looking within the Safe Harbor Protections of the Private Securities Litigation Reform Act of 1995.

Although the company believes that its forward-looking statements are based on reasonable assumptions, such statements are subject to risks and uncertainties that can cause actual results to differ, materially.

Important factors that could cause results to differ materially are set forth in reports on Forms 10-K and 10-Q and news releases filed with the SEC, which are available on the company website.

Today's conference call is also available and being broadcast at clevelandcliffs.com. At the conclusion of the call, it will be archived and on the website and available for replay.

The company also discusses results, excluding certain special items. Reconciliation for Regulation G purposes can be found in the earnings release, which was published, this morning.

At this time, I would like to introduce Cliffs Executive Vice President and Chief Financial Officer, Keith Koci.

Keith Koci
Thanks, Diego, and good morning everyone. Our second quarter numbers for revenue, net income and EBITDA were all quarterly records. They clearly demonstrate our operational and commercial success in integrating the two acquisitions into Cleveland-Cliffs, as well as a sustainable steel environment supported by strong and resilient demand for our products.

This being said, our Q2 record numbers: revenue of $5 billion; net income of $795 million; and adjusted EBITDA of $1.4 billion, should not be our all-time records for long.

With the lagged and fixed pricing mechanisms we have in place with our customers, we have enough visibility to be confident that these records should be broken again, here in the third quarter.

Drilling down, specifically, on our adjusted EBITDA, the $1.4 billion performance represented a 165% increase over the past quarter, primarily due to increased steel pricing, fixed-price contract improvements, favorable product mix and higher volumes.

Unlike most of the American steel industry, we have been relatively well shielded from inflationary force, thus far, due to our self-sufficiency in raw materials, namely pellets and HBI. More specifically, our overall cost per ton barely moved, compared to the first quarter.

In the steelmaking segment, we sold 4.2 million net tons of steel products, which included 33% hot-rolled, 17% cold rolled and 30% coated, with the remaining 20% consisting of stainless, electrical, plate, slab and rail.

Due to lighter automotive demand pool related to the chip shortage, we were able to sell more tons of higher-margin material into the spot market.

Direct automotive shipments were about 1.2 million tons during the quarter, about 300,000 tons less than what we anticipated back in March. This contributed to an inventory build of about $300 million during Q2, which along with rising receivables, due to rising prices, produced another working capital build, during the second quarter.

Our free cash flow generation will certainly be further increased in the third quarter. We expect to generate $1.4 billion in cash from our expected $1.8 billion in adjusted EBITDA for the third quarter.

These numbers result from continued rise in prices on our HRC linked contracts and spot sales, offset by higher employee-related costs and the planned outage at our largest blast furnace, Indiana Harbor Number 7. Furthermore, we are increasing our full year adjusted EBITDA guidance to $5.5 billion.

Our free cash flow expectation still includes minimal federal cash tax disbursement, as a result of our NOL position. Given our immense profitability so far this year, we have been able to effectively utilize our sizable NOL balance and we'll continue to utilize it for the rest of the year.

With these NOLs rapidly being used, we expect to become a federal cash taxpayer again at some point either later this year, or early next year.

Our main priority with this free cash flow continues to be the pay down of debt. The level of free cash flow we are expecting has created a generational opportunity to completely de-risk our balance sheet, and we are taking full advantage.

In the second quarter, we made open market bond repurchases and completely redeemed the remaining $400 million of our 2025 unsecured notes, the only bond we had that was callable, this year.

Our debt-to-cap ratio is currently at a nine-year low, and we have already repaid another $455 million in debt, during just the first 20 days of July.

As the year progresses and into next year we will be rapidly and methodically reducing our debt balance, and we expect to reach net debt zero, sometime next year.

With that, I'll turn it to Lourenco.

Lourenco Goncalves
Thank you, Keith, and good morning to everyone. The best way to understand the new Cleveland-Cliffs is by comparing Q2 results with Q1.

Our revenue line increased by $1 billion, and our cost of goods sold increased by just $100 million.

The seamless and complete integration of both AK Steel and ArcelorMittal USA into Cleveland-Cliffs has generated a new and very efficient business model, geared toward value creation.

Demand for steel is very strong across all sectors, and strong demand supports strong prices. Q4, 2020, was supposed to be the peak for steel prices, then Q1, 2021, and then again in Q2. Well, we are in Q3, and the reality is demand is relentless.

Most of our customers are experiencing record profits and learning that higher prices are good for pretty much everyone in the supply chain. Actually, some of the customers who were complaining earlier this year about rising steel prices, then turned around and decided to accept the reality. They cut deals with Cleveland-Cliffs at that time and are now just plain happy. Others probably will be unhappy for a long time.

Also, as new electric arc furnace capacity continues to be brought to operation in the United States and abroad, the notion that prime scrap is precious metal will be better understood. Iron ore fundamentals are strong as well, keeping the price of pig iron imported by the mini-mills elevated and also pushing up the pricing of steel offered by foreign sources.

Russia is restricting exports of ferrous materials including pig iron, of which they are the largest exporter of to the United States. China continues to say that they want to cut emissions, which they can do by either cutting steel production to reduce sinter usage or using more scrap, or both. With all that, the trend on the price of prime scrap is also upward.

Separately, investments towards decarbonization will need ROI, return on investment, unless you operate in Europe, in Japan, or in Canada.

The steel companies in these countries and continent are being awarded general subsidies and free money like the grants. Canadian and European steel producers are so happy to advertise as they get their gifts and handouts from their respective governments.

That's another compelling reason why imports need to be held in check, as other countries take advantage of a totally uneven playing field with their much worse environmental performance than ours in major government subsidies that we don't get here in the United States. China is not our only problem; our so-called friends are bad, too.

While all of our relevant Q2 figures represent company records revenue, net income adjusted EBITDA, I would argue we haven't reached our full potential, yet.

Due to previously agreed upon sales contracts so far this year, we have sold a significant chunk of our volume, well below price levels that would make us comfortable.

Our most important commercial priority through the end of this year will be to improve these contracts.

We know the real value we provide to the clients, including but not limited to our ability to manage complex just-in-time requirements in several different highly specified products.

We also know the unique technological capabilities that we have and the limitations of others in the steel industry that cannot match what we do, particularly, at the massive scale that we do.

Simply stated, it's time to be awarded a better return on our capital invested to serve these clients, and we are well underway to achieve that. Being the largest supplier of steel by a lot to the automotive industry, we are obviously affected by the supply chain issues they have experienced, all related to things other than steel.

Nevertheless, our Q2 results were actually better than our guidance, among other reasons, because we were able to take advantage of the reduced demand from these customers and managed to divert automotive volume to spot buyers or to other contract clients willing to pay market level prices.

When stated like that, it sounds simple. But reorganizing both the melt schedules and deliveries of these materials was a challenge that our team did a great job overcoming, during the quarter. Even with all the difficulties in finding available rail cars, trucks and truck drivers during the quarter, we were still able in Q2 to increase our shipment volume, in comparison to Q1.

One thing that should not be holding up anything any longer is COVID-19. Brilliant scientists have developed not one, but several, truly groundbreaking vaccines that would stop the virus in its tracks and any current variants. But we need enough people taking the vaccines.

With the safety of our workforce always a top priority, earlier this month, we instituted a company-wide vaccination bonus program that offers a cash bonus of $1,500 to each vaccinated employee, if the level of vaccination of their working sites achieves 75%.

If the level of vaccination of the site achieves 85%, the cash bonus paid to each employee of the site doubles to $3,000. Upon announcement of the program, we saw an immediate uptick in vaccination rates. And some of the locations are already at the first threshold with two locations already at a second threshold of 85%.

Protection from the virus is just as important as any other safety mandates we have in any of our locations, and we are willing to spend real money to ensure each of our facilities reach herd immunity.

In order to meet current market demand, our assets need to be well staffed and well maintained. This process involves preplanned maintenance outages, including the one taking place at Indiana Harbor, later in this quarter, from September 1 to October 15.

Indiana Harbor Number 7 is the largest blast furnace in North America and for reference produced 33% more hot metal, per day, than our two blast furnaces at Cleveland works, combined.

The outage includes repair to two BOF converters in the steel shop and a partial reline and several upgrades to the blast furnace. Some of these upgrades are related to our ongoing work towards decarbonization, such as further enhancements to our ability to use massive amounts of both HPI SP stock and natural gas as supplemental reduction at Indiana Harbor Number 7 blast furnace.

Another success story of the past quarter is our Toledo direct reduction plant. We reached our nominal capacity, within six months of start-up. And thus far in July, we are producing at a 2.1 million tons annualized rate, well above nameplate of 1.9 million tons, per year.

Our timing could not be better. Prime scrap is scarce. And every day the price of scrap goes up, our cost savings from HBI becomes more significant.

On top of that, we have actually used the vast majority of our internally consumed HBIs in our blast furnaces, enhancing hot metal output and allowing us to capture additional margin on incremental steel tonnage produced and sold to clients.

Along with the productivity benefits, this action alone, reduced our implied carbon emissions by 163,000 tons, during the quarter.

Direct reduction and DR-grade pellets are critical to the future evolution of a clean and environmentally friendly steel industry.

Cleveland-Cliffs sees decarbonization as part of our license to continue to exist. As you can see in our recently published sustainability report, we are well on our way to achieving our targets, through the combination of natural gas usage, HBI production, and internal usage and carbon capture.

There's a lot of talk about hydrogen as a reduction in Europe with little recognition that we already use hydrogen in the United States, through the use of natural gas.

Natural gas composition is 95% CH_4 methane and 4% C_2H_6 ethane. Natural gas is used in our blast furnaces as a partial replacement for coke. That means we emit good old H20, when we reduce our iron ore. And CO_2 emissions are cut by more than half, when compared to reduction exclusively by coke or coke plus PCI.

Also, our direct reduction plant uses 100% of natural gas, as a reduction. The total amount of natural gas we currently use in our eight blast furnaces and in our direct reduction plant, eliminates the need for 1.5 million tons of coke per year, the equivalent of two coke batteries.

And we continue to explore and increase the use of natural gas, throughout the entire footprint.

Hydrogen is promising, actually, our direct reduction plant was designed and built to be able to use up to 70% hydrogen. But in order to make hydrogen a viable reduction, serious cost improvements and breakthrough technical developments are still needed.

Europe does not have abundant natural gas, other than in Russia. So, they have embraced the hydrogen route, even with the current uncertainty surrounding the economical use of hydrogen.

That might not take them anywhere as far as emissions control, but is actually a great shortcut for free money and more subsidies from government to companies. And we all know how these things end.

Replacing blast furnaces with EAF is not a solution either. There are technical reasons. No major steelmaking nation runs entirely on EAFs.

When producing flat-rolled steels, EAFs need a significant amount of virgin material like pig iron, prime scrap, DRI, HBI and even oxygen injection just to try to mimic the blast furnace BOF route. In reality, even here in the United States, soon to achieve 75 participation of EAFs, we may be near a peak, particularly, if further investments in direct reduction are not made.

Just don't count on Cleveland-Cliffs for that. This ship has sailed, when we acquired ArcelorMittal USA and AK Steel, and successfully integrated both into a single unit company named Cleveland-Cliffs.

At this point, we are very comfortable using our DR-grade pellets to, exclusively, supply our plant in Toledo, and our blast furnace grade pellets to supply our own blast furnaces.

To wrap-up, Cleveland-Cliffs is doing well, actually very well. As of today, our leverage is already below one time EBITDA. And we expect to be at net debt zero, sometimes next year.

With that, I'll turn it over to Diego for the Q&A. Diego, please.

Operator
Thank you. And at this time, we'll be conducting our question-and-answer session. If you would like to ask a question, please press "*", "1", on your telephone keypad. A confirmation tone will indicate that your line is in the question queue.

You may also press the "*" key, followed by the number "2", if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset, before pressing the "*" key.

Once again, to ask a question, press "*", "1", on your telephone keypad.

Our first question comes from Phil Gibbs with KeyBanc Capital Markets. Please state your question.

Phil Gibbs

Hey, good morning.

Lourenco Goncalves
Good morning, Phil.

Phil Gibbs
Lourenco, I had a question just on the automotive piece of the equation. I think the revenues declined there a little bit, and you mentioned some chip issues impacting production.

How is that evolving as you look into the back half of the year? The automotive supply chain has been kind of tough to read from our vantage point.

Lourenco Goncalves
Yeah, I agree. You can only read what you get good information. And they are not really sharing very good information, because we, at this point, Phil, we here at Cleveland-Cliffs, we're no longer relying on, by and large. Of course, there are exception.

Some of our clients are better than others. But by and large, we rely on our own assessment of how they are going to pull from the just-in-time inventory because they are always from the outside standpoint, overly optimistic. But actually, they are hedging their position just in case they get what they need and then they will need the steel.

But on the other hand, our commitment primarily is with our shareholders, and we can't just play with that.

So, that's why we moved a lot of tons in Q2 from automotive to other clients and that was a good thing for us. Something that we can only accomplish if you are managing a fully integrated and a synergetic company like the new Cleveland-Cliffs.

So, what's my view? Yes, things will get better. They will not get worse. They will get that. But you always take lessons from situations. And this serious things that they put themselves on with microchips, between the microchips being the tip of the iceberg shows that the supply chain is pretty weak and it's too complex.

So, I assume that going forward they will--they being the automotive OEMs--they will start to manage their supply chains a little better with more emphasis on real things like being close to the supplier, understanding that short term is better not rely on part that is mandatory.

So, I'm very optimistic that things will get better.

Phil Gibbs
Okay Lourenco. And then as we look at the third quarter, I know you've got some scheduled maintenance. Is that from an incremental standpoint versus the second quarter kind of a

transitory cost headwind for you all as you have more maintenance in there, or is that really not a factor?

Lourenco Goncalves
It's minor--it's minor. And at the end of the day, what matters is that all numbers that we gave as guidance, they are already embedding all these things. So, we are talking about $1.8 billion EBITDA in Q3.

And Keith Koci just released our full year guidance of $5.5 billion for 2021. So, that implies another $1.8 billion EBITDA in Q4. So, all these two numbers Q3, Q4 EBITDA of $1.8 billion are set in stone at this point the way we normally do our assessment, and all these cost fluctuations are taken into consideration.

The important thing is that a lot of the reliability that the clients are seeing, right now, and the way we supply from our big footprint is already a consequence of how we approach maintenance.

We are taking very good care of the assets that we acquired, and we are playing extremely well with production planning and making sure that we are prepared for all the plant outages. For example, this one in the Indiana Harbor 7 with a 45 days duration, we of course, already built a lot of slab inventory.

And a lot of what you see in cash flow is related to that cash flow in Q2 because we have to prepare for this outage. Otherwise, the clients would not be taken care of.

So, our holistic approach to the footprint, our way our technical and a matter-of-fact approach on how to deal with the assets is a big change. I think it's a very welcome change to this industry since we acquired the assets that we did, last year.

Phil Gibbs
Thanks. And if I could ask just a follow-up just on the guidance that you guys have provided, the $5.5 billion. There's some puts and takes. What's the expectation for hot rolled for the rest of the year in that equation? Thanks guys.

Lourenco Goncalves
We are using the curve that we have available to us with--from the commodity stacks of the big banks. And we are sticking with the same way and assessment that we used before. So, there is nothing very negative about; there is nothing overly positive about.

We just are using the forecast, the same forecast that you and other research analysts probably used, using the fourth curve of the commodities that's of the big things.

Phil Gibbs

Thanks, Lourenco. I appreciate it.

Lourenco Goncalves
All right. Thank you, Phil.

Operator
And our next question comes from Lucas Pipes with B. Riley Securities. Please go ahead with your question.

Lucas Pipes
Hey, good morning everybody. And congratulations on another really strong quarter and a very positive outlook, from my perspective.

Lourenco Goncalves
Thanks, Lucas.

Lucas Pipes
Lourenco, I wanted to touch a little bit on the net debt target of zero. It makes all the sense in the world to me. But maybe the market could benefit from getting an explanation from just what is the strategic rationale for a net debt zero target? Thank you very much for your perspective.

Lourenco Goncalves
Look, Lucas, first of all, net debt zero in a cyclical industry is something that should not cause anyone surprise. That's the very first thing. We--I have been in this business for four decades. I have seen everything: the good, the bad, the ugly, the surprising, the boring, everything.

But one thing that you cannot deny is we are in a position of strength, from a balance sheet standpoint, you are a lot better, and you are a lot more likely to survive any downs through the ups and downs. I'm not anticipating any downs, but that doesn't mean a thing, because I was not anticipating COVID, either.

Nobody was and I was not, either. I just tried to put myself prepared to take advantage. When others will freeze, how we'll react? We proved that in 2020 with the two acquisitions.
We also proved that we don't fight the reality. Like when I realized that I could continue to operate the plants. I had to reduce output. That's why I shut down the Dearborn blast furnace.

But I could not continue to build the plant in Toledo with people working in confined spaces. So, we have to shut down construction.

So, take a reality as the backdrop net debt zero is always a good thing, if you can accomplish that. We are having an opportunity of a lifetime to accomplish that. That's why net debt zero is our goal.

This being said, we are always open to other things. I'll give you an example, Lucas. Due to the stock price performance during the last several days, I am now considering a full redemption of the ArcelorMittal preferred for cash.

I have never done that before. I have never thought about that. But when I realized that the market is skeptical about a lot of things that I know that the market is wrong, and I know about the cash flow that's coming, the $1.4 billion in cash coming in Q3 is real, the way our prices are--our pricing structure is construed, as well as the Q4, another $1.8 billion.

So, I know the cash that's coming in. I can use that cash. And based on the way that calculation is made, it will be a good thing for us. It will be a good thing for ArcelorMittal.

So, I'm not saying I'm going to do it, but I'm considering redeeming that preferred in cash, at this point.

So, don't feel like a net debt zero is what we are going to accomplish no matter what and ignoring all the rest. It's just a reasonable goal to accomplish, coming from a company that has been reasonable all the way. Sorry for the long answer.

Lucas Pipes
No. That's very, very helpful. And I appreciate that perspective very much. My second question, Lourenco, is in regards to the fixed price contracts. You touched on those in the remarks and in the release, this morning.

And I wonder, just in terms of contract structure, what is on the table here? Could we be seeing some index pricing with some of your auto customers, later this year? Is that a possibility, or how would you describe these negotiations at this point? Thank you very much.

Lourenco Goncalves
Lucas, I think you appreciate that I'm not going to say, publicly, or any outside conversation about how we are actually negotiating with the clients. That's off limits. So, we are not going to talk about that.

I would just say that people still talk about synergies and things like that. If there's one synergy that people can’t deny that we accomplish are commercial synergies. So, we are now a much stronger commercial animal than with either of the three companies that were behind the new Cleveland-Cliffs have ever been.

We are in good shape. And we are doing everything we need to do to the business, to the shareholders, to the balance sheet and to the debt holders. So at the end of the day, everybody will be happy, including the clients.

I'm not saying that all clients will be happy. I'm prepared to dump a client, if I need to. That's another thing that, in the past, I am 100% sure that AK Steel have never considered, because they believe that if they do, ArcelorMittal will certainly go there and grab the business and vice versa. That opportunity is gone. And I'll leave at that.

Lucas Pipes
Lourenco, thank you very much and continue. Best of luck.

Lourenco Goncalves
Thank you.

Operator
Thank you. Our next question comes from Tristan Gresser with Exane BNP Paribas. Please go ahead with your question.

Tristan Gresser
Yes. Hi. Good morning. Thank you for taking my question. Maybe first a quick one on the outlook for maybe working capital in H2. Obviously, you had a big deal in Q2 as you mentioned to prepare for the outage.

What should we expect for H2? Maybe a more neutral release, given the outage. And also, if you can touch on if anything has changed regarding CapEx for next year, as well. Thank you.

Keith Koci
Yeah, sure, Tristan. So the working capital, the two big factors are receivables and inventory. Receivables will really just be dependent on pricing. So, whatever pricing assumption is used for the rest of the year is the way the receivables will go, because volumes are likely to remain similar to where they are now.

So probably, it depends. Prices go up, receivables will go up and if prices were to move down--we don't expect that--but if they were then the receivables will come down.

So, but more than likely, you're just looking at flat for the rest of the year on receivables. Inventory same thing, it’s going to depend on if and when the automakers can pull--pull the additional demand to catch up for the chip shortage. We do have a small inventory build for them ready to go.

So if they can pull, we can probably release a couple of hundred million out of inventory. If the chip shortage goes into next year, then that might sit and go into next year.

So it's, again, it's going to depend on how our customers produce here in the second half.

As far as CapEx, we would--we haven't developed our ‘22 CapEx forecast, yet. At this point for modeling purposes, we would assume just to use a similar number where we're heading this year. We're heading to about a 650 number, this year.

So at this point, that's probably a good number, as well, to use for ‘22. But we'll be updating that number, as we continue our analysis and our budget process for ‘22. And we'll make an update in the coming quarters.

Tristan Gresser
All right. Thank you. If I may follow-up regarding your environmental targets to reduce emission, I think minus 25% by 2030. You talked about the interesting use of natural gas, but also, I think, energy efficiency, carbon capture and storage.

Between all those options, is there really one that stands out that will enable you to achieve most of the gains in terms of CO_2 reduction? And also, when you look at this time frame, is there any CapEx, gross CapEx, associated with those efforts?

And lastly, I think the US government is also kind of preparing to help the industry to de-carbonize. Do you expect to receive some kind of formal help or financing, as well? Thank you.

Lourenco Goncalves
I'm sorry. Expect to achieve what? Say it one more time.

Tristan Gresser
Your carbon emission reduction, 25% by 2030.

Lourenco Goncalves
Yeah. We are totally confident that we are getting there. And we also will continue to refine these numbers toward targets for 2035, 2040, 2050. We're going to get there. But I don't feel like at this point, there is any need other than for press release purposes to be stating that we will be carbon neutral by 2050, because nobody knows, at this point.

Let’s face it. Every single company that committed with that are just telling what people would like to hear.

My 2030 number is real, as real as my net debt zero target, as real as my $9 billion in revenues year-to-date, as real as my EBITDA, year-to-date. That is a number that nobody could have imagined, six months ago. That's how we do things.

We are in the United States, Tristan. You guys in Europe, you guys talk a good game. But the best contribution that Europe can really give to the decarbonization of the world is not in subsidizing losers and mavericks that come with proposals, just to keep people employed.
So, Europe sucks from the environmental standpoint.

So, we are real here in the United States. We have the best footprint. We have the best carbon compliance in the entire world. Europe is light years behind. Japan is light years behind. Korea is light years behind. And China doesn't even make it to the picture, yet. That's the reality. People will start to see that in the very near future. Did that answer your question?

Tristan Gresser
Yes, kind of. Just give me a quick follow-up. When you look at--

Lourenco Goncalves
What part did you not understand? I'll tell you that the plants that are talking a good game should be shut down, by now. Spain--these folks. You are in Europe, right? You're out of London?

Tristan Gresser
Yes, yes.

Lourenco Goncalves
Yes. So you know what I'm talking about. You know. You know better than anyone on the call. But you get the same. So keep doing. Be my guest.

Tristan Gresser
So, one follow-up I had was just on the elements you can leverage to decarbonize. And you talk about natural gas, and I think it's really interesting. But for your targets, would you say that natural gas will be, I don't know more than 50% of all the reductions you can realize, or carbon capture and storage is also a part to play in energy efficiency as well? Just trying to figure out the different elements in that target. Thank you.

Lourenco Goncalves
Yes. Natural gas is hydrogen, at the end of the day. Look at the proportion of carbon and hydrogen in the CH_4 and CH286. Think about the chemical reaction to reduce iron ore in a blast furnace or in a direct reduction reactor, when you use coke, alone, produces CO as a reduction or reform the natural gas when you produce a lot of H_2 and a little bit of CO that will be transformed in CO_2 only in minor proportion.

So, natural gas is the way to decarbonize the steel industry, the only technologically dominated way, at this point.

Everybody else that's talking about anything is just technologically speculating. That's the story we are doing right here. When people are talking about I put $1 billion in a plant that nobody believed that would be a game changer.

So much of a game changer that made us able to change the landscape of the American steel industry by consolidating the two best mills in the integrated route and supplying them with HBI. HBI, that was never considered feedstock for blast furnaces other than a weak attempt to buy voestalpine that I don't know if it plays out or not because nobody hears about, because of the problem that I have just mentioned to you about the European steel mills.

So, but look, it takes time for people to see things. I am a patient guy. I never fight to take. So, I'm always ready to take advantage of the weakness of investors. They give me money-I'll take it.

I'll leave at that, Tristan. All right. Thanks. Appreciate it. Diego, who is next?

Operator
Thank you. And our next question comes from Matthew Fields with Bank of America. Please go ahead.

Matthew Fields
Hey, Lourenco. Hey, Keith. A couple of questions on the cash flow balance sheet side of the house. Clarification on that $455 million of debt retired in July. Is that mostly ABL? Is that some additional market repurchases of bonds?

And then how do you anticipate using that kind of free cash flow that you're telegraphing for debt reduction on ABL versus open market repurchases? None of the bonds are callable, until 2022. So, I just wanted to get a sense of the trajectory there for the rest of the year.

Keith Koci
Yeah, sure Matt. Yeah, so far, the whole--the entire $455 million went to the ABL, this quarter. And it's--we'll look at open market repurchases from time-to-time when they're available. Generally, we can only get so much going that route.

So, ABL is obviously the priority and where the majority is going to go but we'll always be a little bit opportunistic at times to pick off some stuff in the open market.

Matthew Fields
Okay, great. That's very helpful. Thank you. And then second on the MTNA preferred stake. You don't have to do anything until December 2022. I guess you have a free option on deciding what to do then before that starts paying dividends.

But now that you're considering paying it in cash, I guess at $20 a share roughly, that's $1.1 billion, $1.2 billion proceeds, if I'm correct. Does that affect the net debt zero target in 2022, if that's now considered to be paid in cash versus retired with equity?

Lourenco Goncalves

Well, based on our current projections, if we decide to do the pay down, the payoff of the redemption of the entire tranche of preferred in Q3, that would delay our net debt zero accomplished by one quarter. So, we said that we would get net debt zero within 2022; that doesn't change. It might change, might delay one quarter.

So, instead of accomplish that by let's call Q3, will come in Q4. So what? Still in 2022. That's the scale of things right now.

But paying the preferred now and spending the $1.1 billion that you have just said is just again LG not fighting the tape because if I try not to do it, I will end up to having the opportunity to do the same thing. Instead of paying $1.1 billion, I would have to pay $2.2 billion because if you believe that we are going to continue to trade at this ridiculous low price, be my guest.

Actually, you know that that's not the things we'll play, right? You are from Bank of America, right-so?

Matthew Fields
Well, I know not to fight Lourenco on the tape. So, thanks for the clarity on that. And it's just a stunning kind of--to see where the company is now versus a few years ago. So, thanks very much for the questions. Appreciate it and good luck in the rest of the year.

Lourenco Goncalves
I appreciate that very much the support. And you are in the bonds and it's always great to have a good partner within Bank of America. Thanks Matt.

Operator
Thank you. Our next question comes from Karl Blunden with Goldman Sachs. Please state your question.

Karl Blunden
Hi, good morning. Thanks for the time. Maybe just a follow-up here on the net debt zero position that you anticipate getting to in 2022. Gives you a lot of options. And you've outlined a couple of the other--the different options available to you.

At what point do you consider accelerating your decarbonization investments or, potentially, also reducing pension obligations?

Lourenco Goncalves
Let's start with the accelerating decarbonization. We continue to work with a plan that was put in place in 2017. So, I don't know where you are coming from. But we are the only ones that, instead of talking about we have already done things. You understand that we are using 54% of our internal usage of HBI in blast furnace, right?

So, you understand when you put more HBI inside the blast furnace, you are putting more pre-reduced iron inside the blast furnace. If it's pre-reduced, you need less reduction. If you need less reduction, you are loading less carbon. So you are, as a consequence, generating less CO. So, it's happening as we speak.

Also I said that one of the guidelines for the Indiana Harbor 7 order that's coming and starting September 1st is to enhance our ability to use more HBI, more natural gas through the two years. So that will reduce coke-that will reduce fuel. So what else I'm missing here is that you feel like we are not doing enough for decarbonization.

Karl Blunden
No. I think you guys are a leader on the HBI, at least, as far as blast furnaces are concerned. But at some point, you might have an opportunity to make another big investment, either EAF or additional HBI capacity.

Lourenco Goncalves
In order to invest in HBI capacity, I need to be short in HBI. I'm not short in HBI, just yet. So, I'm still pretty much in line.

By the end of this year, I will have zero HBI to sell to the market because micro internal consumption will be pretty much equivalent to my two-point something million tons production a year. So, they are going to be even, in terms of our internal consumption. So at that point, we might consider.

As far as investing in EAF, they're going to need to have to invest on HBI because if you follow my line of thought, there's a scrap shortage in the making, particularly, for highly specified products that was kind of ignored by others.

That's another thing that I can't prove right now. You're going to have to bear with me. So one more year, two more years to be crystal clear. But that's the history of my life. And I'm not surprised that you are not there with me, just yet.

And another thing, last but not least, we are very comfortable with the footprint that we have. We are generating a lot less CO than any other integrated steel mill in the entire world right now as we speak. I'm talking about Nippon Steel, JFE, Thyssenkrupp, TISCO.

And we are going to continue to reduce the CO2 generation and we're going to implement carbon capture. No, they're not planning to go EAF. I'm not going to tell you what you'd like to hear. And the Goldman Sachs needs to move on from this concepts that are W-R-O-N-G, wrong. You got it?

Karl Blunden

No. I got you. I mean you guys are doing on a lot of different areas. I'm just thinking about different…

Lourenco Goncalves
--I'm sure you did not get.

Karl Blunden
…uses of cash.

Lourenco Goncalves
But you will get in six months, one year, two years, you and Goldman Sachs.

Karl Blunden
No. A lot of that makes sense. In terms of what you're using cash for you discussed the preferreds. Is there any intended use or potential use of cash for pension obligations, some of the acquired obligations, for example?

Lourenco Goncalves
Yeah. Keith will take that.

Keith Koci
Yeah. Hey, Karl, right now our balance sheet has the pension and the OPEB, right now. The pension obligations are shrinking, as we speak. Our asset returns are outperforming all other costs on pensions, right now.

We're in a position now where we don't--we see pension, cash pension funding requirements of almost less than $20 million a year, going forward. So, it's basically a zero, going forward. So, we're there on pension.

As far as the retiree health and OPEB, it's less than $200 million a year to fund in cash. And with a company of our size that's--we consider that to be negligible. And we can handle that, going forward. It's a 40, 50-year run out on those obligations.

So there's no reason to pre-fund or do anything like that. It would be probably not the best use of our capital to prefund anything like that. But it's a long run out.

Karl Blunden
That's helpful. I guess the one quick follow-up is on, I haven't seen a gross debt target. It sounds like you could continue being flexible there. And you wouldn't really want to put that out there because I think it would commit you to taking out bonds at given points in time. But is there anything you can share around gross debt?

Lourenco Goncalves

Yeah, you already answered your own question-yes.

Karl Blunden
Thanks.

Lourenco Goncalves
All right. Thank you for calling. Who's next?

Operator
Our next question comes from Lucas Pipes with B. Riley Securities. Please go ahead.

Lucas Pipes
Hey, thanks very much for taking the follow up, Lourenco and team. And it's somewhat of a high-level question, but you take kind of the second half guidance here, multiply it by two, annualize it. And on a forward basis with your net debt target you're--it's 1.5x EV to EBITDA.

And so clearly what market implies a rapid deterioration in steel prices.

And Lourenco, I wondered if you could share your views on how steel markets, specifically in North America, are different? And how it might be a comparison to other commodities that have rolled over may not be reasonable here? Thank you very much for your perspective.

Lourenco Goncalves
So, I don't know exactly what other commodities you have in mind, but if you have in mind stuff like lumber and things like that, it's night and day. So it's just not--it doesn't apply.

The other thing is that you need to understand that a lot of what's called commodity in our market is actually highly specified material that cannot be interchangeable. It cannot be just replaced at will, even though that's the perception that is sold to the market.

One--actually, one very relevant thing that's coming from our M&A move last year with AK ArcelorMittal USA is to show just that because we deal with situations that we have a lot of leverage in the negotiations. Not blood force.

But the fact that we are in control of things that can make or break for these clients because we're not dealing with commodity products. We are dealing with highly specified parts that can derail development.

I'm not saying that we're going to put this to good use, but it's real and exists. That's a big difference between pork belly and steel specified--advanced high-strain steels for specific users.

Another point to be considered is that one thing is, when you're talking about the ability to do something. I don't really question the ability of a plant, or a furnace, or a company to do something in more scale.

But to manage our supply chain with 5 million tons--give or take a year--of complex parts in a way that keeps the flow of metal into the assembly lines on time and on quality, that's an enormous task and knowing that, every three to four years, we need to redo everything to comply with new models and things like that.

We are working now on things that will happen in 2025, 2026, 2027. So, it's a beast that keeps speeding on itself.

And then the follow-up question would be, Lucas, why this--why it's never done before? And the question is good. But the answer for me is that, I don't know, because I always thought it would be possible. And since we--this is what we did last year, I'm proving every day that it's possible, and we're doing it. But the proof is in the pudding.

And again, I don't find the tape. So I'm prepared for any type of outcome in the marketplace. They like it, great. They don't like it, I'll do something to be good for my shareholders, or my bondholders, for my clients with whatever the market gives to me.

Lucas Pipes
Very, very helpful. Lourenco, I really appreciate that additional color, and continued best of luck.

Lourenco Goncalves
Thanks, Lucas.

Operator
Thank you. Our next question comes from Sean Wondrack with Deutsche Bank. Please go ahead.

Sean Wondrack
Hey, guys. And really nice job in the quarter, again.

Lourenco Goncalves
Hey, Sean.

Sean Wondrack
My first question, just when you take a look at the 9.875 secured notes you have outstanding, are there any other means other than open market purchases, where you could redeem that tranche below the make whole price at this point in time?

Keith Koci
Yeah. Sean, they're callable, next year. So, the call periods opens up, I think, in the first quarter of next year. So, between now and then not a whole lot of options on that tranche.

Sean Wondrack
Got you. Okay. Thank you. Appreciate that. And then just with the massive debt reduction that's ongoing right now. I know, this is probably a hard question to answer. But is there a rough idea, what the potential interest savings could be there? I mean, I think you paid a pretty considerable amount of interest, last year. And obviously, that's going to come down in time.

Keith Koci
Yeah. I mean, it depends on where we go. So the ABL is, obviously, our lowest cost to a debt. So, as we pay down the ABL, we're saving about 2% on that. And then as we--we took down the 25s in the second quarter and that was--those were 5.75%. So it depends on the order, and how we do it.

But yeah, you're going to see a sizable reduction. It will show up more kind of starting early next year than it will this year. But yeah, there will be a sizable reduction in our cash interest costs starting in--

Lourenco Goncalves
--Yeah, but look, to say at this point, that we are paying an enormous amount in interest expense is not really reflecting the reality of the numbers.

Look, we are talking about a company that will have revenues in the $20 billion level. So we have one tranche that I don't like. And that's the tranche that we put in place at the peak of the pandemic.

And that one is not callable. And that one is the biggest candidate for me to bite the bullet and pay the make whole. Everything else will vanish, because all other tranches are priced in perfection. Remember, we are pricing at BB level, when we were B minus.

We are now pricing at a BBB level when we're a BB. And we have no plans to issue. And we know that if we issue that right now, it will be very cheap.

So, now, we are in good shape. Our debt is not a problem right now. Our debt is good.

Sean Wondrack
Right. No. That makes a lot of sense and that kind of helps us frame on the gross debt side. That you want to keep some of this capital outstanding because it's low cost which makes sense.

Keith Koci
Yeah.

Sean Wondrack
Just my last question, if I may in the M&A market. We saw Nucor made a small downstream acquisition, I think yesterday. Another one of your competitors recently mentioned the potential for a pickup in the M&A market.

Obviously, you got way ahead of the curve with your transactions, last year, and that's shown up in the P&L. But can you just maybe provide some thoughts of after you get through your debt reduction goal? Sort of what your capital allocation priorities are there?

Lourenco Goncalves
Yeah. Our information one, the redemption of the ArcelorMittal preferred is the very first one. And I'm glad to see other companies doing M&A is good, not to the level and to the extent that we did, but it's still good. Small things are good, too.

So--and we will only talk about our own plans when they are done. So, we don't have anything to discuss right now, Sean.

Sean Wondrack
Okay. Thank you very much for answering my questions.

Lourenco Goncalves
Thank you. Thank you.

Operator
Thank you. There are no further questions at this time. I'll turn it back to management for closing remarks.

Lourenco Goncalves
Thank you very much. I appreciate the interest and we will keep in touch. Bye now.

Operator
This concludes today's conference. All parties may disconnect. Have a great day.