

Cleveland-Cliffs, Inc.
Q3 2021 Results-Earning Call
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Presenters

Lourenco Goncalves, Chairman, President and Chief Executive Officer
Celso Goncalves, Executive Vice President and Chief Financial Officer

Q&A Participants

Michael Glick – JPMorgan
Lucas Pipes – B. Riley Securities
Emily Chieng – Goldman Sachs
Carlos De Alba – Morgan Stanley
Alex Hacking – Citi
Tristan Gresser – Exane BNP Paribas
Matthew Fields – Bank of America

Operator

Good morning, ladies and gentlemen. My name is Donna, and I am your conference facilitator, today. I would like to welcome everyone to Cleveland Cliffs Third 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 could cause actual results to differ, materially.

Important factors that could cause results to differ, materially, are set forth in reports on Form 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 on the website and available for replay. The company will also discuss 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 Lourenco Goncalves, Chairman, President and CEO. Please go ahead.

Lourenco Goncalves

Thanks, Donna. And good morning, everyone. Though many of those listening today know him already, I am pleased to introduce on this call our new Executive Vice President and Chief Financial Officer, Celso Goncalves.

In his previous role as Senior Vice President of Finance and Treasurer here at Cleveland Cliffs, Celso was instrumental to our business and financial transformation.

Over the past five years, he has led all of our capital structure efforts, being the key person behind the execution and financing for our transformation of acquisitions and managed our liquidity, through the pandemic. Prior to Cliffs, Celso had a very successful career as an investment banker, first at Jefferies and then at Deutsche Bank.

Also, if you couldn't tell by his last name, Celso is my son. During the last several years, Keith Koci and I have been preparing Celso for this job. With Keith now in charge of our new business unit, as President of Cleveland Cliffs services, we could not have a better or more prepared professional to lead our financial organization.

With that, I will turn it over to Celso.

Celso Goncalves

Thank you. And good morning, everyone. I am humbled by the opportunity to serve as Cliffs' CFO, fully aware of not only our rich 174-year legacy, but also our position of immense influence as the largest flat-rolled steel producer in the U.S.

I also fully expect that, given my family name and the high standards set by our CEO, the expectations for me will be even greater than for anyone else in this seat. I am prepared to deliver.

My experience here at Cliffs, over the past five years, has taught me that strategic and financial opportunities exist at all points in the cycle. My priorities as CFO are simple: one, allocate capital in a way that strengthens our business; two, maintain and enhance our financial flexibility; three, deleverage the capital structure; four, evaluate and execute opportunistic M&A and capital market transactions, always with a focus on long-term shareholder return; and five, continue our five-year track record of share outperformance, relative to our peer group and the broader market.

With those introductory remarks aside, I will jump right into our third quarter results. We reported another quarter of record revenues of \$6 billion, record net income of \$1.3 billion, and record adjusted EBITDA of over \$1.9 billion, ahead of the guidance we recently set of \$1.8 billion.

Our 42% quarter-over-quarter growth in adjusted EBITDA was primarily driven by continued price increases on our index linked and spot shipments. These sharp increases on the revenue side were only partially offset by gradual increases on the cost side, including for labor and natural gas and additional repairs and maintenance, most notably, the realign of Indiana Harbor No. 7, the largest blast furnace in North America.

And even though it was clearly a one-timer, we did not add back to EBITDA the vaccination bonus payment of \$45 million that was awarded and paid out to our workforce under our very successful vaccination incentive bonus program, which resulted in over 75% of our workforce fully vaccinated against COVID-19.

In the Steelmaking segment, we sold 4.2 million net tons of steel products with a mix of 32% hot rolled, 18% cold rolled, and 31% coated steel with the remaining 19% consisting of stainless, electrical, plate, slab, and rail.

Our automotive percentage of revenue was 20%, compared to 33% just two quarters ago, clearly reflecting the reduced volumes and the legacy annual prices from that sector, both of which should dramatically improve, next year.

We expect the trends on pricing and cost in Q3 to carry over into Q4 with higher prices from both index-linked contracts and some of our repriced automotive contracts, offset by similar cost impacts we experienced in Q3. Shipments will likely be lighter in Q4, due primarily to seasonality in lower automotive shipments.

Offsetting this, we will be moving up to the fourth quarter some planned maintenance outages originally scheduled for next year, including the Dearborn hot end and both blast furnaces at Burns Harbor, along with a few other associated rolling and finishing facilities. These outages are being accelerated to this year in anticipation of a strong automotive recovery in 2022.

All these events considered, our fourth quarter production should be reduced by approximately 300,000 net tons, compared to the third quarter.

Our free cash flow generation came in at \$1.3 billion for the quarter, slightly lower than our original guidance, due to slow demand pull from automotive, leaving more inventories to close out the quarter than we expected.

The remaining outage period at IH7, as well as the additional outages we scheduled for the fourth quarter, should allow us to reduce these inventory levels, during Q4. This free cash flow

generated during Q3 was returned entirely to shareholders in the form of a stock buyback executed via the complete redemption of our 58 million common share equivalent preferred stock.

With only one quarter's worth of free cash flow, we completely redeemed our preferred shares. I will note that because of the weighted average calculation and the fact that the prefs were outstanding during a portion of Q3, the full 58 million share reduction is not baked into our Q3 EPS just yet, and we will see a further reduction of diluted share count in the fourth quarter.

With the prefs now completely out of the way, we have resumed our aggressive debt reduction activities. In only the last three weeks since the end of Q3, we have already generated approximately \$500 million in free cash flow and have allocated all of it toward debt repayment under the ABL.

Upon closing of the FPT acquisition next month, all excess free cash flow will continue to be allocated towards further debt reduction.

By next quarter, our LTM adjusted EBITDA should exceed our overall net debt balance, resulting in less than one turn of overall net leverage for the foreseeable future at any reasonable HRC pricing assumption, going forward. Because of our strong profitability this year, at some point in the fourth quarter, we will have utilized the majority of our tax NOL balance, leading to an expected Q4 cash tax rate of around 10%.

Prior to the acquisitions of AK Steel and AMUSA, we once expected to be utilizing these NOLs for several more years, but the significantly higher profit generation following the acquisitions will result in the consumption of the majority of the \$2.5 billion NOL balance, within a year of closing the December 2020 transaction.

Even with the additional cash tax outflow and payments related to the CARES Act FICA deferrals from last year to this year, free cash flow should remain, remarkably, healthy in Q4. The \$775 million price of the previously announced acquisition of FPT is equivalent to less than two months of our free cash flow generation.

Wrapping up, the financial position of the Company is on stronger footing today than it has been during my entire time here at Cliffs, and the trend should continue into Q4 and 2022.

The fixed price contract business we have with high-end clients, such as the automotive OEMs, gives us significant downside protection, if spot prices trend lower. Therefore, even under the current bearish futures curve for HRC, our average selling price should be much higher next year than it has been this year, leading to the expectation of another year of outstanding EBITDA, cash flow generation, and debt reduction in 2022.

With that, I'll turn it back to Lourenco.

Lourenco Goncalves

Thanks, Celso. Very few companies can show the magnitude of growth Cleveland Cliffs has delivered, during the last couple of years. We were a \$2 billion revenue company in 2019, became a \$5.3 billion revenue company in 2020, and expect to be a \$20 billion, plus, company in 2021.

All of this growth was achieved, preserving and enhancing our profitability as demonstrated by our Q3 numbers of \$1.9 billion of adjusted EBITDA and \$6 billion in revenues for an EBITDA margin of 32%.

These numbers have come primarily from the 55% of our business that is linked to an index price with a smaller contribution from the fixed price contracts that were signed before the market price recovery of last year. In the fourth quarter, these will begin to change.

And even more so, starting next year when the bulk of our annual fixed contracts for automotive, as well as appliances, stainless, electricals used, plate and tin plates, all reprice at significantly higher levels. That should protect our profitability into next year, even assuming the spot prices go down, next year.

This being said, we do not believe we will see steel spot prices returning back to historical low levels.

And the main reason for that is prime scrap. Prime scrap is what electrical furnace mills, old ones or brand new, need to produce flat rolled steel. We have seen a looming shortage of this type of scrap coming for several years, which partially motivated our \$1 billion investment in our direct reduction plans, four years ago.

We were planning to supply HBI to EAF mini mills. And that was in the past, but not anymore. At this time and going forward, we also plan to use more prime scrap ourselves in our BOFs. That will allow us to stretch our hot metal without building new production capacity. Building new capacity is a common mistake the steel industry insists in making, time and time again.

Cleveland Cliffs is different, and we are not going to add capacity, ourselves. But we are definitely seeing what others do, and we act accordingly. With that in mind, a few days ago, we announced the acquisition of FPT.

While the majority of scrap companies we looked at, had a prime scrap mix of 10%, 15%, FPT stood out with an outsized 50% of prime scraps in their mix.

FPT is actually one of the largest processors of prime scrap in the country, representing 15% of the entire merchant market in the U.S. Prime scrap is a byproduct of manufacturing, including

automotive and Cleveland Cliffs is the largest supplier of steel to this automotive and other flat-rolled consuming manufacturers.

As such, we can offer a compelling proposition for their scrap offtake, keeping the lifecycle of our steel in a closed loop between Cleveland Cliffs and the OEM. Furthermore, the main theme for this new industry is decarbonization, and melting clean, low impurity scrap is a good way to reduce carbon emissions. That applies to both EAFs and BOFs.

The BOF is often overlooked as a user of scrap, but in our footprint it's actually where we consume the most. The use of higher amounts of scrap in the BOF boosts liquid steel output for the same amount of hot metal, which is what we call the liquid pig iron from the blast furnace.

So, the more scrap we use in the BOF, the less coke needed in the blast furnace per ton of crude steel produced.

With ample access to our own prime scrap, we can optimize our productivity with a higher scrap charge while, significantly, reducing our carbon emissions. On top of that, during the last 50 years, the supply of prime scrap in the United States has been steadily shrinking. We expect that half a century trend to continue, as yields continue to improve, and unfortunately, China continues to dominate manufacturing.

Finally, all of the new flat-rolled capacity coming online in the United States is from the EAF side, which means that demand for prime scrap and metallics will continue to increase. That is very conservatively another 9 million tons, or 40% growth, of demand for these products, over the next four years.

With our decision to use our HBI internally at Cleveland Cliffs and primarily in our blast furnaces, there's a zero response in supply to this massive growth in demand for prime scrap and metallics coming from the EAFs.

Pig iron may be the most likely alternative, but the CO₂ emissions that comes attached to pig iron, whether imported or made in North America, effectively create a negative impact to the Scope 3 emissions associated to these EAFs.

In that regard, we fully expect that in a not-so-distant future, the Scope 3 emissions will have to be reported as much as our Scope 1 and 2 already are reported, today. That would create a level playing field for all the steel makers, integrated and EAFs.

Moving forward, this is a good opportunity to remind everyone that no other steel company in North America has more capabilities in modern ones, by the way, than Cleveland Cliffs, when it comes to producing flat-rolled steel.

That's particularly true regarding automotive. People tend to confuse old plant names, like Indiana Harbor, Cleveland Works, or Burns Harbor, with old plants. In fact, old plant names actually carry pre-modern state-of-the-art equipment. For example, our hot-dip galvanizing line at Rockport Works was built in the 90s, and it's 80 inches wide, and that is 6 foot, 8 inches wide, or 2032 millimeters, if you are a metric system person-more than 2 meters wide.

There's no other facility on the continent that can produce what we make, there. The same is true for the six-footers at Tek and Kote in New Carlisle, Indiana and Columbus, Ohio.

Also, our advanced high strength steel capabilities at Cleveland Works are second to none, and the automotive OEMs know that. Our pickling line tandem cold mill and galvanizing lines in Dearborn, Michigan, by the way, another six-footer, specialized in exposed panels, were both built in 2011.

Say that one more time, Dearborn Works was built by Ford Motor Company in the early part of the 20th century. But the PLTCM and the hot-dip galvanizing line are only 10 years old.

Our level of technological sophistication and our ability to produce all kinds of automotive flat-rolled products, including stainless steel, are the reason why Cleveland Cliffs is, by far, the biggest supplier of automotive steel in this country.

A couple of our competitors will be spending billions of dollars in working very hard to build capacity, during the next three years. We don't need to because we already have the capabilities we need. That's why Cleveland Cliffs supplies two and a half times more steel to the automotive industry than the second largest supplier, or more than the second, plus the third, combined.

Another important accomplishment during the quarter was the consistent performance of our direct reduction plant in Toledo. The plant continues to operate above nominal capacity and to exceed our expectations, not only on production, but also in quality and cost.

Case in point, our all-in cash cost of HBI in Q3 was \$187 per net ton, a number much better than the cost projected when we first approved the construction of the plant, a few years ago. This figure is also much better than the price our competitors pay for both, prime scrap and imported pig iron.

Also differently from our original plan, HBI sales to outside EAF mills are not significant and may be discontinued completely, very soon.

We actually had already decided to use the majority of our HBI in our blast furnaces, not even in our own EAFs. That allows us to improve much better cost and productivity while, improving our coke rates and reducing our CO2 emissions. Also, as a consequence of our HBI using our

blast furnaces, we have already idled the coke batteries at Middletown Works, as that coke is not needed, at this time.

Another operational change we started to implement in the third quarter involves our Minorca mine and pellet plant, which we acquired as part of the ArcelorMittal USA acquisition.

Based on our tests, we will soon be shifting our DR-grade pellets production away from Northshore and into Minorca, where we will not have to deal with the unreasonable royal structure at Northshore.

As we plan to no longer sell pellets to third-parties in the coming years, Northshore will become a swing operation, which will keep idle every time we decided is to do so.

In any event, we'll continue to be able to feed our Toledo plants with a consistent feed of DR-grade pellets, but from Minorca and not from Northshore.

As Celso explained earlier, we continue to generate plenty of cash and should see a meaningful reduction in debt during the fourth quarter, even after paying for the FPT acquisition.

Based on our expected EBITDA for this year, our 2021 full-year leverage is already at a very comfortable level of less than one-time EBITDA. With the new sales contracts we have already signed, our ability to continue to pay down debt is even stronger than what we announced, last quarter.

Wrapping up, I want to send a special thank you to our workforce for making another record quarter possible.

The \$45 million that we paid in vaccination bonus this quarter was, by far, our best use of cash. And we are pleased that we reached above 75% vaccination rates, across our entire footprint, beating by a large margin the percentage of vaccinated local population in all communities we operate.

We are keeping our workforce safe, healthy and compensating them to do so. Soon, we look forward to welcoming another 600 Cliffs employees from the FPT acquisition. We can't wait to bring them into our Company and our way of doing business.

I will now turn it over to Donna for Q&A.

Operator

Thank you. Ladies and gentlemen, the floor is now open for questions. If you would like to ask a question, please press “*”, “1” on your telephone keypad, at this time. A confirmation tone will indicate your line is in the question queue. You may press “*”, “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 start keys. Once again, that's "*", "1" to register questions, at this time.

Our first question is coming from Michael Glick of JPMorgan. Please go ahead.

Michael Glick

Morning and nice print. On the contract side, I was wondering if you'd give us a bit more color, there. I know you probably can't get into the quantitatives and to the extent you can, that would be great.

But qualitatively, what are you seeing now in contract negotiations versus the old dynamic and how much of your contract book is still open? And then, when you talk about higher average prices next year, just wanted to be clear for the non-fixed business, sounds like you're using recurrent HRC strip.

Lourenco Goncalves

Yeah. Look, we--Michael, first of all, thanks for the compliments. Talking about automotive. Cleveland-Cliffs today supply, give or take, 5 million tons of steel to automotive. As you know, one car-one ton, so--of steel. So, we're talking about a market that's now in the below 15million tons. So, Let's call it 15 million tons just to make life easier in terms of the calculation.

If we supply 5 out of 15, we supply one third. It's a big percentage, but it's a lot less in terms of percentage than when we're just the owners of AK Steel. Now that we're Cleveland-Cliffs, combine all this footprint, we diluted the participation of automotive in our mix. We are renewing contract by contract.

And so, we are done with a number, a significant number. We're not done with all. The important thing to consider is that as we renew one contract, things get a lot more complicated for the next one because I'm not going to continue to add automotive.

And every single contract that we're negotiating right, now we're not only negotiating for a higher price, but they also offered us a lot more tons.

So, we're going--growing the tonnage that we're delivering for the car manufacturers that we have already closed the negotiation. And even though I don't have a hard talk for the number of tons that I will supply to the automotive industry, we are going to get to a point that we are going to get selective at the end.

And another point that I would like to clarify to you because it's a change on the way we do business with automotive OEMs, there is not such a thing of we're going to supply a few things, like exposed parts, then not supply everything.

If we are supplier of a car manufacturer, we are considered that we're going to supply everything from the most complicated parts that we're the only ones that can produce, all the way down to the easy stuff.

But the microchip shortage has showed that these small things can complicate the life of a car manufacturer, a lot. So long story short, we are doing what we plan to do. We're executing, the car OEMS are behaving extremely professional, as do we, and I think we're going to be okay at the end. That's all I can tell you.

Michael Glick

And then, could you talk maybe about what you're seeing on the input cost side? I mean, you're obviously well integrated on metallics and coke. But curious what else you're seeing in terms of alloy and materials and the like and any supply chain issues you're focused on mitigating from a procurement perspective.

Lourenco Goncalves

Yeah, look, supply chain issues are reality. One of the most important parts of the new Cleveland-Cliffs is the logistics business. It sits under Keith Koci and is head by Executive Vice President of Logistics, Chris Cebula. We've designed the company this way because we anticipate that we would have to do a lot of work, specifically, on that.

We are not suffering. We just need to work very hard to make sure that we have the trucks, we have the rail cars, and we have access to everything that we need in a timely fashion. We just-- case in point, we just concluded the repair of Indiana Harbor Number 7. It's a big beast.

We've started the day, we planned it and we finished 24 hours ahead of schedule. And everything came in a timely way, and we didn't have any problems with parts and things that were involved in the repair.

So yeah, it's there, but it's like the current way of doing business, and we are not losing any sleep over that.

As far as costs, we hedge a lot of things, and we have the financial expertise to do a good job on that, so we're not exposed. Celso has been doing this for a while, and he continues to do. I don't have anything specific to report on that front, Michael.

Michael Glick

Okay. great. Thank you.

Lourenco Goncalves

Thank you.

Operator

Thank you. Our next question is coming from Lucas Pipes of B. Riley Securities. Please go ahead.

Lucas Pipes

Good morning, everyone. Lourenco and team, congratulations on the strong quarter and outlook. And Celso, congratulations to you as well, specifically. Lourenco, really appreciated your prepared remarks on metallics and how that market is continuing to evolve.

And on that, I wanted to ask you about how you see the spread between prime scrap and HRC, over the coming years. Would really appreciate your perspective on that. Thank you.

Lourenco Goncalves

Thanks, Lucas. First of all, this language of scrap is not my language. We are not a melter of scrap; we are steelmakers. So, we start from iron ore. And with iron ore, we produce pellets and with pellets we load 100% of our iron ore needs with pellets.

Until we no longer do that because we load a lot of HBI that we produce from our own pellets. So, it's not having HBI or direct reduction capacity. You have to have the capacity--you have to have access to iron ore.

Otherwise, you're going to have your capacity sitting idle, like we have a bunch of plants, MIDREX plants and other supply plants, sitting idle in the Middle East right now, because they can't have access to DR-grade pellets. We don't have that problem.

So anyway, I don't play that language of scrap. But I will talk about the true components that go to this scrap. One is prime scrap.

If you understand that prime scrap comes from manufacturing and manufacturing has moved to Asia and, right now, resides in China. The United States is no longer the United States of the 20th century when we were a real powerhouse, in terms of manufacturing. We want to bring that back, but we're not there yet. So, we're still playing around with China, and China is where manufacturing is.

So, we don't have the support from the manufacturing base. Very stable but we're not growing. If consumption is growing, you don't need to be an economic genius to understand that you have more demand and you don't have more supply.

Prime scrap will become more expensive. And because I want more prime scrap for my own use, BOFs, we went ahead and bought the best company that we could find to have access to prime scrap.

So, if things are not really nice in terms of prime scrap for the ones that depend on prime scrap, things will get worse. Because now we have a big beast called Cleveland Cliffs going to the market to put our hands around as much prime scrap as we can.

And on top of that, keep in mind a lot of--actually, the vast majority--of prime scrap that is generated in the United States in automotive and things like that, comes from my steel.

So, talk about a closed loop, that's exactly what we're going to do. We're going to reclaim our scrap because it's our scrap that comes from our steel, not somebody else's steel. That's a real closed loop.

So, the situation from prime scrap is that--shortages, higher prices. That's what we're seeing and that's how we're going to play the game. As far as the price of hot-rolled, it's all about the services centers

I have never seen a group of people that like so much to suffer. I was a CEO for a service center company for 10 years, and I was fighting that from the inside. Now I'm a supplier. It's unbelievable for people that leave out of the value of their inventory, how much they work against themselves to feed the press with bad information, to sit on their hands where they should be buying, and then they come begging for material.

And that's what pushed prices up. We could have a business that would be more stable if service centers learned how to play the inventory game. But I have been trying to communicate that for too long; I don't think I will be able to do so.

So, whatever hot-rolled prices will end is whatever the service centers would like the auto price to land. But at the end of the day, the scrap component, we're taking care of them.

I don't know if I covered everything you'd like to know, but that's my take on this difference between the hot-rolled and prime scrap.

Lucas Pipes

I appreciated your comments, especially in regards to the circular loop. And one quick follow-up question on that. If I recall correctly, you all have about 15%, or FTP at about 15% share of prime scrap. What's your ultimate goal in terms of market share? Can you articulate that?

Lourenco Goncalves

Yeah. Look, this 15% is what comes with the company as is, as we acquired the company. But we are already communicating with our clients that would like to acquire our own scrap back. And our proposition to our clients is very compelling, because it's not only--look, I want to acquire your scrap back to melt for you again, so they like that because that kind of confines chemical composition to what they really have, they really need, and they really want.

That's number one. But second, because I--scrap is still secondary in my matrix of the raw materials, it's not my primary source of raw material. So, I can offer to these clients a proposal to pay for their scrap more than they are receiving, today.

So, it's a double dip. It's good for the business and it's good for the pocket. So I believe we are going to grow this percentage from 15% to a higher number. How big? I don't know. But it will be bigger.

Lucas Pipes

Super helpful. Thank you. Thank you, Lourenco. Changing topics. You bought back a lot of stock during the quarter. You commented on the exhaustion of the NOLs. I remember my corporate finance one-on-one class kind of makes debt incrementally more attractive. How do you think about buybacks here, especially where the stock is trading? Really appreciate your perspective on that.

Lourenco Goncalves

Yeah. Look, what we did with the preferred was really take advantage of a very unique situation. Stock buybacks are always a double-edged sword. Even though they are very tax efficient way to return money to the shareholders, it's also an invitation to bring the stock price down in the next cycle no matter if the cycle is on one week, one month, or one quarter. So, and it happened again.

So, I don't have really a one-size-fits-all opinion on share buybacks. I want to reward the shareholders. I'm a big shareholder, myself. I bought stock of this company in the open market close to 20 times, I think 17 times or something like that, since I came to the company, seven years ago. So, I'm a shareholder, myself.

So, I like shareholder-friendly actions even because I'm a shareholder, myself. This being said, I'm not going to commit with share buybacks or things like that because things evolve. I believe that we're doing for the shareholders so much better, so much bigger, and so much efficient than just say a meager dividend or doing share buyback that will compromise our cash position that really, doesn't really matter, at the end of the day.

What company can say, two years ago I was \$2 billion in revenue. Now, I'm \$21 billion in revenue. Two years ago, I was making \$50 million, give or take, \$100 million EBITDA quarter. Now, I'm making \$1.9 billion of EBITDA a quarter. So, very few.

You've got to be intact. You've got to be an advertisement. You're going to be producing yoga pants in order to do that. We're doing that with steel, with manufacturing. So, we're changing our business, completely. Shareholders are rewarded if they understand that and play along.

Lucas Pipes

Lourenco and team, keep up all the great work and best of luck. Thank you very much.

Lourenco Goncalves

Thanks.

Celso Goncalves

Thanks, Lucas.

Operator

Thank you. Our next question is coming from Emily Chieng of Goldman Sachs. Please go ahead.

Emily Chieng

Good morning, Lourenco and Celso. My first question is around the prime scrap or HBI usage that you mentioned in your blast furnaces. Maybe can you discuss a little bit about how much less coke you can use here if you increase that higher-quality raw material input? And then perhaps, is there a rule of thumb to think about what the percentage increase in volumes could--you could potentially save from using more prime scrap, there?

Lourenco Goncalves

Yeah, two things. We are using, primarily, the HBI in blast furnaces and we're using the prime scrap, exclusively, in BOFs, just to make sure that we're on the same page on where things go.

The HBI, Emily, used in blast furnaces is pre-reduced iron. So, iron ore pellets or sinter like they do in China to pollute the world and create global warming. We don't do that, here in the United States.

We use pellets. Pellets in blast furnaces make for an extremely environmentally friendly blast furnace. But when you load the pellets, you are loading--and I'm going to simplify this a lot--you are loading Fe₂O₃, so you are loading an oxide. So, you load coke to reduce the Fe₂O₃ and reducing is the opposite of oxide.

So, we're removing the oxygen with the coke to create Fe metallic. And that's why you need the coke over there.

Well, when you load a big portion, and we're loading a big portion of HBI in the furnace, we're no longer loading a big portion of Fe₂O₃, you're loading a big portion of Fe already metallic. So to reduce that portion of the metallic burden, you don't need coke. So, we can--at this point, we're reducing to the order of 20% coke rate.

We are going to go forward. We are going to continue to increase. Indiana Harbor 7, for example, which is the biggest blast furnace in North America, hasn't used massive amounts of HBI just yet because Indiana Harbor 7 wasn't the end of its life. But now, Indiana Harbor 7 is brand new. So Indiana Harbor will start to eat HBI a lot.

And that will push our total tonnage consumption of coal and coke in this company to a much lower level. I don't know we have the number because Indiana Harbor came back to operation

on October 14. So we are too early in the game and the furnaces are stable already. We're starting to use HBI, we generate data.

At the next conference call, I will have a lot of information about Indiana Harbor, the users of HBI, and we will continue to use our HBI in other blast furnaces. That's the HBI portion, the blast furnace. Are you with me on that, so far? Because now I'm going to move to the BOF.

Emily Chieng

Yep.

Lourenco Goncalves

Okay. So in the BOF, we are using prime scrap and prime scrap is exactly the steel that we want to produce. So it's already done, we only need to melt. So, when you add scrap, you are basically melting like the EAF melt scrap, we also melt scrap in the BOFs. But we use more prime scrap, we are melting more.

When you are melting more, you need less tonnage of what we call hot melt. That's the pig iron that comes from the blast furnace into the BOFs. So, less pig iron for the same tonnage still produced, we increase the yield. Or the pig iron, you stretch the pig iron to produce the same amount of steel.

Therefore, you're using less pig iron, less coke to produce the same amount of steel. So, the two components, more HBI in the blast furnace, more scrap in the BOF. Altogether, massive reduction of coal and coke and less emissions because coke and coal are C, and C plus O₂ is what generates the CO₂. And that's--those are the emissions we'd like to avoid.

Emily Chieng

Thanks. That was a good chemistry lesson. Maybe my second question is just coming back to the average selling prices that you alluded to being high, next year. Can you remind us really quickly what percentage of your book is contracted at fixed prices?

And then in your discussions, your contract renegotiations, any changes to sort of length of contract and appetite for floating versus fixed contracts, going forward?

Lourenco Goncalves

Yeah. Look, just because you mentioned my chemistry lesson, now I'm compelled to give a little bit of an accounting lesson. Your number of your share count in your first model, this morning, was wrong. That's why your EPS number was wrong. So, please go ahead and fix that, Emily.

As far as my percentage of fixed contracts, around 45%.

Emily Chieng

That's very helpful. Appreciate it.

Lourenco Goncalves

Did you fix the share count already, or not yet?

Emily Chieng

We will certainly be looking into it. Thanks for the flag.

Lourenco Goncalves

No, it's wrong. Don't look it, just fix it. You used the wrong numbers. And you need to fix that because when you use the wrong number in the share count, you calculate the wrong EPS for the same net income. That's math lesson, not chemistry.

Emily Chieng

Thanks, Lourenco.

Lourenco Goncalves

Thank you.

Operator

Thank you. Our next question is coming from Carlos De Alba of Morgan Stanley. Please go ahead.

Carlos De Alba

Yes. Hello. Good morning. Thank you very much for taking the question. So in the press release, you alluded to \$21 million--billion in revenues for the year. Basically, that suggests around \$6 billion in fourth quarter revenues, which I take is going to come from a combination of slightly lower volumes and higher prices.

Could you mention what do you expect for cost and EBITDA, given relatively stable revenues in the fourth quarter, implicitly in your comments?

Lourenco Goncalves

Carlos, you already put all the numbers on the table and now the EBITDA is just a consequence of everything that you have just said, right? You said the revenues, you said how we're going to get there, and yeah, you have it. I'm not changing my guidance at this point because that's another fool's exercise. You change the guidance and you have set yourself for failure.

So, I've got that. I'm not changing anything.

Carlos De Alba

All right. Fair enough. Is it fair to say then the price increases that you expect will more than offset the cost pressures?

Lourenco Goncalves

They will more than offset. They will more than offset.

Carlos De Alba

Alright, great.

Lourenco Goncalves

Okay. I'll give a few indications. Our tinplate business, for example, which we have already renegotiated with all the clients, they are increasing between 2021, 2022 price-wise, 100%. In other words, we're doubling the price of our tinplate because the costs are not increased, not even marginally close. It's a fraction of that.

So, we are going to have a meaningful, bigger contribution from tinplate.

Another one that I will give to you-electrical steels. Electrical steels have been a problem and were a problem until this year until supply chain problems showed the clients that we're eager to import and use dumping grounds in Mexico and dumping grounds in Canada to try to disrupt the transformers markets, here in the United States.

That proved then to be naked because the same ports that bring goods and gadgets from China, are the ports that bring stuff to the United States, as far as electrical steels. So, we protected the clients that are not importing, and we punished the ones that are--were importing.

So, we are heading into next year with much higher prices in electrical steels for the book and we're privileging the clients that were with us during the times that others were importing. We're still selling to the ones that were importing, but we're selling to them at a much higher price than they were paying, before.

So, the pricing equation for us has very little to do with this thing of the spot prices of hot-rolled that went down \$5 yesterday or went up \$2 today. We don't care about that, to be honest with you. We're a contract business type of operation. And we are always looking 12 months ahead. Not necessarily calendar year counts, but the 12 months ahead.

Carlos De Alba

All right. That makes sense and is clear. And talking about imports, how do you see the potential impact if Europe comes out of Section 232 and that is replaced, the 25% import tariff is replaced by a quota system?

Is there enough steel in Europe that could come to the U.S., even when China may be reducing exports?

Lourenco Goncalves

Yeah, China is reducing exports, by the way. China is reducing exports. That's probably the first time I said that in several years. China is reducing exports. China is trying to knock down pollution. And that's a good thing for the world, for our global warming.

But the problem with the Europeans is that they want--it's like same thing with the Japanese and South Koreans.

But the South Koreans and the Japanese, I can understand. They're too close to China, geographically. But Europe is an enigma to me because they had no business to play both sides of their mouth. China and South Korea, they do that all the time. They want to be friends with the United States; they don't want to upset China.

But the Europeans, they need to work with us. And not to try to work with others, too, is mild to Xi Jinping.

They need to understand that if you--they are with us, they should not be with China. Australia, that has a much more geographical compromised position in the globe, understands that better than the Europeans. So, every time I have a chance to convey my message to the Biden Administration, I keep saying, pay attention to these friends in Europe. They are not our friends; they just like to take advantage.

So, I am supportive of a tariff rate quota, as long as the quota is fair and the tariff that kicks in after the quota is high. Anything else, we're going to be very vocal in opposing and expressing our opinion. And another thing that needs to be taken to consideration, among our 25,000 employees, we have 25--20,000 plus employees that are unionized.

And the unions shared the same opinion that I have just expressed. So, even though I don't speak for the USW or the UAW over the machines, I have been talking to them all the time. So, we are going to be extremely vocal if the negotiators on behalf of the United States don't play our side of the game and play the European side of the games.

That's one of the very few things that I believe that unifies this industry, this country, Democrats, Republicans, everybody understands that we need to protect ourselves, at this point. And not allowing the Europeans to take advantage of us in the negotiation table is extremely important.

Carlos De Alba

Alright. And the last question, if I may. How does switching to Minorca would help or could help the DRI cash costs, and how much is the royalty component?

Lourenco Goncalves

It would have to go down a lot of because of the royalty component at Northshore is absurdly high. Even with absurdly high costs out of Northshore, you saw the number I reported for the

all-in cash cost of production of HBI of \$187, per net ton. So, even those are prohibitive, could be a lot less. And that's why we're moving from the Northshore with a very bad royalty structure to Minorca.

That will be a big savings in terms of cash cost from the royalty standpoint. But still even with Northshore, it was \$187 per net ton, so we're good, but we can be better. We're always looking for better costs, and that's why we're going to Minorca.

By the way, phenomenal plant. Great plant, great equipment, a General Manager that has things under full control, around doing a great job leading Minorca integrating into our Cleveland-Cliffs way of doing business.

And they are very excited with the opportunity to produce DR-grade pellets that they just started. And also the General Manager of Northshore, Paul Carlson, was the guy that developed the DR-grade pellets for us first as a General Manager of technology, and then as general Manager of Northshore. So, he is helping, and he will continue to help.

So, I have my Northshore people working to help our Minorca people to move DR-grade pellets from Northshore to Minorca. And we're going to have a much better royalty structure, lower payments for royals. And we're going to keep Northshore idle, every now and then. That's what we're going to do.

Carlos De Alba

All right. Excellent. Thank you very much. All the best in the quarter and next year.

Lourenco Goncalves

Thanks, Carlos, really appreciate it.

Operator

Thank you. Ladies and gentlemen. We're showing time for one final question, today. Our final question will be coming from Alex Hacking of Citi. Please go ahead.

Alex Hacking

Hi, Lourenco. Good morning--and Celso.

Lourenco Goncalves

Alex. Alex. Alex.

Alex Hacking

Yes. Yes.

Lourenco Goncalves

Even though Donna already said that will be the last question, I am going to--I'm going to take a question from Tristan and Matthew Fields that I'm seeing in the queue. So, please don't disconnect. We have time, sorry.

Alex Hacking

Okay, sure.

Lourenco Goncalves

Please.

Alex Hacking

I didn't know if you were going to cancel my question or not.

Lourenco Goncalves

No, no, no. I'm just saying that because I would have the other two that are lined up to ask questions. They would probably disconnect. I don't want them to disconnect. I will take their questions, as well. Just trying to be respectful. And I appreciate you guys joining the call and asking the questions. It is very helpful for us, as well. So, please go ahead, Alex.

Alex Hacking

Yeah. And we appreciate all your candor and straightforward talk, Lourenco. I guess, as you look at the--your cash that's coming in, right. If we look at--there's going to be a lot of free cash flow next quarter, going to be a lot of free cash flow, next year. Where are you looking to reinvest in the business, sort of upgrading capabilities.

I mean, you've been clear that you're not going to lack capacity but, obviously, there are other kind of investments that you could make. So far, we've seen you investment in raw material on the raw material side.

Are there any sort of significant investments that you're looking to make and how are you thinking about what CapEx is going to be, over the next couple of years? Thanks.

Lourenco Goncalves

Yeah. Look, it's a great question. Like I explained--I believe I explained clearly during my prepared remarks--we don't have because we have modern capabilities to produce high-end steels, we don't and yet we have a very environmentally friendly footprint at this point with pellets, HBI, less coke, everything that I explained during the call.

We don't have the massive needs of CapEx that other companies are expressing, and they committed to deploy. We don't have that. So our CapEx, we will always be CapEx for the existing footprint. So CapEx for our existing footprint at this point, we're seeing something

between--let's go \$750 million to \$850 million, every year. That's more or less what we are envisioning at this point, going forward.

So, it's not something to really take our breath away, at this point. The biggest project that we have in mind right now in like markets being planned as we speak, is the relining of Cleveland Blast Furnace No. 5, and that will be, give or take, \$100 million type of project. So, it's a little more than what we would expect for a furnace that's not that big.

But that's a first that we need of things to allow the furnace to take more HBI, to use more natural gas, to reduce coke rate. All the things that we have been implementing in other points. So, but that's already included in this \$750 million to \$850 million that I gave to you. What else was in your question, Alex. Sorry, did I miss something?

Alex Hacking

No, that answered the question. I guess just one very small follow-up. You've talked about the importance of decarbonization in the steel sector, and I guess what kind of investments are you envisioning Cliffs making over the next few years, in terms of decarbonization? And any thoughts on the most promising technology, there? Thank you.

Lourenco Goncalves

Look, we are actually the only company that I know of in the United States, or abroad, that has already spent more than \$1 billion to decarbonize.

We put one \$1 billion in our HBI plant, and we improved our capabilities at Northshore to produce DR-grade pellets at Northshore to the level of production that would feed the plant. Little I know at the time that I made that investment, that I would be able to acquire Minorca inside the transaction of ArcelorMittal.

If I had a crystal ball, I would not have invested that \$100 million. But the fact of the matter is that I did, at a time that Northshore was the only one that I could use to produce DR-grade pellets.

So, we have already applied \$1.1 billion to decarbonize, just in these two projects, \$1 billion for Toledo and a \$100 million for Northshore. That's real money.

Am I going to do HBI, two? At this point, the answer is no. There is no plan to put HBI, two. And the main reason for that is I don't need it because we changed course. We are no longer selling HBI to the market. We changed course. We are not going to continue to sell pellets to the market beyond the expiration of the last contract. It will be all internal. And we changed course. We acquired a scrap company.

Am I going to acquire new scrap companies? Maybe. But I believe that our growth can be organic, and we might not even need to buy a scrap company. What I like the most about FPT is

not only the fact that they have already control over a lot of prime scrap, but also that the management team is phenomenal.

And we are excited about the people that are coming with the company and the mindset, and how we're going to grow the business with Keith Koci who, by the way, is my go-to guy for these things for 15 years, and we have been doing this together, since metals were a thing.

So Keith Koci in two months, he went from not knowing the market by being the go-to-person in this market at this point in scrap and knowing everything and finding the right target on FPT and guiding through and working with Celso to get this thing closed in a record--not close, signed definitive agreement in a short period of time and everything is lined up for closing in Q4, record time. Great performance, perfect solution for us.

So, we are not going to go and buy scrap companies because if we find something that fits, maybe. But we don't need. We're going to go to the organic growth and that's the way we want to do.

So, long story short, Alex, we don't have big projects to buy--to build new plants, build capacity. Oh my gosh, this has--this mistake has been made for so many times. U.S., Bethlehem, keep going. And it's sad to see the same mistake being made again, but it's not going to be made by Cleveland-Cliffs. Alex

Alex Hacking

Yeah. Thank you. Thanks.

Lourenco Goncalves

All right.

Alex Hacking

And best of luck.

Lourenco Goncalves

All right. Appreciate it. Donna, next one.

Operator

Thank you. Our next question is coming from Tristan Gresser of Exane BNP Paribas. Please go ahead.

Tristan Gresser

Yes. Hi. Thanks for taking my questions. First one, a quick one. I may have missed it, but just wanted to clarify the prior full-year '21 EBITDA guidance you provided is still valid.

Lourenco Goncalves

Still valid, \$5.5 billion.

Tristan Gresser

Okay. Thank you.

Lourenco Goncalves

You know what Tristan? It will be higher-it will be higher. But I just don't want to give a--commit with a number because I commit with a number and then everybody bumps up and then they find a way to--for me to miss. So, I always miss. If I don't miss the numbers, I'll miss a comma in my prepared remarks or something like that, or my accent is not good. So, I'm tired of missing.

So, that's why I'm tired of updating guidance. We do these things at the end of the day to help your--you guys model. And then you guys say, "They missed against my model. " No, your model missed against reality. That's what happens. So, it's not you alone Tristan; it's everybody. We don't miss anything. We do what we have to do.

You guys eventually miss your latest--eventually miss because your model is not good. Sometimes it's just share count. Like I was talking today, respectfully, with Emily Chieng, if you use it wrong share count, your EPS will be wrong, and they will call it a miss. That's absurd. But go ahead, Tristan, please.

Tristan Gresser

Yeah, no, second question, maybe on energy. I think your energy mix is 40% natural gas. Have you seen any meaningful increase in energy costs in the quarter? And can you remind us a bit of your procurement strategy for natural gas, do you have any contracts or hedges in place?

Lourenco Goncalves

Yeah. Look, we use a lot of natural gas, and we love natural gas. Actually, I have been trying to educate the U.S. government about how relevant natural gas is for us, not only as the support for the manufacturing that we have today, but also the support for the manufacturing of the future.

For example, our use of natural gas in Toledo in our direct reduction plant is actually the real use of hydrogen to reduce ore because we--the natural gas that we use inside the direct reduction plant is reformed gas.

And reformed gas is basically H₂. And the CO₂ stays in loop just to keep the gas hot. The reduction becomes H₂ that's developed by the process of reforming natural gas. So we buy a lot of natural gas. The impact in cost is not meaningful. We do a lot of hedging. Celso, talk a little bit about the hedge on natural gas, please.

Celso Goncalves

Yeah, sure. Hey, Tristan. Just to give you some data points, we consume about 190 million MMBtus of natural gas, per year, across our entire footprint. And very simplistically, our goal is to be half hedged, 50% hedged for the next 12-month period. So, we use a number of different instruments to do that.

So, the impact of the increase in price is pretty muted based on the fact that we have those hedges in place. And I think it's important to note, as well, that higher natural gas prices tend to lead to more drilling, which helps steel demand in the long run. So, we don't see this as a big impact for us going into next year.

Tristan Gresser

All right, that's really helpful. And my last question, maybe on low carbon steel. You lay out well the competitive advantage versus flat-rolled mini-mills and raw materials and better grades capabilities. So, how do you see the efforts by certain players in the U.S. to gain market share on no-nos, by selling low carbon steel products?

Do you see that as a risk or how do you plan to mitigate that? And what OEMs tell you about that topic in contract negotiations?

Lourenco Goncalves

Well, we sell today 5 million tons like I said, of steel to the automotive. So, there's an opportunity for these folks to grab a lot of market share, even because I believe that 3 million, 5 million tons is excessive. The problem is that when I cut tonnage, I'm not going to cut tonnage a little bit here, a little bit there.

I'm going to take one car manufacturer and say to this car manufacturer, "I'm not selling to you anymore."

So, let's assume that I cut that with one car manufacturer that I sell a million tons and oh, by the way, I have more than one that I sell a million tons. And that makes us go from five to four. We are still with four, twice as much as the second largest. With four, not with five. With five, we're more than twice. And there is a huge opportunity for this type of steels.

Let's put it like that. But the car manufacturers have to do everything with that type of steel. I don't think it's a good proposition. I don't think that they will entertain that. And that's how I do business. They like it, great. They don't like it, be my guest. I will be the next microchips. Do you understand my point, Tristan?

Tristan Gresser

That's helpful. Thanks a lot.

Lourenco Goncalves

Just helpful? So let's try one more time. The Europeans--you are in London, right? You work out of London, is that correct?

Tristan Gresser

Yeah, I don't think my location has anything to do with the question, but thanks for the answer.

Lourenco Goncalves

Your location is a question that I'm asking you. Are you in an undisclosed location? Are you a person that can't disclose where you are at? Do you work for a company that's headquartered in Europe, or not?

I need to know because I want to give you an explanation on something. I would like to know. Can you share with us?

Tristan Gresser

Yeah, of course. I mean, you asked last time, I'm in Europe.

Lourenco Goncalves

Okay, so you're in Europe. So, the Europeans have been playing the steelmakers for a long time, the European car manufacturers. And the European car manufacturers have been doing a great job making them slaves of the car manufacturers.

Well, here in the United States, the biggest supplier of steel to car manufacturers does not accept this role. And that's guiding all of our negotiations with them. We want to be treated in an equal footing.

We don't want to be the bully, but we are not going to be bullied, and we're not going to accept lip service. If you are going to be buying steel with a brand of being environmentally compliant, please make sure that the ones that are really reducing emissions, like we are, and investing a lot of money to reduce emissions, like we are, we are going to be treated the same way at the very least. And that's the thing.

So I'm not feeling threatened by this type of steels. We are actually--just to give you a few examples--we are actually working on carbon capture here in Indiana Harbor. And that's pretty much a well-known thing that we are the ones that have developed carbon capture technologies in steelmaking for the entire United States, and this thing will be used for the rest of the world.

Also, we are starting to work with one of the upcoming company--upstarts that are trying to develop a breakthrough technology called Boston Metals. We're working with Boston Metal to develop their component inside one of our plants here in United States, Burns Harbor, to see if

their technology will work in steelmaking, which I truly believe can be a breakthrough technology.

But these things, Tristan, are breakthrough technologies. And Europe is trying to make breakthrough technologies to sound like well-established technologies. They are not. You cannot supply 50 million tons of automotive steel and base your thing in breakthrough technologies.

If that was the case, Japan would be doing that because they don't have iron ore. They don't have coal, but they have a lot of blast furnace. Do you know why? Because they have a lot of automotive. South Korea, same thing because they have no iron ore, no coke, but they have a lot of blast furnaces. Do you know why?

Because they have a lot of automotive. I'm talking about Toyota, Honda, Nissan, and Subaru, that's Japan. And Kia, Hyundai in South Korea. We all know the names. Same thing here in United States. So, you know the names of the car manufacturers, and you now know the name of the biggest supplier for the car manufacturers called Cleveland-Cliffs.

And we're not only supplying environmentally friendly steel today, but we are going to be at the cutting edge of producing the next generation of steels because we're already working on. You don't see the press release because I tend to only put the press release out when we have results. We don't brag and then we try to do, we tried to do work hard, then we brag.

Tristan Gresser

I appreciate the answer. Thank you.

Lourenco Goncalves

Thank you.

Operator

Thank you. Our next question is coming from Matthew Fields of Bank of America. Please go ahead.

Matthew Fields

Hey, Lourenco, thanks for reserving time. I appreciate it. And Celso, congratulations on the promotion. Well deserved.

Lourenco Goncalves

Hey, Matt. Appreciate that. But just a question for you. Where are you located?

Mathew Fields

New York.

Lourenco Goncalves

Good. I love New York. Just to make sure that it's not an undisclosed location.

Matthew Fields

No, I'm not important enough for an undisclosed location. Just a quick one about Minorca, first. Is there any kind of a construction or project CapEx associated with that transition or is because it's so close to Northshore, you can use that DR-plant facility for the Minorca pellets?

Lourenco Goncalves

Yeah, we can do a lot of things there, but we'll take over now use, I will not use iron ore from the Peter Babbitt--Peter Mitchell mine in Babbitt, Minnesota because I don't want to pay that royalty. And it's my decision to use the iron ore from another location. So, I use iron ore from another location.

Matthew Fields

Okay. Great. And then they--that mine sort of got a 3 million ton, at least, capacity. So is that essentially just going to be feeding the HBI plant and sort of no DR Pellets on the merchant side or no DR pellets outside of what gets flown through the HBI plant?

Lourenco Goncalves

That's correct. Of course, I will comply with all the contracts that we have in place. But these contracts will go away. And when they go away, we'll no longer supply. And we will concentrate Minorca for DR-grade pellets. We are moving Mustang pellets to United because we've--under the previous configuration, we produced Mustang pellets, half at United and half at Minorca.

There is no reason for that. We can concentrate Mustang--Mustang pellets are the ones that go in Indiana Harbor 7, the superflux pellets. So, we can concentrate Mustang pellets into United at 100%. So we free up Minorca for DR-grade pellets. And make Northshore our swing operation. We'll be using, as needed.

Matthew Fields

Okay, great. Thank you very much. And then you already sort of talked about metallics today, and you are, obviously, a few years ahead of your peers on the kind of shortage of metallics coming to this country with the HBI investment and what not.

But can you talk a little bit about the balances that you have to thread between--and you already said you might sort of grow your appetite for scrap, organically.

I appreciate that, but what are the kind of--the balance point that you have to hit, the benefits from the increased yield, from using more scrap on--it can actually--on the con side, the prime scrap can be a little bit expensive, compared to your internal pellet production.

And then ultimately, is there a ceiling on the amount that you can use of scrap as a percentage of the batch with when you get up to losing quality between flexibility and strength on the ultimate end product? What are the constraints that you kind of see for your footprint on hitting all those points?

Lourenco Goncalves

That's a great question. But the very first thing to consider, Matt, is that we are way below what would be the theoretical point of thermal equilibrium about what we can't use more scrap. I mean, we have furnaces, BOFs, vessels today, converters that we're using 82% hot metal.

We can go down to 75%, 74% with no fear, with no problem. I actually--when I was a U.S. General Manager long ago, I used to do 75% hot metal because--and 25% scrap--because that was a good practice in terms of stretching my hot metal. So, I implemented that.

Another thing that, over time, changed for cost reasons in order to save pennies while the replacement of wood scrap with prime scrap, with obsolete scrap.

I would like to free up obsolete scrap for the one that produce rebar and to produce other things that are less sophisticated that will be in high demand with the infrastructure deal. We're going to be building back better in this country, hopefully soon. And there will be a lot of rebar, a lot of lightweight things that will need obsolete scrap. We're going to free up that for them.

And I want to use prime scrap where branch scrap belongs. And I'm glad to hear that the flat rolled EAFs are in the process of replacing prime scrap with obsolete scrap. Good for them and good for me because then I will have more prime scrap to use to produce highly specified materials because that's what we do.

We don't produce steel for the floor of the cars. We produce steel for everything, from the door rings to the skin; the skin is the exposed parts. So, pretty much everything. So, we need prime scrap for ourselves, but we are far from the theoretical breakeven point because it's a thermal balance problem, not a cost thing.

Matthew Fields

Okay, so in theory over the next couple of years, or what not, we should look to kind of you growing that scrap business, either organically or inorganically.

Lourenco Goncalves

Yeah. We are going to grow by reclaiming our own scrap for our own clients. Let's put it like this. And because again, because it's not my main source of feedstock, I can both be a little more flexible with the client and pay the clients a little more because it's not my cost, it's my--it's in order to produce better steel. So, it will go back to the other hand with us for the producing and supplying these very same customers with better steel.

Matthew Fields

That's helpful.

Lourenco Goncalves

Matt, I'm not sure if I'm being clear with that because of course, prime scrap, it will cost a little more than what we are paying, today. But on the other hand, everything you gain in terms of higher yields, less rejects, things like that will offset the fact that we are increasing \$1 or \$2, per ton. You know what I'm saying? So, in the big scheme of things, this is nothing.

And that's how technological this business used to be in the past. And over time, it kind of started to go away from the technological center of things. We're bringing this back because it's a very technological moment, right now. We want to produce the same high-quality steels with a lot less emissions.

And that's what we're doing. Instead of just throwing press release and saying, we're going to do this we're going to do that. We're doing, and we are doing in technological cooperation with the car manufacturers, primarily car manufacturers, but other flat-rolled consumers, as well.

Mathew Fields

No, that's, that's helpful. I mean, it's a complex system of raw materials that you're feeding in to optimize along more constraints than the steel business is used to having, especially, with carbon emissions now becoming a bigger constraint. So, helpful for us to get kind of where you're coming from on all of it.

Lourenco Goncalves

Yeah, and I apologize to the ones on the call that we got to, into too much of the nitty-gritty details of the chemistry. But at the end of the day, you guys are going to have to be prepared for that because when you talk about the emissions, you are talk about chemistry.

You're no longer talking about cost accounting. You're no longer talking about the average price of HRC. You're going to have to--you, the research analyst community, will have to prepare yourselves to get this conversation to the next level because the phase of announcements, and bombastic declarations and trademarks, and things like that, will pass.

Because after you do a little bit of that, everybody including the clients and yourselves, will say, okay, where is the beef?

How many tons of this thing you're producing? Where is this steel going? Is this in the door of the Ford Explorer? And I'm making this up; it's the first car model that came to my mind. Or where is this being used and what for? So I will tell you, we produced 5 million tons of steel to the car manufacturers.

I would love to purchase less, because I still believe that's too much of automotive exposure, even though it's less than half of what I had, when I only had AK Steel.

So, the biggest synergy--nobody asked about synergies today, by the way--the biggest synergy from the acquisition of both AK Steel and ArcelorMittal USA, Matt, was the fact that we could bring back technological sanity to this business.

And we are also translating this technological sanity into much higher revenues, much higher profits, EBITDA margins that were unheard of, before. By the way, I don't know if you guys noticed, for the companies that reported so far, we reported the highest EBITDA margins, among them all. So, we're doing all that, in a profitable way.

And we'll continue to do so. Next year will be better because of the way we do business, with fixed contract pricing situations that will protect the customer and will protect Cleveland-Cliffs. And the rest we will play around with the market.

Alright, Matt, appreciate the question, though. Donna, I thought I think we're done.

Operator

Yes, sir. Do you have any additional or closing comments, today?

Lourenco Goncalves

I already did.

Operator

Wonderful.

Lourenco Goncalves

Have a great thanksgiving. I will not be talking to you, before. There's a lot to be--to thank for, and here at Cleveland-Cliffs, we thank every day. Let's continue to try to reunite America to show that we are the best country in the world, particularly, when you're no longer just talking, and you are doing things.

Let's continue to do things for the betterment of life of the American people. Let's think about the people, about the employees, not only to pay lip service to safety. Let's pay them better. Let's do things that can improve the lives of average Americans. That will bring peace to this country.

Thanks a lot. Bye now.

Operator

Ladies and gentlemen, thank you for your participation and interest in Cleveland-Cliffs. You may disconnect your lines or log off the webcast at this time and enjoy the rest of your day.