

**Cleveland-Cliffs, Inc.**  
**First Quarter 2022 Earnings Conference Call**  
**April 22, 2022**

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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**

**Lucas Pipes - B. Riley Securities**  
**Michael Glick - JP Morgan**  
**Emily Chieng - Goldman Sachs**  
**Seth Rosenfeld - BNP Paribas**  
**Carlos De Alba - Morgan Stanley**  
**Timna Tanners - Wolfe Research**  
**Matthew Fields - Bank of America**

**Operator**

Good morning, ladies and gentlemen. My name is Kevin, and I 'm your conference facilitator today. I'd like to welcome everyone to Cleveland-Cliffs First Quarter 2022 Earnings Conference Call.

All lines have been placed on mute to prevent any background noise. After the speakers' 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 protection 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 Forms 10-K and 10-Q and news releases filed with the SEC, which are available on the company's website.

Today's conference call is also available and being broadcast on [clevelandcliffs.com](http://clevelandcliffs.com) and at the conclusion of the call, it will be archived on the website available for replay. The company will also discuss results including 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 Celso Goncalves, Executive Vice President and Chief Financial Officer.

### **Celso Goncalves**

Thank you, Kevin, and thanks to everyone for joining us, this morning. Let me start by summarizing the key highlights from our Q1 results, and then I'll provide some additional context around our increased outlook for the remainder of the year.

Our adjusted EBITDA of \$1.5 billion in Q1 of 2022 is three times higher than the year-over-year adjusted EBITDA in Q1 of 2021, boosting our last 12 months EBITDA to \$6.2 billion, which is a record for any 12-month period in our company's history.

Relative to last quarter, our sequential Q1 EBITDA was essentially steady with Q4, despite the sharp drop in spot steel prices that started around September of last year and lasted into early March of this year, before rebounding higher.

In late Q4 and early Q1, we also saw relatively weak service center demand due to generally elevated inventory levels.

Despite this unfavorable backdrop of falling HRC prices and weak service center demand, we were still able to maintain a steady quarterly EBITDA level from Q4 to Q1, primarily, due to the magnitude of our fixed contract price increases that went into effect at the beginning of this calendar year, 2022, ultimately more than offsetting the spot price weakness backdrop, and resulting in higher overall average selling prices for Cliffs quarter-over-quarter from Q4 to Q1.

We have been foreshadowing that the strength in fixed price contract renewals would eventually materialize in our numbers, and that has now been clearly demonstrated, through our Q1 results.

From a volume standpoint, we also achieved a 200,000-ton sequential improvement in direct volumes to the automotive industry, our best shipment quarter to this end market, since the semiconductor shortage began in the first quarter of last year. This resulted in improved sales volumes of 3.6 million tons in Q1.

Going forward, as we expect the automotive sector to continue to improve and the distributors and converters market to replenish inventories, we anticipate sales volume to increase further on a quarterly basis.

During Q1, we also concluded negotiations on all of our remaining fixed price automotive renewals that reset on April 1, with significant further price increases executed on all 1.5 million tons of annualized volumes that matured on that date. We are already benefiting from these price increases here in Q2.

Beyond that, our next round of fixed price contract renewals will be negotiated this summer and re-priced on October 1, and we look forward to continuing this favorable pricing momentum on those negotiations, as well.

Now, adding additional context around our updated favorable outlook for the remainder of the year, we are increasing our expected average selling price by \$220 per ton, compared to our prior guidance in February.

Our expectation is now for a full year average selling price of \$1,445 per ton at the current curve, compared to our previous guidance two months ago of \$1,225 per ton, based on the curve at that time. This improved outlook is driven by three things.

One, our successful fixed contract renewals, as I've just explained; two, a higher futures curve today compared to February; and three, wider than historical spreads between hot rolled and cold rolled steel prices.

On the cost side, we are better positioned than any of our competitors to mitigate pressures from the current inflationary environment, given our vertically integrated and internally sourced iron ore pellets, HBI, and scrap, as well as annual fixed price contracts for met coal.

Our Q1 unit costs moved up sequentially as expected, due primarily to coal, alloys, and energy cost increases. We also took \$111 million in one-time accounting charges related to some operational and financial decisions that we executed during the quarter: namely, the closure of Mountain State Carbon, and the idling of the Indiana Harbor #4 blast furnace, as well as the redemption of our convertible notes.

Looking into Q2, we expect our unit costs to increase, sequentially, due to our Cleveland #5 outage and generally higher scrap and energy costs, although these will not impact us nearly as much as others in our industry that are much more exposed to high scrap prices and need to buy slabs, externally.

From a cash flow standpoint, our inventory build of \$372 million during the first quarter was more reflective of costs than actual units, as our total tonnage of steel inventory actually declined, over the past quarter.

With this one-time inventory build out of the way, our Q1 free cash flow of \$297 million should be the trough in quarterly free cash flow generation for the year, with much higher rates of EBITDA-to-free cash flow yield conversion in Q2, Q3 and Q4. At the current steel forward curve, we expect our total 2022 free cash flow to exceed the record that we set last year.

And that is even as we become a substantial cash taxpayer this year, which we were not in 2021.

Speaking of cash flow and capital allocation, we continue to clean up our capital structure and favor debt reduction over other uses of capital, at this time. This year, we have already redeemed our convertible notes and our 9.875% secured notes, which we completed this week, well ahead of its 2025 maturity.

With this proactive approach, our most expensive bonds are now completely gone, and our annual cash interest expense has significantly reduced. Looking ahead, we have a few more tranches of debt that we can pay down with our cash flow, prioritizing our 6.750% secured notes, as our next target.

In a few quarters, our debt should be so low that it will no longer even be a discussion point, and I look forward to talking about other ways of returning capital to our shareholders, at that time.

Our LTM EBITDA of \$6.2 billion already implies leverage of 0.8 times, the lowest level for Cliffs, in over 12 years.

As you can also see from this morning's release, we only spent \$20 million in share repurchases during Q1, executed opportunistically, at very attractive prices. Other than this, we used most of our remaining free cash flow generated during the quarter toward paying down debt, as discussed.

Going forward, we will continue to favor debt reduction over share repurchases in the near term, and buybacks will continue to be only opportunistic.

In closing, because of our domestically sourced raw material supply chain, as well as our heavy weighting towards fixed price contracts, our 2022 financial outlook is very compelling with strong margins, record levels of free cash flow and equity value creation through a massive conversion of total enterprise value to market value, via debt reduction.

With that, I'll turn the call over to Lourenco.

**Lourenco Goncalves**

Thank you, Celso, and good morning, everyone. I will start addressing the most significant developments that we are facing, at this time. The Russian invasion of Ukraine is a barbaric act. Its impact on the civilian population of Ukraine has made these events, above all else, a human tragedy.

As a matter of fact, Russia and Ukraine have been at war, since Putin invaded the Crimean Peninsula in February of 2014, a few months before we began the turnaround process at Cleveland-Cliffs.

Our business, at that time, was to supply raw materials to North American steel makers and we identified the massive share of pig iron coming into the United States from Russia and Ukraine as unreliable and at risk.

Representing two thirds of all U.S. imports of pig iron at the time, it was pretty remarkable that no one was really concerned about it or working to reduce their dependence on both Ukraine and Russia.

This helped us formulate our decision made in 2017, after we had already fixed the financial situation of the company, to build up a massive source of virgin metalics with our Toledo direct reduction HBI plants. That was an attempt to provide the U.S. electric arc furnace market with a more reliable and carbon friendly source of metalics, which they absolutely need to make higher specs of flat rolled steel.

In the seven years following the invasion of Crimea, we were the only company to act on this potential to re-shore ore base metallic supply back to the United States.

Fast forward, now that we are a steel producing company, we are better off using our HBI in house. That has allowed us to reduce our blast furnace footprint from eight to seven units, while maintaining similar level of the steel production output following our recent idle of the Indiana Harbor #4 blast furnace.

This has also created a huge competitive advantage for us. With our own in-house pellets and relatively cheap natural gas, our cost to produce HBI has been just over \$200 a ton, and that compares very favorably to the \$1,000 per ton price tag for pig iron imported into the United States, these days.

The ongoing importance we placed on prime metalics did not stop with HBI. In November of last year, we acquired FPT, the leading prime scrap company in the United States. Since acquiring FPT just five months ago, we have already increased our access to another 400,000 tons of prime scrap, per year, elevating our market share in merchant prime scrap from 15% at the time of the acquisition to 20%, now.

Both of these strategic moves, FPT and HBI, each underscored by our forward-looking view on the necessity of domestically sourced high quality iron units can pay off in very short order. These actions were based on our view of the world, and we are benefiting now.

Iron metalics are, absolutely, necessary to make high quality flat rolled steel. We at Cleveland-Cliffs are long on metalics in a country that is short of them. EAFs cannot make high quality flat rolled steel just by melting scrap. They need metalics. That's why they import so much pig iron, the vast majority from Russia and Ukraine.

However, important pig iron comes from some of the least environmentally friendly plants in the world, generating a level of Co2 emissions that would put them out of business here in the United States. But that is scope three emissions for the American importers of pig iron and so far, that important piece is ignored when a company reports emissions.

We at Cleveland-Cliffs will continue to educate investors, members of Congress and government officials on the importance of accounting for the scope three emissions. If you are serious about emissions, the scope three can no longer be ignored.

As a result of the invasion of Ukraine by Russia on February 24, more than 4 million tons per year of important pig iron supply have been disrupted. While the new situation hit very late in Q1, particularly due to vessels already sailing and material already unloaded on the massive grounds, 4 million tons out of a total of more than 6 million tons is a full-blown disaster for companies depending on imported pig iron.

For these folks, Q2 should be very challenging. Supply from Ukraine will, likely, be out of the market for a very long time, due to the significant damage to blast furnaces, bulk batteries and other equipment that cannot be fixed, quickly. As far as Russian pig iron, well, we are sure that production will not be discontinued.

Due to outdated trade laws and powerful lobbying efforts, pig iron from Russia can still come into our country with effectively zero restrictions, even after Russia losing PNTR, Permanent Normal Trade Relations, status with United States.

Their revocation of PNTR status came with hefty tariffs of 25% or above for most steel products from Russia, but the tariffs on pig iron is still a meaningless \$1 per net ton. This dates back to the 1930s when pig iron was not even a product imported by the United States, and certainly not from Russia's predecessor, the Soviet Union.

Again, as far as Russian pig iron, production will not be discontinued. Even if American companies decide to stop buying Russian pig iron, as early as right now in Q2, Russia's next move on the international trade arena is very predictable for shipment of Russian pig iron through Russian friendly business as usual type of countries, such as China, India, Brazil, and a few others.

Cleveland-Cliffs will be watching the current developments around the international trade of Russian pig iron in Q2, and we fully expect the U.S. government to be on the lookout to block such predictable moves on fresh shipments of pig iron from Russia, through third parties countries.

Taking one step back and learning from current events. The impact on supply chains would have been a lot worse, if we are talking about the invasion of Taiwan by China. But the ongoing invasion of Ukraine by Russia should be enough for a clear call for the end of globalization.

We call it de-globalization. I believe de-globalization is the most important game changer of these decades in United States and for the American people. De-globalization is not just relevant for our industry, but for our customers, as well.

If the automotive OEMs had not set themselves up to be so reliant on imported semiconductors, they could--they would have the demand to support the production of 18 million cars, both last year and this year, rather than the 14 million to 15 million units they are currently able to produce.

We are encouraged by investments made in on-shoring this production, including a major \$20 billion factory down the road in Columbus, Ohio. Cleveland-Cliffs is an automotive supplier, first and foremost, by far the largest supplier of steel to the sector.

AS Celso noted, Q1 was our best shipment quarter to the automotive sector in a year, but we will be able to do much more in a fully utilized business environment. That day is coming and the amazing results we have shown over the past year will only be further amplified, once we get there.

Looking ahead to the rest of the year, based on the rationale I have tried to lay out today, we are set to benefit from our perfectly constructed business model. There are seven real producers of flat rolled steel in the United States, and we are the only one among the seven that does not rely on imported pig iron or slabs.

In simple terms, the high cost that our competitors are facing from sourcing these materials will force them to keep the steel prices elevated, and we will benefit through higher margins, as our cost structure is not nearly as impacted.

Also very important, new flat rolled mini mills ramping up capacity will only exacerbate their current issues with sourcing prime scrap and metallics, which will just further widen the competitive advantage we have.

While I have focused the majority of my remarks on raw materials and substrate, the Russia Ukraine conflict removed a lot of finished steel from the global marketplace as well, including the slabs rerolled in Europe. The war induced steel shortage has pushed global steel prices up, making imports less appealing in the United States.

We continue to read the same headlines about inflation, rising rates, rising slower growth and the increasing likelihood of a recession. We long for the days that Fed officials will just keep quiet and do their job, rather than giving doomsday interviews on Zoom, almost every day.

For us, underlying demand is good, customer inventories have begun to decline, and issues related to sourcing labor or critical materials are showing signs of easing. The panic buying of

2021 is behind us, but we still have a lot of hungry mouths to feed, and that will only increase, as the semiconductor shortages gets progressively better.

Wrapping up, we did not wish for the current Russia Ukraine situation and want to see peace, soon. Russia should be punished for their vicious attacks and the steel industry around the world, particularly the American steel industry, can play an important role in inflicting maximum pain to the perpetrators of this despicable act against the civilian population of Ukraine.

We have geared our strategy around the importance of a domestic supply chain and it's unfortunate that it took this situation to be the wakeup call for the one's that were not paying attention. We are proud to provide our customers with steel free of association with Russia.

With that, I will turn it over to Kevin for the questions.

### **Operator**

Thank you. We will now be conducting a question-and-answer session. If you would like to be placed in the queue, please press "\*", "1" on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press "\*", "2" if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset, before pressing "\*", "1".

Our first question today is coming from Lucas Pipes from B. Riley Securities. Your line is now live.

### **Lucas Pipes**

Thank you very much and good morning, everyone. Lourenco and team, great, great quarter. Lourenco, there's a lot of concern, in your prepared remarks, you touched on this that 2022 will be another challenging year for automakers from the supply chain folks and kind of as the largest automotive steel supplier, how are you engaging with your customers to manage these product flows and inventory. Thank you very much.

### **Lourenco Goncalves**

Thanks, Lucas. Look, as we showed--numbers are numbers, you can't deny numbers. Q1 was better, was our best quarter of automotive delivered since the problem started, so since COVID. So we are in better shape now than we were in Q4. That's a good sign.

So, we are moving in the right direction. They are moving in the right direction. Another thing is that I have been in direct discussions with the CEOs of each one of these companies, these are big clients of ours, we are the biggest supplier of each one of them.

You name it, we are the biggest supplier, and we are in direct discussions with them about how they are going to do next. Each one of them is also on the brink of developing new products in



the EV arena, in the EV space, in the electric vehicle space, and this is very important to them. We are the sole suppliers of non-oriented electrical steels for the engines of these cars.

We are developing the body and the exposed parts of these cars. We are improving the quality of these materials for these cars. So, we are seeing their efforts, we appreciate their efforts. And we are working together with them to improve their own ability to forecast to us.

When you deliver the amount of tons that we deliver every quarter, there is no other way to go. So we appreciate the interaction. We are seeing improvements and the number--the shipment numbers are starting to show.

### **Lucas Pipes**

That's terrific to hear. Thank you for that detail. And Lourenco, you have been prophetic about vulnerable supply chains of the North American steel industry. And I appreciated your detailed comments in your prepared remarks, but I wondered if you could speak on the numbers for both metallics and steel imports in a little bit more detail.

What amount of pig iron is still coming to the U.S. today? What are the sources? How do you expect that to change over the course of this year? And on the finished steel side or slab side, similar question, what are the levels of imports today? And how would you expect the impacts there on European suppliers, for example, to ricochet back to the U.S., over the course of this year? Thank you very much.

### **Lourenco Goncalves**

Lucas, first of all, there is no such thing as readily available and made to order pig iron, everywhere in the world. That's not true. There's an integrated competitor of us that needs pig iron and nowadays they are importing pig iron, buying other iron substitutes from third party.

Now they are going to supply their own pig iron. You take their one year to be able to produce pig iron, so there is no such a thing as someone of several parties will be ready to shine in who will replace Russia and Ukrainian in pig iron.

So let's go to the numbers. The importation of pig iron in the United States has been above 6 million tons a year, give or take, and more than four coming from Russia and Ukraine. Ukraine counted out. Of course, we'd like Ukraine to continue to be able to produce and provide for their people, but that's not the case when you have bombarded plants.

So, Ukraine is out, and Russia should be out. But normally Russia, of course, they're not going to be out. They're going to sell these things to Brazil, to India, to China, to South Africa, to Middle Eastern countries and this pig iron will come here.

So, it's up to us to not allow the Russians to do that and not to turn a blind eye to pretend that these things are--this pig iron is coming from a different country-it's not. So, we will see. I will be watching. Q2 will be interesting.

**Lucas Pipes**

Thank you. And on the steel side?

**Lourenco Goncalves**

Well, on the steel side, the biggest impact is in Europe and its slabs, because the Russian slabs are part of the picture and Europe now is finally acknowledging the fact that they made themselves dependent on Russia, with gas and with steel. There's a lot of steel being rerolled in Western Europe that really comes from Russia.

We were able to educate the administration on that thing, and it was reflected in the trade agreement that we cut with Europe. But again, it's a lot of steel that's no longer available, so a lot of steel that needs to be replaced in Europe. So, overall, in the international trade in emerging markets for steel, this is out.

So, I believe that the pressure on imported steel into the United States will decrease, based on the fact that Russia is now outlawed in Europe.

**Lucas Pipes**

Lourenco, thank you very much and continued best of luck. Really appreciate it.

**Lourenco Goncalves**

Appreciate it. Thanks, Lucas.

**Operator**

Thank you. Our next question today is coming from Michael Glick from JP Morgan. Your line is now live.

**Michael Glick**

Good morning. Just on the raw material side, do you guys have interest in pursuing incremental third-party sales of pellets since it looks like Europe's going to need a lot of those? And then on scrap, specifically, how much do you think you can grow the closed loop process with some of your larger customers on the auto side?

**Lourenco Goncalves**

Michael, first on the sale of pellets, we produce pellets, we have spare capacity, we are treating Northshore in Minnesota, as our swing producer. We are not planning to run Northshore at this time because we feel that that would not be the right thing to do.

This being said, I sell pellets to third parties. I sell pellets to two companies. I'm not committed to sell beyond what we have contracted but, at this point, we still sell pellets to clients. So, it's not like if we will do, we already do that. We could be selling more, yes, that's true.

Do we have a compelling reason to do that? No. I always have a finite resource, I keep saying that. There's no point in selling just to beef up a quarter. I run this company for the long run, and shareholders after eight years that I'm doing the same way, they are now understanding.

So, I can make another buck, yes. Do I want to make another buck? No. So, that's the one on pellets. The other question was about what, I'm sorry, I missed the other one.

**Michael Glick**

Just closed loop recycling on scrap for your auto EOMs.

**Lourenco Goncalves**

Yeah, closed loop is busheling scrap, prime scrap, it is extremely relevant for Cleveland-Cliffs. We believe and we are proving that every day and showing to our clients every day that we can improve the environment, we can absolutely reduce emissions. And we can use a lot less carbon intensive raw materials, if you use more busheling scrap.

So, for the clients that understand--and the vast majority understand this right away--it's easy for us to gain control over that brand scrap, that busheling the scrap that is generated, inside their facilities. And remember, the biggest source of busheling scrap is automotive. We are, by far, the biggest supplier of automotive.

So, it's not a big stretch to realize that our conversations and our negotiations with our automotive clients go through scrap. And I don't believe that any common factory in this country would deny access to prime scrap. So far, so good, we are growing our access to prime scrap.

I said in my prepared remarks, when we acquired FPT, it was already the biggest, the leader in prime scrap with 15% market share--now it's 20%. So, it's good to know that my competition doesn't care about prime scrap. I heard this week that they are decreasing the use of prime scrap in their own furnaces.

So, I will continue to use either these arguments to continue to convince my clients to give me more and more prime scrap. So, we will continue to grow our prime scrap. We will continue to grow the use of HBI in our blast furnaces, reduce coke rate, reduce emissions, do all the right things. One day, scope three emissions will be accounted for and that day is coming and we are ready, others are not.

**Michael Glick**

Understood. And then from a capital allocation perspective, it is very clear that debt is the key priority near term, but could you also just remind us your thinking on building an EAF versus doing a blast furnace reline, in the future?

**Lourenco Goncalves**

Look, at this point, building an EAF is a possibility for the future. And we will analyze when the time is right. We are right now relining Cleveland #5 blast furnace. So we have the processes ongoing. So we are fully committed to supply the steel to the automotive industry.

We are not a supplier of steel for the construction markets. We are a supplier for steel for the automotive market. That's the biggest difference between us and our competition. It's not EAF against blast furnace, it is the market that we serve. We are designed to supply automotive. Automotive has been not so great, but it's getting better. That's us, that's Cleveland-Cliffs. So, the future is bright for us.

Competition is geared toward construction, and construction has been phenomenal. I'm not sure with inflation and stuff like that, if construction will be good in the near and midterm future so, therefore, there's no incentive for me to do EAFs, to build an EAF and try to nibble in construction.

I don't have that confidence that the EAF type of market that's basically construction would be a good one for us. We have enough scrap to produce wide beams to produce rebar. That's easy, melting scrap to produce rebar is a walk in the park. The difficult thing is to make is producing automotive steel to exposed parts, that's Cleveland-Cliffs and the clients know it.

**Michael Glick**

Understood. And thanks for all the candor.

**Lourenco Goncalves**

Thank you.

**Operator**

Thank you. Our next question is coming from Emily Chieng from Goldman Sachs. Your line is now live.

**Emily Chieng**

Good morning, Lourenco and Celso. And thank you for taking my question. My first one is just around the contract renegotiation process. Are you able to provide some color around the contract renewals that were reset in April?

Perhaps how did they compare relative to your previous contracts that were already set late last year and earlier this year in terms of with contract length and pricing to the extent that you can provide color there? And any early indication ahead of re-contracting season over the

summer, as to what themes are particularly important, as you discuss deglobalization's shortening of supply chains?

**Lourenco Goncalves**

Good morning, Emily. Thanks for the question. First of all, the April contracts were a big success. We were able to achieve everything that we are planning for. And we are very thankful that our clients that were at the other side of the negotiating table understood our proposals and our good intentions.

So, we're all good, and we are in partnership going into not just to help them navigate their own problems with the supply chains, but also to help them go into the electric vehicles. That's the biggest challenge that they have.

As far as the negotiations that will come in the summer, towards the ones that we have to negotiate on October 1, this is something that for us now is an ongoing thing.

And we believe, based on what we have been in a daily basis discussing with these clients, it will be a no brainer, it will be a no problem type of situation. In other words, the same level of high success that we got in the April 1 contract, we believe we're going to get in the October 1 contracts.

With the addition that now the story and the proposition around prime scrap has been completely understood, even more now than the competition's telling out loud that they don't need prime scrap. We do and we do in order to provide the closed loop, to improve the environmental impact of our work together with them, they understand, and things will be fine.

**Emily Chieng**

Understood, that's very clear. And my second question is just around supply discipline. There's certainly been a lot of news from you and your peers, as well, around being more disciplined around not putting tons into the market for the sake of putting volume out. And you also had the idling of Indiana Harbor #4, a couple months ago.

Could you perhaps talk about the cost benefit you could potentially see here and perhaps how you think about the broader suite of domestic assets being sustainably run at much higher utilization rates, going forward?

**Lourenco Goncalves**

Yeah, and there are two things in your question. The one is the supply discipline. The other one is Indiana Harbor #4. Indiana Harbor #4 being taken out of operation was not to produce fewer tons. It was because now we have a lot of scrap, a lot of HBI, we can produce the same amount of steel with one fewer blast furnace, which is a remarkable accomplishment in terms of emissions.

Keep in mind, pig iron has 4.5% carbon. With 4.5% carbon you produce a certain amount of Co2. It is still 0.3% carbon, the steel that we--which we scrap, that we load in our BOFs. It was 10 times less or more than 10 times less carbon. So that's a lot less Co2, as well.

So, using more scrap in the BOF is the right thing as far as emissions, and it stretches our liquid pig iron and makes us able to shut down a blast furnace.

And for the remaining blast furnaces, because we're using a lot of HBI, that's pre-reduced iron, inside the blast furnace, we use a lot less coke. And coke is carbon and carbon produces Co2, so less coke or lower coke rates, lower levels of Co2. So, that's the Indiana Harbor #4 thing.

It was an environmental decision, and it was our way to produce fewer emissions with the same amount of steel with the use of less pig iron, then we could save on costs by reducing one blast furnace.

As far as supply discipline, we appreciate what pretty much everybody is doing in terms of not over producing. I think it's the right thing. So I applaud my competition to at least say that they're doing what we're doing. You check our volumes against our own volumes in previous quarters, you will see that we really have supply discipline.

Would you have been selling more tonnage? Absolutely, but we'll be selling more tonnage for lower prices. Look at our results. So, tonnage is not the answer; the answer is profitability, the answer is cash flow, the answer is generating shareholder value. That's what we're doing at Cleveland-Cliffs.

**Emily Chieng**

Very clear. Thanks, Lourenco.

**Lourenco Goncalves**

Thanks, Emily.

**Operator**

Thank you. Next question is coming from Seth Rosenfeld from BNP Paribas. Your line is now live.

**Seth Rosenfeld**

All right, good morning, Lourenco and Celso. Thanks for taking our questions.

**Lourenco Goncalves**

Good morning, Seth.

**Seth Rosenfeld**

If I had to follow up, please, with regards to supply discipline and the shipment outlook, obviously, Q1 shipment volumes are quite modest, down very sharply year-over-year. By how much should we expect certain volumes to potentially recover in coming quarters?

Is it reasonable to assume that by Q2, you could return to stable year-over-year run rate with respect to more gradual rebound in shipping volumes as needed to push better discipline to support higher prices? We can start there please.

### **Lourenco Goncalves**

Well, supporting higher price for us is better negotiation of our contracts. That's what supports higher prices. So I believe--I really believe, Seth, that the way things are set right now, we have a chance that the spot prices will fluctuate, go up or go down. But what I do know is that our contract prices will continue to go higher, and that's our business model.

So we do not go, based on our massive participation of automotive. And the way we are dealing either with the clients outside of automotive that we are going to be exposed to these fluctuations, as much as we were in the past. What others will do, you'll see.

Another thing that will be inflation in terms of price, one is the shortage of pig iron throughout the entire world, which I tried to explain during my prepared remarks. And the other one is the fact that more capacity or EAFs in the United States will force more people to buy more pig iron, to buy more bushing scrap, to buy more scrap, in general. And these will have an impact on the price of feedstock.

And that's a positive for steel price. It is not a problem for us, because we have our iron ore for us fixed, so we're in good shape.

### **Celso Goncalves**

And maybe--this is Celso. Let me, Seth, if I may, maybe to add some numbers to what Lourenco explained just so you have them. Our volume, just to clarify on the volume point, our volume picked up from 3.4 million to 3.6 million in Q1 and looking into Q2, we do expect another increase in Q2 of at least another 100,000 to 200,000 here in Q2, particularly, as automotive continues to recover.

But as Lourenco stated, we're still taking a disciplined approach on price. But just wanted to add some numbers around that 100,000 to 200,000, going into Q2 and, potentially, higher for Q3 and Q4.

### **Seth Rosenfeld**

Great, thank you very much. And on the significant investment in inventory values and working capital in Q1, can you give us a bit of color on how we should expect that to progress, throughout the course of the year? Obviously, 2021 saw a very meaningful investment over the

12 months. On your current forecast and your guidance, would you expect working capital be a source of cash in '22?

**Lourenco Goncalves**

Celso, take that.

**Celso Goncalves**

Yeah, sure. So, just to comment on Q1 first, the working capital build in Q1 was largely driven by inventory and that's cost, not units. Going forward, receivables and payables will generally kind of trend with prices as you would expect but we do expect that, going forward, we will see a meaningful release of working capital from the inventory standpoint and that will--that's baked into our guidance of free cash flow for the year.

**Seth Rosenfeld**

Great, thank you very much.

**Operator**

Thank you. Our next question today is coming from Carlos De Alba from Morgan Stanley. Your line is now live.

**Carlos De Alba**

Thank you very much. Good morning, Lourenco, Celso, and other members of the team. So the first question is, you spoke quite significantly about the auto sector, but I wonder if you can give us more color on the other end markets that you also serve, particularly, distribution is an important share of your volumes.

What are you seeing there? What are the conversations that you're having with them? Given that you are the sort of destocking that they went through in Q1 that impacted volumes, is that changing? How are they reacting to the increase in prices that we have seen recently?

And then a follow up--a second question will be on your balance sheet. Now clearly, significant free cash flow generation this quarter and improving, throughout the year. You have been buying back your debt, the most expensive debt. Is there a level of net debt or net debt to EBITDA where you might pause and maybe start to consider more cash going to other uses of cash and return to shareholders?

**Lourenco Goncalves**

Yeah, let me start from the second one and then I will address the other markets beyond automotive. Look, we are already at 0.8 leverage, so we are a very comfortable level. We will continue to pay down debt. So, this number will continue to be reduced towards the end of the year. And at a certain point we are going to seriously consider reinstating a dividend.



At this point, a dividend is not being instituted right now because we feel like we are getting more bang for the buck by paying down debt-as simple as that. Our goal of generating shareholder value is easily accomplished by continuing to pay down debt, as Celso explained so well, during his prepared remarks.

We'll continue to do that. And in a certain moment that I'm not going to commit right now, we are going to be reinstating a dividend. We still have the buyback authorization in place, which will be used as our insurance policy. We are not trying to prioritize share buybacks or overpay and all that.

Paying down debt is the priority and after that--after we get to a level that--we are getting there, well, we are not there yet. I want to pay more debt down before we should do the dividend, we will do what we were talking here in terms of a dividend.

As far as the analysis on other markets, the OEMs outside of automotive, they are going through the same process as automotive. We treat them the same way. We want their scrap that we are getting their scrap. We are trying to work on fixed price like automotive has; it's working well. We are making progress on that.

They are just starting to see the benefits of having a fixed price and not be worrying every day what's going to be published on CRU and if things are going up or down in the book, too, and what the impact we're going to have here.

That's not the way it should work. It's benefiting very few, not the broad market. So, we are going towards that. Everybody can make money in an environment that we have the stability in high prices.

As far as service centers, some decided not to buy. And their strategy was waiting for lower prices. They're now seeing--confronting the tough reality that prices are not going down, and what we have been saying about scrap is materializing is starting to shrink.

What do--we have always been concerned about in terms of metallics is happening, there is a shortage in the world. So the backdrop, the underlying conditions for higher prices is totally in place. So, they're coming back and buying. So, things are getting better in these other sectors, Carlos. That's all I can tell you at this point.

**Carlos De Alba**

All right, fair enough. Thank you very much. Good color.

**Lourenco Goncalves**

Thank you.

**Operator**

Thank you. Our next question today is coming from Timna Tanners from Wolfe Research. Your line is now live.

**Timna Tanners**

Hey, good morning, guys.

**Lourenco Goncalves**

Good morning.

**Timna Tanners**

Wanted to ask a little bit more about the right inventory levels, and then ask about your footprint. So on inventory just, obviously, prices are higher, input costs are higher. But can you remind us how much tonnage you have in inventory and how to think about what that can look like even if we have flat prices from here, how that unwinds and how that contributes to volumes?

**Lourenco Goncalves**

Yeah, we're not growing inventories in Q1 with the value of the inventory increased, but not the tonnage of inventory. So we've lowered the tons in Q1. We'll continue to do that. We are no longer taking the forecast of our clients at face value. We are negotiating with them, their own forecasts, and that's has been good for us and good for them.

So we are not adding tons on the ground that they are not taking. And aged inventory is moving faster, because we're pushing them to take those aged tons and the numbers show that. So, we're not adding tons to inventory.

As they continue to improve their performance, as we continue to fine tune their forecasts with our own input on what they are taking, the tendency is to continue to reduce inventories. But one more time, we did not increase inventories in Q1, the value of the inventory increased.

**Timna Tanners**

That's helpful. But you don't have a tonnage value you can share with us on how much is there and how that should reduce, over the year?

**Lourenco Goncalves**

No, no, that'd be lower. Lower is good. The trend is good. The number would just put you in a straitjacket and you will make people comfortable when they get to the number, they believe that they accomplished something. They didn't, they can always do better. That's why I don't have numbers in there.

**Timna Tanners**

Okay, understood. Fair enough. And the second question is just that since we saw an application come through for an electric arc furnace permit, I think in Middletown, I think

you've said that that will be a long-term strategy, but just wanted a little more color around how you're thinking about your current footprint, if you're satisfied with it, and what it would take to think about converting to an EAF down the road.

**Lourenco Goncalves**

I'll give you a very objective answer. Let's see how many of my clients will be really doing what they're saying they are going to do, in terms of electric vehicles. If they are very successful, all of them, and we need a lot more non oriented electrical steels to supply engines of electric vehicles that electric arc furnaces will materialize. For now, it's just a permit.

For now, it's just the preparation for something that might happen only if clients perform as they are saying that they're going to perform. Remember, we are the sole producers of electrical steels in the Americas, and we are seeing every single car manufacturer saying they are going in that direction.

I don't believe that all of them will be successful. One of the things that I discuss with the CEOs that I'm talking to is to gauge how much they are real, how much they are really controlling what they are talking about. If this thing starts to materialize, we're going to be the first ones to jump in. Well, that's what the EAF is about.

**Timna Tanners**

So the EAF is for electrical steel, or is it for the EA--is it for EVs sorry?

**Lourenco Goncalves**

Mainly to increase our ability to produce more electrical steels. We are sold out, right now. We already started to auctioning electrical steels. We are selling the electrical steels both grain oriented and non-oriented through auctions. So, there was a thing the highest price will take because I don't have capacity for more.

**Timna Tanners**

And Russia is a big supplier of that too, okay. All right. Thank you.

**Lourenco Goncalves**

I am sorry. Say that again.

**Timna Tanners**

Russia is a big--Russia is a big electrical steel supplier, historically, as well.

**Lourenco Goncalves**

No, they are not. They are not. They are not. The biggest supplier of that type of steel that I'm talking about is South Korea. South Korea among their friends is the biggest enemy.

**Timna Tanners**

Thanks, again.

**Lourenco Goncalves**

Yeah, they love to dump, but that's a different ballgame. But Russia, on the electrical steels, they're not really that relevant, because they are better with the lower quality stuff.

**Timna Tanners**

Okay. Thanks again.

**Lourenco Goncalves**

Thank you.

**Operator**

Thank you. Our final question today is coming from Matthew Fields from Bank of America. Your line is now live.

**Matthew Fields**

Hey, Lourenco. Hey, Celso. Good morning.

**Lourenco Goncalves**

Good morning, Matt.

**Matthew Fields**

I know you sort of outlined the change to your guidance with kind of three aspects about the forward curve, the new auto contracts and current sort of hot rolled, cold rolled spreads. But I just wanted to sort of drill down. The guidance is up on sales price, \$220 a ton from last quarter, but the hot rolled curve is up well over \$300 a ton.

So, not to sound--not meaning to be a brown nose or anything, but does this bake in some conservatism to your guide or is there something else there that's sort of the mix of the contracts implying that the spot--the contracting is sort of dragging down your average realized price, due to not participating in the spot market?

**Lourenco Goncalves**

No, look, it's all blended. It is all blended on the curve, on the reality of the contracts that we have already renewed, the very concrete expectation on the contracts that we're about to renew, so it's all in. But, at the end of the day, we are not sent back, if that's your concern. We are being as realistic as we can, like, I'm always. I'm always very realistic. I always am very realistic about these things.

I try to give you guys and ladies the best approach, the best advanced view of how the business is taking care in our company. I think that the takeaway of this new price guidance is that, well,

the curve changed, and they disciplined it--in a disciplined way, they reassessed the curve. So, that's one points to consider.

Second, the contracts that are renewed, they're better and they are much better than the numbers that they had at home or when they supplied the previous guidance, so that helped , as well. If it changed, it will change accordingly, but that's our best view, at this point. I don't know if Celso has any point to add or that's pretty much it.

### **Celso Goncalves**

Yeah, no, sure. I think the important thing to note too, Matt, is the lag impact of our pricing contracts. So, Q1 benefited from contracts and the pricing that was happening in Q4. And going forward, prices suffered a little bit in Q1, and that's going to impact the results in Q2, but five months of actuals are already set in our new full year guide.

This conservative curve that we're using has pricing trending down a little bit, too, in the second half. So, even though Q2 is going to have this negative impact from lower Q1 pricing, the \$220 per ton increase, the way to think about it is basically \$3.5 billion in revenues, in addition with very limited cost offsets. So that's kind of the best way to think about it.

### **Matthew Fields**

Okay, great. That's very helpful. And then last question for me. I know you've spent a lot of time talking about sort of global metallics sourcing, and your insights there are very valuable.

On the other side of the coin, for blast furnaces, have you thought more about maybe vertically integrating more on the coal side? With prices the way they are now, does that change your thinking about being more of a vertically integrated--having more sort of domestic supply chain in house for coal?

### **Lourenco Goncalves**

Not really. Not really, actually because we are going the opposite direction, we continue to leverage the use of HBI, which has reduced the through natural gas. That's a godsend for the United States. We have it, Europe doesn't have it, Japan doesn't have it, South Korea doesn't have it. Only Russia has, but Russia is Russia.

So, we are in a differentiated position, as far as de-carbonization here in the United States, because we have natural gas. So because we have natural gas, my priority has been direct reduction. HBI is a great product.

High quality metallics, high quality metallics, always the ones that haven't got good HBI cannot appreciate the benefit of HBI. There are several types of HBI. Our HBI, so far, has been using at home at Cleveland-Cliffs, it is phenomenal. It has been--allow us to reduce coke rate and increase the productivity of the blast furnace, while reducing Co2 emissions.

That's just perfect. But if I'm reducing coke rate, going into coal would be going in the wrong direction. So I believe in natural gas as an environmentally friendly reductant, and we are going to try hydrogen just to prove that the plant works with hydrogen.

And then I'll go back to natural gas because there's no economical feasibility to use hydrogen, at this point in time. But we are going in that direction, not toward coal.

**Matthew Fields**

Okay, fair enough. Thanks very much, and good luck for the rest of the year.

**Lourenco Goncalves**

Thanks, Matt. Appreciate it.

**Operator**

Thank you. We reached the end of our question-and-answer session. I'd like to turn the floor back over to management for any further or closing comments.

**Lourenco Goncalves**

Thank you so much for being with us today and we look forward to speak with you in three months. Keep up the work with us, and we believe that we will continue to reward the good long shareholders of Cleveland-Cliffs. Thanks a lot. Have a great day. Bye now.

**Operator**

Thank you. That does conclude today's teleconference webcast. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.