

**Cleveland-Cliffs Inc.**  
**First-Quarter 2023 Earnings**  
**April 25, 2023**

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**Presenters**

**Lourenco Goncalves, Chairman, President and CEO**

**Celso Goncalves, Executive Vice President, Chief Financial Officer**

**Q&A Participants**

**Emily Chieng – Goldman Sachs**

**Lucas Pipes – B. Riley Securities**

**Carlos De Alba – Morgan Stanley**

**Curt Woodworth – Credit Suisse**

**Timna Tanners – Wolfe Research**

**Tristan Gresser – BNP Paribas**

**Alex Hacking – Citi**

**Sean Wondrack – Deutsche Bank**

**Operator**

This is Daryl, and I am your conference facilitator today. I would like to welcome everyone to Cleveland-Cliffs' First-Quarter 2023 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 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 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 at [Clevelandcliffs.com](http://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 yesterday.

At this time, I would like to introduce Celso Goncalves, Executive Vice President and Chief Financial Officer.

**Celso Goncalves**

Thank you, Daryl, and good morning, everyone. Our Q1 results marked the rebound in profitability from the trough in Q4, as we effectively doubled our adjusted EBITDA from the

previous quarter. We outperformed on our three most important metrics, selling price, unit costs and steel volumes. We guided to a Q1 implied selling price of around \$1,120 per ton and realized around \$1,130. We indicated that unit costs would decline by \$50 per ton and they declined by \$60. We said volumes would rise to around four million tons, and we delivered 4.1 million. Most importantly, we set the stage for another highly profitable year in 2023, which we expect to further materialize with a much higher Q2 EBITDA and strong free cash flow generation in the last three quarters of the year.

Q1 free cash flow was lower, largely because we invested in working capital due to strong demand. As pricing and volumes went up, we saw higher receivables and higher inventory tons. In Q2, we expect this trend to continue, but EBITDA will be so much higher, and CapEx will be so much lower, that the massive amount of free cash flow coming in Q2 should far outpace any further build in working capital.

Adjusted EBITDA in Q1 was \$243 million, a 98% increase from the previous quarter, driven almost entirely by reduced unit costs, a function of normalized repair and maintenance spend, lower input costs and higher steel production. Our Q1 shipment volume of 4.1 million net tons was roughly 250,000 tons higher than the previous quarter, making Q1 of 2023 our highest steel shipment quarter since Q3 of 2021. Automotive demand was robust, service center buying behavior has improved, and we did not have any significant maintenance outages like we did for much of last year.

Q1 selling price of \$1,128 per net ton came in ahead of expectations due to higher tonnage and higher value-added mix in automotive. A little more than half of our sales are index-linked, with lags generally varying from one to three months. Due to these lags, the recent rise in flat-rolled index pricing was barely reflected in our Q1 results. This improvement is now in full force, which will benefit our results meaningfully here in Q2 and beyond. We have been successful in implementing several spot price increases over the past few months. We have also achieved continued increases in our fixed price contracts for the April 1st renewal cycle. Taken together, these improved prices will propel our realizations in Q2.

In addition, due to the same factors that drove Q1 costs lower, our unit cost should continue their downward trend going forward. We also expect that our strong volume performance will carry over into Q2 as the order book remains full, and we run at our configured capacity levels. As pricing and volumes improved in Q1, particularly in the month of March, we built around \$230 million in receivables, contributing to the lower free cash flow quarter-over-quarter.

As these receipts come in, our cash flow performance will ramp up significantly in Q2, particularly as we have already received \$110 million in tax refunds here in April. This comes after a tax refund receipt of \$25 million received during Q1. Furthermore, we expect our Q1 CapEx of \$188 million to represent the peak CapEx quarter for this year due to some carryover maintenance projects from 2022. So Q2, Q3 and Q4 CapEx should each be lower than Q1. In

fact, we have lowered our total expected full year CapEx range by \$25 million, to \$675 million to \$725 million, reflecting primarily sustaining projects.

Touching now on the capital structure. Two weeks ago, we completed a seven year unsecured notes offering for \$750 million, pricing at only 325 basis points above the comparable treasury. This was our tightest spread on any unsecured high-yield bond ever. We took advantage of the inverted yield curve to issue these notes, which are priced off of lower longer-term rates and used the proceeds to pay down our ABL, which is priced off of currently much higher short-term rates.

We have been comfortable using our ABL as an effective source of liquidity for some time given it was nearly free money, but with the rapid rise in the Fed fund rates, this is no longer the case. So terming some of this ABL balance out with longer-term bonds was a no-brainer. In fact, the coupon on these new notes is effectively the same as the all-in interest rate on the ABL. The additional liquidity provided as a result also gives us more flexibility for whatever market conditions or opportunities may come up.

This being said, this swap of shorter-term debt with longer-term notes does not change our capital allocation priorities. We intend to continue using the robust free cash flow we expect to generate this year toward continued debt repayment and opportunistic share buybacks. We still have over \$1 billion in prepayable debt on the ABL and another \$1.5 billion in callable bonds. For now, the main priority for debt reduction will be to continue driving down the ABL balance. When that has been paid off in full, we will then target redeeming our 2026 secured notes.

As we've shown in the past with aggressive bond buybacks, even our noncallable long-dated unsecured bonds are effectively prepayable since we can also opportunistically buy them back in meaningful amounts in the open market. We plan to continue this capital allocation strategy until our net debt gets down to around \$3 billion. And assuming market conditions remain as they are now, we should achieve that at some point this year.

With that, I will turn it over to Lourenco for his remarks.

**Lourenco Goncalves**

Thank you, Celso, and good morning, everyone. During the past quarter, order release rates from our automotive clients were the strongest and the most consistent we have seen since becoming a steel company three years ago. Also, service center buying behavior in Q1 came back to more normal levels. These two factors, combined with reduced imports of flat-rolled steel forced the buyers to increase their order levels with domestic producers.

In addition, the excess scrap and metallics inventories that were built by other steel companies in response to the war in Ukraine were ultimately drawn down, forcing scrap prices back to what we believe are higher but still acceptable and sustainable levels. We used all of these

factors in our favor to implement several spot price increases, which have ultimately driven index pricing higher.

Our conviction that this country's prime scrap and metallic shortage will continue to tighten over the coming years is at the core of our strategy. Last year's strange scrap movement in the second half of the year has been proving to be an outlier and the prime scrap market is back in a shortage position. There is less than 20 million tons of annual prime scrap and metallic supply in North America currently. And unless you are a producer of only rebar and nothing else, you need prime scrap and metallics.

Our in-house production of two million tons of HBI per year at Cleveland-Cliffs is an integral part of our own internal supply chain. We use our HBI primarily to feed our own blast furnaces to reduce coke rate and CO2 emissions, and that results in very limited availability to sell HBI to third parties. We anticipate that with the new electric arc furnaces coming online, demand for prime scrap and metallics will be at 30 million tons by 2026. This will require significant levels of imported metallics.

The largest sources of these imports up until last year were Russia and Ukraine. More than a year after the invasion of Ukraine, that import avenue remains heavily disrupted. Said another way, unless one is rerouting Russian supply through other countries for transshipment, which is, by the way, illegal, they cannot get all the feedstock they need. Because prime scrap is a byproduct of manufacturing, and we as a country, have been moving manufacturing offshore, prime scrap supply has been shrinking in this country for over 50 years. Bringing more manufacturing back to the United States over the coming years should help alleviate the situation, but that will take time.

The alternative to address the scrap shortage would be additional metallics production, but that requires iron ore. As the largest producer of iron ore pellets in North America, this plays right into our favor. For the majority of the last three decades, flat-rolled steel production with EAFs took advantage of cheap and plentiful prime scrap. This historical situation is changing fast.

Greenfield flat-rolled production from EAFs also plays into our favor in the automotive market. As some EAF start-ups have been demonstrating for a few quarters now, the metallurgical challenge in automotive is too big for them. This fact, along with our customer service and our R&D capabilities are the three main reasons why Cleveland-Cliffs remains the supplier of choice to the automotive industry in the United States. That also helped us achieve annual price increases from all and each one of our major automotive clients.

Some of this price increase will only show in our Q2 results as they are effective April 1st. Our shipments in the first quarter to our direct automotive customers were the highest they have ever been in our three years as a steel company and at higher prices. This was the biggest

reason for our strong quarterly shipment number of 4.1 million tons and why we are running all of our steelmaking shops at full capacity.

Our higher levels of steel production have led to the partial restart of some operations at our iron ore mining and pelletizing swing facility at Northshore earlier this month. As you may recall, Northshore has been totally idle since the spring of last year. We will continue to treat that facility as our swing operation. And at this time, we still do not expect to operate Northshore in full any time this year.

The remarkable improvement in automotive demand is a combination of the easing of their supply chain issues and the American consumers' growing appetite for new cars. Auto sales seasonally adjusted annual rates usually called SAAR in the United States averaged about 15.2 million units during Q1, a massive uptick after averaging 13.7 million units during all of 2022. As such, our forecast for North America automotive builds in 2023 of 15.5 million light vehicles is the best in four years. With one car equaling roughly one ton of steel and with Cleveland-Cliffs representing nearly half of the flat-rolled market for automotive steel, you can do the math on the additional volume this will bring.

The auto sales and production increases we have been seeing are further confirmation of our view on how steel demand in the U.S. will shift in our favor. For the last couple of years, nonresidential construction has been the outperformer in the steel market with automotive lagging significantly behind. As you know, Cleveland-Cliffs is not a big player in non-res. That said, given the massive backlog that has been created as a result of supply chain issues over the past few years and with the Federal Reserve reaching the end of their interest rate hike marathon going forward, all signs point to automotive being the outperformer.

Cleveland-Cliffs is ready to accommodate any improvements in demand from the automotive sector, whether that be from internal combustion engine vehicles or EVs, and our clients know that very well. At Cleveland-Cliffs, we are agnostic to whatever ways that demand materializes over the coming years as we are the clear-cut leader in supplying steel for both types, electric or conventional vehicles. That said, earlier this month, President Biden's administration put forth their latest push to drive large-scale EV adoption in the United States. The proposal includes a projection that two out of every three new cars sold in the United States in 2032 will be electric, compared to about only 7% today in 2023. This is a structural reset that we have dedicated our research and innovation center efforts toward since we acquired AK Steel in March of 2020.

Put simply, due to our size as a supplier of automotive steel in the United States and also due to our unique technical capabilities, these goals of the U.S. government cannot be reached without Cleveland-Cliffs. We are an integral part of this transition from ICE vehicles to EVs in the United States, regardless of whether it happens at a fast or at a slow pace. This includes our supply of exposed body parts, structural cages, battery support and non-oriented electrical steels for motors.

Regarding non-oriented electrical steels, we call NOES, and responding to growing demand from our existing customers, we have already deployed \$30 million as CapEx into our Zanesville, Ohio facility to increase our production capacity of NOES by another 70,000 tons annualized. We should start operating this new capacity in the third quarter of this year. Also as a reminder, Cleveland-Cliffs is the sole producer and a well-established supplier of both GOES, grain-oriented electrical steels and NOES in our country. That's our technology originally from ARMCO, the A in AK Steel.

The market for these products is huge, but any new entrants to this market will have to first learn the products and then perfect the manufacturing process. Then the rookie producer will have to qualify these products with each one of the clients. That's not our case. We are already in the house with all of these clients.

A couple more things before we open for Q&A. Earlier this month, we published our 2022 sustainability report. We are pleased to report that as of 2022, our absolute scope one and two greenhouse gas emissions were already below our aggressive target for 2030 of 25% reduction, in comparison to our emissions in 2017. That was when we made our decision to build our state-of-the-art direct reduction plant. This early accomplishment of our target was made possible primarily by the use of massive amounts of HBI in our blast furnaces, helped by hot metal stretching through the increased utilization of scrap in our BOFs and natural gas injection in our blast furnaces.

We also reported that our scope one and two emissions intensity from our blast furnace and BOF operations in 2022 was down to 1.60 metric tons of CO<sub>2</sub> per metric ton of steel. This number puts Cleveland-Cliffs in the third percentile of integrated steelmaking emissions worldwide and compares extremely favorably to the global average of 2.32 tons of CO<sub>2</sub> per metric ton of steel. Because of the metrological requirements and quality needs of our automotive customer base, we remain committed to the blast furnace BOF steelmaking route, and we will continue to work to make it less carbon intensive.

In order to further reduce these already low-emission numbers, we are pursuing potentially high IRR projects in emerging technologies, particularly carbon capture and storage and iron reduction by hydrogen. As things progress on these fronts, we will continue to keep you informed.

With that, I'll turn it over to Daryl for questions.

### **Operator**

Thank you. We will now be conducting our question and answer session. If you would like to ask a question, please press star, one, on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two, to remove yourself from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before

pressing the star keys. One moment please while we pull for your questions. Our first questions come from the line of Emily Chieng with Goldman Sachs. Please proceed with your questions.

**Emily Chieng**

Good morning, Lourenco and Celso and thanks for taking my questions this morning. My first is just around the electrical steel market. I wanted to follow up here and understand a little bit more about what's happening. Could you perhaps talk to the size of the non-grain-oriented and grain-oriented electrical steel markets and growth outlook, and perhaps what electrical steel production capacity Cliffs will have after the 70,000-ton capacity investment later this year?

**Lourenco Goncalves**

Sure. Well, good morning, Emily. Look, first of all, the non-oriented electrical steels are totally associated at this point with the pace of adoption of electric vehicles. We have developed a special product called the MOTOR-MAX, and the MOTOR-MAX is for this type of high-end applications in non-oriented electrical steels. This investment, that was not a massive investment. We're talking \$30 million, which, by the way, has already been deployed to produce another 70,000 tons of NOES, will take care of that. And we'll take care of that for the time being and freeing up capacity to produce more grain-oriented electrical steels at our Butler, Pennsylvania plant, because today, we basically do both in Butler. So we are moving 70,000 what is significant when you notice that our production capacity is around 240,000 tons at Butler. So we are really growing our ability to supply more GOES.

GOES is related to the grid because it goes into, no pun intended, it goes into the production of laminations and core for transformers. And transformers are utilized everywhere into the grid, and we are, at this point, the sole suppliers of these materials. So as monies are deployed and there are monies to be deployed coming from legislation that will free up capital to be invested in the improvement of the grid and also in the improvement of charging stations that is coming, we're going to have to continue to grow the production of GOES. So that's pretty much what we have at this point. And I think we are rightsized for the pace of the growth of the market at this point.

**Emily Chieng**

Understood. That's very helpful. And a follow-up, if I may, just around the cost outlook there. I think, Celso, you mentioned there was a \$60 a ton decrease in 1Q in terms of the cost profile. And I think previously, you've also talked about further reductions in 2Q and 3Q. Do you have any numbers as to help us frame where those numbers could land? And remind us what the moving pieces driving those costs down on a dollar per ton basis.

**Celso Goncalves**

Yeah, sure. Hey, Emily. We've already decreased costs by, call it, \$140 a ton in just two quarters. And the Q1 cost reduction of \$60 a ton is \$10 more than we guided down \$50 for the quarter. As the inventory continues to come out, you can expect further cost reduction here in



Q2. Now, the magnitude won't be as great as it was here in Q1, but we're still working hard to bring costs down. Call it, a \$15 to \$20 a ton reduction here for this coming quarter, Q2.

**Emily Chieng**

All right. That's very helpful. Thanks.

**Celso Goncalves**

Thank you.

**Operator**

Thank you. Our next questions come from the line of Lucas Pipes with B. Riley Securities. Please proceed with your questions.

**Lucas Pipes**

Thank you very much, operator. Good morning, everyone. My First question is also on the electrical steel side. And Lourenco, I wondered if you could maybe frame up the project pipeline after this year. I assume kind of capital intensity would move up somewhat, but maybe that's a wrong assumption. And yeah, I would really appreciate color on the potential growth opportunities after this year and what the capital intensity would look like for you or your competition. Thank you very much.

**Lourenco Goncalves**

Good morning, Lucas. First of all, I would like to position electrical steels in a historical perspective. That's always very helpful to understand. When I acquired AK Steel back in March of 2020, Butler and Zanesville were both slated to be shut down. Actually, the first meeting that I participate representing AK Steel happened in a steel caucus meeting in Washington, D.C. four days before we closed. And I sat in for Roger Newport, then CEO of AK Steel. He was very kind to allow me to be there and speak. I basically put everybody on notice that if nothing would happen, we would just go ahead and execute the shutdown process that was slated to happen.

So long story short, we were being slaughtered by imported steel at that time. We were able to stop that. We were able to bring back production to the United States. We were able to shut down the backdoor production of lamination and cores coming mainly from Mexico and Canada using electrical steels from Korea, Taiwan and Japan. So we fixed the market in a way that we are no longer losing money. At this very point, Lucas, electrical steels is our most profitable line of business. So we are very happy with the fact that we are growing our own capacity with the pace of the demand.

We are not going to run ahead of the demand. We are aware that the competition will try to participate in this market. Be my guest, it's not an easy market. It's complicated product. So we know that a lot of the attempts will fail, and this business will come back to us. So at the right time, we will deploy capital. It's not a priority right now. We are happy with what we have. We



are happy with the expansion that we deployed in Zanesville for NOES. That will free up more GOES out of Butler. We are in good shape for now.

**Lucas Pipes**

Very helpful. Thank you, Lourenco. And then my second question is also a little bit more on the near term, and I wondered if you could comment on the second quarter pricing outlook. You mentioned the April batch on the fixed contracts was reset very successfully, and then spot prices obviously moved up very nicely year-to-date. So I wondered if you could comment on what the whole package would look like on the pricing side in Q2. Thank you very much for your perspective.

**Lourenco Goncalves**

Lucas, as far as Cleveland-Cliffs is concerned, the outlook is great because as you know, our contracts with automotive and other clients, but particularly in the automotive business that's big for us, is fixed price. So when underlying hot-rolled price in the spot market is \$1,000, if I'm selling to--and I'm making this up, just to give you the picture. So don't take the number to the bank. But if underlying hot-rolled prices are \$1,000 and my contact is \$1,200, then I'm selling for \$1,200. If underlying market price is \$1,400, my price for the automotive clients is also \$1,200.

Long story short, it doesn't matter where the spot price will go up or down, a lot down, a lot up, our price with automotive slice of the business that's in the quarter was 36% of the business will stay where it is. So we are feeling very good about that because we are protected in a very, very important part of the market.

Celso, do you want to complement something on that?

**Celso Goncalves**

Yeah, sure. Hey, Lucas, just to add some numbers to that as well.

**Lucas Pipes**

Thank you.

**Celso Goncalves**

Relative to Q1, we expect Q2 average selling price to increase more than \$100 a ton, call it, \$120 a ton compared to Q1, and that's largely driven by higher HRC pricing, higher slab pricing. And then most importantly, those lags that we experienced in Q1 from the sub-\$700 index pricing environment in November, December, those all fall off in Q2. So that's why you see the big jump in sales price.

**Lucas Pipes**

Terrific. This is super helpful. Really appreciate your color and continued best of luck. Thank you.

**Lourenco Goncalves**

Thank you.

**Celso Goncalves**

Thanks, Lucas.

**Operator**

Our next questions come from the line of Carlos De Alba with Morgan Stanley. Please proceed with your questions.

**Carlos De Alba**

Yeah. Good morning. Thank you, Lourenco, and Celso. Just on the--a couple of questions. One is on CapEx. How should we think about the CapEx going forward given that it's running below \$800 million, depreciation, which a lot of time we use for reference for sustaining CapEx is closer to \$900 million, \$950 million. So how do you see--for how many years do you think you can keep your CapEx below this threshold of depreciation without jeopardizing the equipment? So that will be very useful for the projection of cash flows.

**Lourenco Goncalves**

Yeah. Just to give you a color on what you have just said. The depreciation is a good reference because it's a good average, but it's not good in short term as a reference because remember, when we acquired the assets, they were mistreated. We had to deploy more capital than the depreciation, and that's why we're still paying in our accounting for the higher costs and lower production during the time that we are doing just that.

So when we average back what's happening this year, and what's going to happen next year with what happened last year, we'll probably go back to your depreciation number, Carlos. But we are now in the back end of the stuff that we have already done, money that we have already spent, and we are not going to spend again. I don't know if Celso wants to complement.

**Celso Goncalves**

Yeah, sure. Hey, Carlos. So if you think of 2022, we spent over \$900 million in CapEx, but that included a lot of maintenance repairs. That cycle is now behind us. So the new sustaining level for 2023 and at least 2024 is that \$700 million level. Now, when you get to 2025 and beyond, and then you have some additional relines and things like that, it could increase again. But for the foreseeable future, what we can see here in '23 and '24, that \$700 million is a number that we're comfortable with.

**Carlos De Alba**

All right. And just you mentioned, Celso, when is the next relining, just for us to have it here in the record?

**Celso Goncalves**

Yeah, 2025 Burns.

**Carlos De Alba**

Okay. Great. And then my second question, if I may, on prices. The October renegotiation for the auto--resetting for the auto contracts, how should we think about that? Is that going to be in line with what we saw in April? Or is that more subject to supply demand conditions of the auto sector, not necessarily the HRC spot market?

**Lourenco Goncalves**

Yeah. The HRC spot Carlos has been taken out of the picture in automotive. I gave each one of our major clients the option to buy from people that sell based on that, no one took it. So now we are in supply and demand in a true relationship type of thing. I know it's a game changer. Yes, it is a game changer, never happened between steel companies and car manufacturers ever. It's happening now.

I believe that the automotive company's relationship with the steel mills are at the core of why we, a small iron ore company, were able to acquire two big suppliers of automotive steel that are actually already consolidated from several others that went down throughout the history of this business in the United States. That party is over. Now, we will continue to support the automotive industry. We will continue to provide them the technical capabilities that they need. We will continue to develop the products for the next-generation cars as we normally do, but we want to be rewarded. On behalf of our shareholders, we need to get paid. They understood that through the last two cycles of negotiation.

So when October comes, we'll talk again. It's too early. I'll get my shoes off when I get to the river. Not there yet.

**Carlos De Alba**

All right. Good luck. Thank you very much.

**Lourenco Goncalves**

Thank you.

**Celso Goncalves**

Thanks, Carlos.

**Operator**

Thank you. Our next questions come from the line of Curt Woodworth with Credit Suisse. Please proceed with your questions.

**Curtis Woodworth**

Yeah. Thanks. Good morning, Celso and Lourenco. How are you?

**Lourenco Goncalves**

Good, and you, Curt?

**Celso Goncalves**

Good, Curt.

**Curtis Woodworth**

Not bad. So I guess with respect to the longer-term CapEx projections around the \$700 million, you also talked about potential investments in CCS as well as iron reduction via hydrogen, which some of the numbers being postulated on some of those things are fairly significant capital. So I realize it may be preliminary, but can you give us a little bit of insight into how CCS or hydrogen could fit into your business model, and what maybe some of the economics could be around that?

**Lourenco Goncalves**

Yeah. First indications are showing that particularly CCS could be a very high internal rate of return project based on not only monies available to develop the project with participation of the government, but also tax credit of up to \$85 per ton of carbon capture. So this is pretty meaningful, pretty significant. It's not a short-term deployment of capital, Curt. So there is nothing really urgent about executing right now, but these are the numbers that we are working with.

As far as hydrogen, we are ready. We are ready to use it. Why is that? Well, we already built the direct reduction plant that can use hydrogen. We just need a pipe with hydrogen to connect to the pipeline that we feed natural gas. We're starting reaching natural gas with 1%, then 5% and 10%. We can go up to 60% hydrogen in that plant. So we are ready. We just need the hydrogen. We are working with several, not one, but several different groups to create hydrogen hubs that can bring a cheap and plentiful hydrogen to Toledo and also Cleveland because we actually have the technology of injecting natural gas into blast furnace.

I think that in the amounts that we use here in the United States, that's only one other country in the world that does, it's Russia. So the other suppliers of steel for the automotive industry throughout the entire world, Japan, Korea, Europe, Brazil, they don't have natural gas available, cheap, plentiful, so they don't have this technique. And we do, like the Russians. So we -- in the civilized world, we are the only ones.

So as far as car manufacturing, we are already a lot greener than the Europeans, a lot greener than the Japanese, a lot greener than the Koreans because we inject natural gas. As soon as we enrich natural gas with hydrogen, we're going to be really green. And we are producing massive amounts of automotive steel. We're not producing press release with brand names. We are supplying the massive tons that the car manufacturers produce. We haven't seen a press release because we are seeing the massive numbers that we produce every quarter in our financial statements. That's why you don't see brand names and press release.

**Curtis Woodworth**

Okay. That's helpful. And then, I guess, second question just on the metallic market. You talked about, I guess, 30 million tons of prime metallic demand in three years, up from 20, I think you said, today. And obviously, you guys are in a unique position having captive ore. And you did the large FPT deal. What is kind of your strategy going forward to either further leverage your metallic position? Would you look to increase your HBI potential? Do you see scope for more consolidation in the scrap market? And kind of how do you see that fitting in? You talked about Burns Harbor up for a reline in '25, is that capital you would spend? Or would that free up iron ore to potentially further leverage the metallic strategy? Thanks very much, guys.

**Lourenco Goncalves**

Curt, look, I'm very comfortable with our situation right now using our finite resources in Minnesota and Michigan for our own use. We like that. So if you're trying to ask me if I'm going to build another HBI plant, the answer is no. What if you get Nashwauk? The answer is still no. Are you considering building HBI to supply other companies? No, that horse has departed the barn when I acquired AK Steel. I built that HBI plant to support mini-mills that I thought they were really serious in producing flat-rolled steel with the high specifications. But actually, they are in the business of producing rebar, wide flange beams, plate. That's all good. Good stuff, but doesn't compete against my automotive. So I'll keep my metallic for ourselves.

FPT is the biggest buyer of prime scrap in the country. We'll continue to do this closed loops. We are happy with what we have. We only continue to grow FPT for ourselves as well. So it's all self-centered. It's all in closing side, Cleveland-Cliffs and everybody else will be outside looking.

**Curtis Woodworth**

Very clear. Thank you.

**Lourenco Goncalves**

Thank you.

**Operator**

Thank you. Our next questions come from the line of Timna Tanners with Wolfe Research. Please proceed with your questions.

**Timna Tanners**

Yeah, hey. Good morning, everyone. Wanted to ask a little bit about the mix in my first question. So I know that Lourenco mentioned that the big driver of improved volumes was the automotive market, but based off of the detail that you provided, I couldn't see a big move coated. I actually saw the biggest movement in HRC. So I'm just wondering, is there a cadence for maybe that ramps up more later in the year? Or is this kind of the mix that we should expect for the balance of the year?

**Lourenco Goncalves**

Yeah. Look, we did gain hot-rolled as well. Like I said, when you allocate more to automotive and you basically fill up your galvanizing lines producing exposed parts and high strength low alloys for structure, cages, for EVs, things like that, you are done with your utilization of high value-added galvanized and then you grow shipments. You are going to grow shipments where it's easier and it's easier to sell hot rolled. So your assessment is dead on. That's where the growth came after filling up all of our capacity of galvanized with high value-added governance.

**Timna Tanners**

Okay. And you're planning to continue to produce at these levels through the rest of the year? Just to my question, I think Nucor mentioned on its call that it was going to manage volumes, and I think other companies have said they're going to run full out, so just wanted your latest thinking there.

**Lourenco Goncalves**

We are running full out to supply our automotive clients. As our automotive clients continue to build more and more cars as the recession has been delayed one more time, and with the Fed getting to the end of this, like I called in my prepared remark, rate hiking marathon. We are going to see that cars will continue to be sold. And we are the ones that will benefit the most from that. And with our other capacity allocated to the rest of the market.

We are also developing closed loop programs with our major clients in appliance and other markets. So we are continuing to deliver more to these folks. So we're in good shape with all that. My perspective for the balance of the year is very positive because it tags along with the growth and demand that's coming from automotive.

**Timna Tanners**

Got it. And then if I could, the last question is just on the guidance you gave last quarter was for net periodic benefit credits of \$140 million, and you started out a pretty high run rate. So just wondering if you have any updated guidance or if we should still be using that value. And thanks again.

**Lourenco Goncalves**

I'm sorry, Timna, can you repeat the question one more time? I think I missed.

**Timna Tanners**

Oh, yeah. Oh, no problem. Yeah. So on the--just a kind of accounting question, I guess, on the net periodic benefit credits. I have in my notes, a \$140 million guided for 2023 on the last call, but the first quarter was already \$50 million. So just trying to make sure that that's still the right value for modeling purposes.

**Celso Goncalves**

Got you. Hey, Timna, it's Celso. Yeah, I think you're missing service costs and interest costs, which are on COGS. This nets to around, call it, \$140 million after you consider that piece. It's still \$140 million.

**Timna Tanners**

Okay. All right. Thank you.

**Celso Goncalves**

No problem.

**Operator**

Thank you. Our next questions come from the line of Tristan Gresser with BNP Paribas. Please proceed with your questions.

**Tristan Gresser**

Yes, hi. Thank you for taking my question. I just have one left. It's on capital allocation. I think in your prepared remarks, you flagged a \$3 billion net debt target that you expect to reach at some point this year, if I understood correctly. So what's the strategy after that? I think you talked about the strong electrical steel market you find with your capacity, you find with the metalics your supply there as well. You flagged some decarbonization needs, but are there more investment coming? Or will free cash flow generation will be more tilted towards shareholder returns after that, after we reach that point? And also, is the net debt-to-EBITDA reference point you have below one time, is it still valid? Thank you.

**Lourenco Goncalves**

We didn't flag anything that you said that we flagged. So let's correct the record. We talked about projects that are multiyear, and you are conflicting everything for the cash flow that we are going to have this year and our target of getting to net debt down to \$3 billion this year. So the only thing that we said that we will do, take notice, please, Tristan. We are going to get to net debt at \$3 billion later this year, still this year. That's what we said.

The carbon capture project is future. The hydrogen project is future because we still don't have hydrogen. The relining of Burns Harbor is in 2025. We are in 2023. So one more time. We flagged that we're going to get to net debt, \$3 billion this year. Before Santa Claus comes to your home, you're going to be with \$3 billion net debt. What else can I do for you, Tristan?

**Tristan Gresser**

No, sorry if my question wasn't clear then. After you get to that milestone, what's you thinking? What's the strategy?



**Lourenco Goncalves**

Your question was clear. Your understanding was wrong. So that's why I've corrected your assessment. But after we get to \$3 billion, we will see. We haven't said anything about it. I'm not going to tell you at this point. But usually, companies at that point, tend to increase return to the shareholders. But return to the shareholders can happen earlier, whereas my stock price is on sale in the stock exchange, as soon as the window opens, I might be buying stock. I myself as CEO, I'm going to buy a lot of stock as soon as the window opens, because it's on sale. It's on sale because people don't understand long term. They believe that three months, a quarter is long term, it's not. In our business, it's a New York minute. Okay, Tristan?

**Tristan Gresser**

All right. Thank you.

**Lourenco Goncalves**

You're welcome.

**Operator**

Thank you. Our next questions come from the line of Alex Hacking with Citi. Please proceed with your questions.

**Alex Hacking**

Yeah, morning, and thanks for the call. I just wanted to follow up on the cost guidance. I think in the last quarter, Celso, you had guided to maybe \$60 of cost decreases in 2Q and then another \$40 in 3Q. And now we're looking, I think, of \$20 in 2Q. I understand it's extremely difficult to forecast. I guess what changed in the forecast, and should we still be expecting the cost decreases to flow into the third quarter and potentially the fourth quarter as well? Thank you.

**Celso Goncalves**

Yeah, sure. Hey, Alex. Let's drill down on that because it's important. So since we gave that guide, scrap prices, for example, have gone up around \$100. So things change, right? And like I said, we guided to \$50 cost reduction in Q1, and we executed \$60. So there's a little bit of pull forward there. And we, as you said, had guided to another \$60 in Q2, and now I'm saying, call it, \$15 to \$20. And the bridge between that \$60 and \$15 is largely driven by that change in scrap. But beyond Q2, we will see further cost reductions as well. So even though I'm seeing \$15 to \$20 here in Q2, Q3 is also going to have further cost reductions, call it, another \$25. So it's still significant, meaningful cost reduction. It's just the timing, like you said, it's hard to nail down.

**Alex Hacking**

Okay. Thanks. I appreciate the color, and I understand. Metallics is a moving target and hard to forecast. And then I guess just on the shipment side, obviously, extremely strong in the quarter to auto and also outside of auto. Is there any part of that you think is restocking? Or do you think this reflects where true underlying demand is and the weakness that we saw at the end of last year was really just driven by destocking? Thank you.

**Lourenco Goncalves**

In our case, Alex, all the fluctuations that we are seeing are coming from end users, particularly coming from automotive. Automotive is buying more. SAAR is higher now than it has been in a long time. It's not back to where it should be, but the consumer continues to buy cars. They continue to produce cars at the OEM level. They continue to push cars into the lots of the dealers, and we continue to sell steel for them to build these cars.

So this north of 4 million tons a quarter pace that we are in right now is supported, basically, I would say, exclusively by automotive demand in our case. All the rest is just gravy. Service centers are continuing to operate at low levels of inventory. And if they see something different coming next week when the Fed will speak, they probably will buy more. I am anticipating car manufacturers continue to buy strong and service centers will be left behind if they don't start to change their pace. It's not bad, but it's not great at this point.

**Alex Hacking**

Okay. I appreciate the color as always. Thank you.

**Lourenco Goncalves**

Thank you.

**Celso Goncalves**

Thanks, Alex.

**Operator**

Thank you. Our next questions come from the line of Sean Wondrack with Deutsche Bank. Please proceed with your questions.

**Sean Wondrack**

Hi. Good morning, Lourenco and Celso. Just first question - when you think about sort of green energy and some of the opportunities you're pursuing, do you see any other tangential opportunities, whether it's within solar or wind or even charging infrastructure that we could look forward to in the next few years? Thank you.

**Lourenco Goncalves**

Yeah. Look, we sell to clients in this submarket, and we are seeing demand coming from them. We believe that monies coming from inflation Reduction Act and the Infrastructure Bill will support more and more investment in these areas, but at this point, it is still at the very beginning of the development of this submarket. One thing that I believe will pick up steam very quickly is the deployment of capital in charging stations because the states are starting to move faster on that, and that will create more opportunities for us, not only for grain-oriented electrical steels, obviously, but also for other types of steel because the charging stations consume steel, not only electrical steels, like normal carbon steel that we produce and sell. So these are mainly the best points of increased consumption that we see right now.

**Sean Wondrack**

Thank you. That's definitely helpful. And then just understanding, you've done a good job paying down a lot of debt, and your top priorities remains debt reduction. That aside, you've been out of M&A for a little while. Is there any opportunity or appetite for M&A or are you still favoring organic improvement as you've laid out on the call? Thank you.

**Lourenco Goncalves**

Neither one or the other because M&A is opportunity. And you don't see small iron ore company buying a steel maker and then buy another steel maker and going from \$2 billion in revenues in 2019 to \$23 billion in revenues in 2022 all the time. So you probably never saw in your life and never will in the future.

So M&A is opportunity. So at this point, I don't see any opportunity on M&A. And I did not commit with the greenfield growth any time during this call or any time in the last two years. So there is no real greenfield opportunity for us. For us, it's paying down debt. And once we pay down debt, we're going to do something with the money good for the shareholders. That's all you can get as a commitment for us at this point.

**Sean Wondrack**

Okay. It's very clear. Thank you very much.

**Lourenco Goncalves**

Thank you, Sean.

**Operator**

Thank you. There are no further questions. I would like to hand the call back over to you.

**Lourenco Goncalves**

All right. Ladies and gentlemen, thanks for being with us for the last hour. We appreciate the interest in Cleveland-Cliffs. We will continue to keep you posted, and we'll continue to deliver the results we are committed to deliver. Thanks again and have a great day.

**Operator**

Thank you. This does conclude today's teleconference. We appreciate your participation. You may disconnect your lines at this time. Enjoy the rest of your day.