Cleveland-Cliffs, Inc.
Second-Quarter 2023 Earnings Conference Call
July 25, 2023

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

Q&A Participants
Bill Peterson - J.P. Morgan
Timna Tanners - Wolfe Research
Curt Woodworth - Credit Suisse
Lucas Pipes - B. Riley Securities
Carlos De Alba - Morgan Stanley
Lawson Winder - Bank of America

Operator
Good morning, ladies and gentlemen. My name is Daryl, and I am your conference facilitator today. I would like to welcome everyone to Cleveland-Cliffs second-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. At the conclusion of the call, it will be archived on the website and available for replay.

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

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

Celso Goncalves
Thank you Daryl and good morning, everyone. Q2 Adjusted EBITDA of $775 million was more than three times higher than Q1. We had our best free cash flow quarter since 2021, with free cash flow generation of $756 million. We used most of that cash to pay down over $550 million of debt, bringing our net debt down to $3.9 billion, our lowest debt level since we were just a mining company in 2019.

Q2 of 2023 was our largest quarterly debt reduction in company history. We also returned nearly $100 million to shareholders by buying back 6.5 million shares at an average price of just over $14 per share. Since the acquisition of FPT in November of 2021, we have dedicated the vast majority of our free cash flow to debt repayment and share repurchases.

To summarize our balance sheet accomplishments, over the past two years, net debt has gone from $5.3 billion to $3.9 billion, down by 26%. Net pension and OPEB liabilities have gone from $3.8 billion to just $750 million, down by 80%. And our diluted share count has gone from $585 million to $514 million, down by 12% to the benefit of our shareholders.

We have remained disciplined in our approach to capital allocation and we'll continue to do so, going forward.

Our current and future CapEx needs are low, and we expect to remain a very strong free cash flow generator for the foreseeable future. Q2 was a multiyear low in CapEx for us.

Looking ahead, very importantly, based on more recent evaluations by our operations team, the blast furnace reline at Burns Harbor that we mentioned on the last call, which was originally planned for 2025, has now been pushed by one year and will now only be done in 2026. With that, we now expect annual CapEx to remain around the $700 million level for 2023, 2024 and 2025.

Drilling down specifically on our results for this past quarter, our volumes and selling prices were both up, sequentially from Q1 to Q2. Shipments of 4.2 million tons effectively matched the high watermark that we set as a steel company two years ago.

This was highlighted by a much richer sales mix, with another quarterly record shipment level to our automotive customers, and more value-added end user sales than originally expected. This mix impact led to better price realizations than expected, with our selling price averaging $1,255 per net ton, representing a significant increase of nearly $130 per ton quarter-over-quarter.

During Q2, the offsetting impact of the richer mix came on the cost side, as our unit costs were effectively flat compared to the prior quarter. We ultimately sold a higher-proportion of value-added tons than originally expected. This being said, the cost reduction targets that we laid out

in the prior quarter remain on track, as we anticipate a $40 per ton reduction in steel unit costs from the second to the third quarter.

You can already see this foreshadowed in our cash flow statement, as replacing higher cost inventory with lower cost inventory drove a working capital benefit in Q2. This cost reduction is a function of healthy production volumes, normalized repair and maintenance costs, as well as lower scrap, energy and alloy costs.

The reduction in cost coming in Q3 will help to partially offset the impact of recently lower index pricing, which will roll through in the back half of the year. As typical for the sector, we will likely see lower automotive volumes in Q3, due to OEM outages for model-year changeovers.

While we still aim to maintain in Q3 the same high levels of total shipments we achieved in Q2, the expected product mix should drive a favorable impact on unit cost.

We are excited that we have now worked through effectively all of our higher cost inventory leftover from our days of elevated repair and maintenance and reduced production volumes.

Looking forward, we not only see the near-term costs coming down in Q3 and then Q4, but also expect to see further reductions into next year, mainly related to lower coal prices.

During the quarter, following the well-timed issuance of our unsecured bonds in April, we were able to successfully upsize and extend the maturity of our ABL facility from 2025 to 2028, pushing out by three years what was previously our nearest dated debt maturity.

With the assets of FPT now included as part of the collateral, we rightsized our ABL from $4.5 billion to $4.75 billion. The ABL, together with our bond offering and free cash flow allowed us to end the quarter with record liquidity of $3.8 billion.

With that, I will now turn the call over to Lourenco.

Lourenco Goncalves
Thank you, Celso, and good morning, everyone. The first thing I will highlight about our second quarter results is our total shipments of 4.2 million tons, which matched the record high we set in the second quarter of 2021.

At that time back in 2021, we were operating a total of eight blast furnaces, and now, in 2023, we operate only seven. If you recall, we idled our Indiana Harbor #4 blast furnace, a 2.1 million ton per year unit in 2022.

So, with one less major blast furnace in our footprint, we were able to accomplish the same levels of production and shipments. This fact demonstrates the efficiency of our strategic use of

HBI as feedstock in our blast furnaces, together with the maximization of scrap usage in our BOFs.

As a result, we were able to use a lot less coke for the same amount of pig iron produced. Let's make it even more evident, had Cleveland-Cliffs not acquired the two steel companies in 2020, the same amount of steel would be produced today, but the CO_2 generation would be a lot higher. The use of large amounts of HBI in blast furnaces introduced by Cleveland-Cliffs, allows for significantly less CO_2 generation.

In our case, 32% less in five years, while maintaining the same level of production and the same product mix, which is heavy in flat-rolled automotive steels. We do not know of any other company, mini-mill or integrated in the U.S., Canada, Europe, Asia, or anywhere else in the world that has achieved similar magnitude of reduction in CO_2 emissions in such a short period of time.

One of our key competitive advantages is having full control of our main raw material, iron ore pellets, from our mines in Michigan and Minnesota. Speaking of Minnesota, in Q2, we got a final resolution of the issue at Nashwauk. We have been fighting for Nashwauk since I came to Cliffs, back in 2014. Nine years later, we now control the State leases. These leases, together with the private land we acquired there six years ago, add decades of high quality ore to our reserves at Hibbing.

We have already started the work necessary to develop Nashwauk, and our preliminary assessment confirms that this ore body will support the production of both blast furnace pellets and direct reduction grade pellets, for the long-term.

On that note, we find ourselves in 2023 reaping the benefits of our early decision to invest in Direct Reduction, back in 2017. We broke ground in 2018, and the plant began production of HBI in late 2020. With natural gas prices where they have been, we are producing HBI at a cost of less than $200 per metric ton; so our HBI has not only been a carbon intensity reduction agent, but also our productivity and margin-enhancing agent.

It is also worth reflecting on our success in building, ramping up and operating our Toledo plant. Neither one of the two DRI facilities previously built in the United States by two other companies are good examples of success. Their failure to execute caused a lot of skepticism regarding our ability to do it successfully, to the point that one research analyst once called it a “widow-maker.”

Moreover, when comparing Cleveland-Cliffs’ execution of the Toledo plant to other greenfield sheet and plate mill projects in our space, and the struggles that they have had, during construction and after startup, it goes underappreciated, that since we built and commissioned our HBI plant, we have been operating uneventfully and at capacity for two and a half years. Case closed.

Our customers are starting to recognize the important role that HBI has played in our carbon reduction goals. With that, we have recently introduced in our invoices to our clients what is called a “Cliffs H” surcharge, which is a $40 per ton surcharge applied to each ton of steel made with Cliffs HBI. For the ones that work in metric tons, it is $44 per metric ton.

We deserve to be paid for a characteristic of our steel that truly differentiates us, particularly when compared to other major suppliers of steel to the automotive industry in the United States, in Europe, in Japan, in South Korea, in China or anywhere else throughout the entire world.

We also believe that the $40 per net ton Cliffs H surcharge should be passed along by the car manufacturers to the final consumer, and that would only increase the window sticker MSRP price of a car by less than 0.1%.

Regardless, as one of the largest suppliers of steel to the automotive industry in the world, Cleveland-Cliffs wants to continue to invest in green initiatives, and therefore we need to be paid for that. That's not unreasonable, and should actually be expected and universally accepted. We at Cleveland-Cliffs are happy to be the first ones on this path.

The next step in our evolution will be the use of hydrogen throughout our footprint, including at our DRI facility and our blast furnaces, which we have already proven are hydrogen ready.

Three months ago on May 8, at Middletown Works, we became the first company in the Western Hemisphere to successfully complete a full-scale trial injecting hydrogen into all tuyeres of a blast furnace for an extended period of time.

Using the existing pipeline and transportation infrastructure in place, hydrogen gas was injected into all 20 tuyeres of the blast furnace, and used as a substitute for fossil fuel reductant. This ultimately replaced the release of CO_2 with the release of H_2O (water vapor), with no impact to product quality or operating efficiency.

We will be next trialing the technology at our largest blast furnace, Indiana Harbor #7. We believe hydrogen will be the true game changer for the decarbonization of steel. It is simple chemistry after all, and we have already proven its effectiveness. The main hurdle right now is economics.

As of today, equivalent units of hydrogen gas are about 10 times more expensive than natural gas. That is why we are an active player on the initiatives to build hydrogen hubs in the Midwest, specifically near our Burns Harbor, Indiana Harbor steel complex in Northwest Indiana and also near our Toledo, Ohio direct reduction plant. As hydrogen becomes more and more economical, we will be able to implement it throughout our entire footprint.

The steel industry in the U.S. represents just 1% of our country's carbon emissions footprint, compared to transportation and power generation, which together account for over 50%. With the role we play in automotive, we are actively engaged in providing solutions for much more capital intensive sectors.

On that regard, I am pleased to report that the 70,000-ton non-oriented electrical steel expansion at our Zanesville plant has been completed, and we have already started producing our MOTOR-MAX electrical steels for use in EV motors. Every electric vehicle on the road needs about 150 pounds of this material, and we are now in a great position to serve the growing demand for these steels.

Outside of automotive, overall demand remains healthy. In recent months, we have seen a massive influx in orders related to solar projects, which are heavy users of our galvanized steel. As a relatively new market for steel, this is by far the largest growth area for us in terms of demand.

Now that it appears that inflation is under control and the soft-landing scenario is a real possibility, caution on the part of service center buyers should begin to ease. Service center inventories remain way too low and with these new sources of demand, along with the incoming new demand related to federal spending initiatives, steel buyers are starting to come off the sidelines.

On a very specific note, for those who have been following the recent I-95 bridge collapse in Philadelphia, I'm proud to report that Cleveland-Cliffs plate division's ability to respond quickly to the crisis, led to us being awarded the contract to supply the steel plate needed to repair the bridge.

We received the PO on a Friday, melted steel on that Sunday, rolled on Monday and began shipping on Tuesday, a four-day turnaround from both our Burns Harbor and Coatesville plants, ahead of the fabricators already accelerated schedule.

This was a huge effort and a great accomplishment achieved by our Cleveland-Cliffs team, and I would like to personally congratulate all the men and women involved in getting this job done, so quickly and so professionally. We look forward to the speedy re-opening of this important piece of our infrastructure.

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

Operator
Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, 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 would like to remove your

question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset, before pressing the star keys.

One moment, please, while we poll for questions. Our first questions come from the line of Timna Tanners with Wolfe Research. Please proceed with your question.

Timna Tanners
Yeah, Hey, good morning, everyone. Wanted to ask for a little bit more color on the commentary related to coal price declines, if you could give any more specifics. And also on the mix correction you talk about helping costs. But any color on the expected implications for prices into the third quarter would be great. Thank you.

Lourenco Goncalves
Okay, Timna. First of all, more color to coal prices, I can't give you right now. We are in the middle of a negotiation. The only thing that I would like to say is that we expect price to decrease year-over-year by a significant percentage. That's all I can tell you right now because it's not done yet. It's too early. Maybe next quarter we can be more numerical, but good things are coming from this negotiation, which this year, I am handling myself. That's number one.

The second one, you mentioned, mix correction. I don't know what this is. Can you clarify?

Timna Tanners
Yeah, absolutely. So, when you talked about the benefits from the mix changes into the third quarter from a particularly strong mix in the second quarter, you talked about how that would help reduce costs. But it also tends to imply, and I don't want to jump to conclusions, but generally, if you have a mix shift like that, you would also see an impact on your average realized selling price. So, I was just wondering if you could also provide kind of that kind of color as well.

Lourenco Goncalves
Understood. Here's the thing. In Q2, we being the, by far, the largest supplier of automotive steels to the OEMs and service centers altogether, we saw bigger demand for automotive steel than we were anticipating.

Several reasons for that. Their supply chain issues have been resolved, by and large. They are building cars more aggressively ahead of union negotiations because it's better to be safe than sorry. Even though I don't expect any disruption, strike, or anything like that. But they are behaving as if they need to stay ahead of the game which is, in my opinion, good management practice when we are entering a union negotiation, even if the negotiation is friendly.

So, being the largest by a lot, we're the biggest beneficiary of this type of thing and that explains why our average sales price went up, because automotive is high value-added in comparison with the rest of what others do. That's more skewed toward the commodity,

commercial grade, the stuff that everyone can produce no matter if it's a mini-mill or an integrated. So, that explains the price side.

On the other hand, because this mix is heavy on our galvanneal, highly specified galvanized, things like that, there's cost involved in producing these higher margin prices. So all in all, it was great for us. We had a slightly higher cost than we anticipated. It was basically in line with the cost of Q1. Our prices went up by more than $200 or more than $100, $100 and something. I don't have the number in front of me, right now.

But it was significant, $127 per tonne, something like that. But don't take this number to the bank. Check that later with Paul Finan, but I don't have this number in front of me, but higher price by $127 per ton just confirms our position in the automotive industry because lots of companies love to talk about gaining market share in automotive.

We are the one that tonnage goes up, prices go up, everything goes up with us and others keep repeating the same story about gaining market share. I don't know what this market share, all the market share, they gain they are buying. But anyway, that's a separate story. So, I think I explained the price thing and the cost thing unless I left something out. Pease feel free to ask if I'm missing something, Timna.

Timna Tanners
Yes. Sorry, Lourenco, I was just trying to understand not how we got to the second quarter, which I think you explained really well but also the implications of the backing off of the extra auto tonnage that you talked about in the third quarter. So, just the implications going--yeah, exactly. Thanks.

Lourenco Goncalves
Yes, what we are anticipating here is basically confirming the reality of July. Even though this year, the summer shutdowns were very mild in comparison with previous years, they still did some shutdown, at the very least a week. in some case, two weeks which, again, much less than what they normally do. I'm talking about the automotive OEMs. So that mix for when you compare Q2 with Q3, less tonnage for automotive.

So, everything that I explained about Q2, you take in reverse into Q3. So, we are going to have lower costs because we are going to be producing less of the steel that carried us well in Q2. On the other hand, this lower--slightly lower average prices will be offset by lower costs. So, these things go together. We will be producing less galvanized, less galvanneal, less aluminized and that will kind of offset. On the cost side, the revenues impact that we're going to have for not producing the same amount. Still be a big number, but we had time in July that we're still doing--playing the game with them shut down for their summer vacations.

Timna Tanners
Okay. Thank you.

Lourenco Goncalves
Thank you.

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

Curt Woodworth
Yeah, thanks. Good morning, Lourenco and Celso, hope you're doing well. Sort of follow-up to Timna's question. So, with respect to cost being down $40, are you saying that the combination of the spot price index shift and then the mix shift would be roughly equivalent to that?

So, do you feel like your EBITDA per ton could be similar to 2Q or can you give any more color on, specifically, what you see average selling price is during this quarter?

Celso Goncalves
Yeah, sure Curt, it's Celso. Yeah, like we said, let me touch on costs and then I'll go over average selling price expectations. But as Lourenco mentioned, with less automotive coming here in Q3, there's going to be higher volume of kind of less value-add driven by service center demand and the impact of that lower cost is going to be running through inventory. And what's driving the lower cost is lower repairs and maintenance and this higher production volume, lower scrap, lower energy and alloy costs.

So, that's what's baked into that $40 reduction per ton, quarter-over-quarter, for Q3 over Q2. And then as it relates to average selling price, you're going to have a similar kind of impacts driven by mix and we've sort of given enough in terms of our average selling price mix and how the lags with index pricing work.

But just to reflect--just to kind of remind everybody how that works, we have a 45% of our portfolio is fixed under full-year prices and those reset throughout the year. And I think we've provided full-year ASP guidance of $1,415 for fixed-price contracts.

And then beyond that, we give the percent of volumes that are impacted by index pricing, which is 55%, and the breakdown of that is 20% of that is on a CRU month lag, 10% is slabs on a two month lag, 10% is CRU on a quarter lag and then the remaining 15% is spot. So, I think with all of that, you can kind of get to what the implied ASP for Q3 should be. But if you need any more color, just let us know and we can try to help a little bit further, but I think we've given enough breadcrumbs there.

Curt Woodworth
And then in terms of the cost progression going down another $10 into 4Q, is that just kind of a similar trend of working off some of the high cost inventory? And then it seemed like what

you're saying with respect to cost guide for next year, for the most part, the only real change in the model would be with respect to coal. So, said another way, do you feel like you'll be at pretty much targeted MRO cost structure going into next year?

Celso Goncalves
Yeah, that's right. So, the goal here is that we're trying to get our costs down to that $1,000 per ton range, by the end of this year, right. And the $40 for Q3 and $10 for Q4 is sort of just directional, but the goal is to get to that $50 by the end of, $50 altogether by the year to get us back to $1,000.

And then going into next year, assuming that we get these benefits on lower coal costs for next year, which we're very confident we will, that will be a big step function down again into Q1, Q2 of 2024. That will be the big driver there.

Lourenco Goncalves
Yeah, Curt, Lourenco here. Just one more thing that I would like you to keep in mind. We continue to use an enormous amount of HBI in our blast furnaces, which I've showed—today, I gave a cost figure in my prepared remarks. So, that needs to be taken into consideration. Also, natural gas prices are back to level that we feel like they are helping the cost structure. So, don't forget that.

And last but not least, because we use so much scrap in our BOFs, everything that the mini-mills do in terms of pushing scrap prices down for their benefit, they're benefiting me, too. So, that's the beauty about owning a scrap company. I was always, in the past, upset with the fact that they had an easy way to accommodate lower prices.

They would just work hard to push scrap price down. Okay. Now they do the work, Cleveland-Cliffs benefits because I use close to 30% scrap in our BOFs. So, I thank them for that. Every time they do what they do, I benefit. My costs go down.

Curt Woodworth
No, that's all understood. And then maybe just quickly, Lourenco, on capital return given the reline push out at Burns gives you a little bit more runway on the CapEx side. Do you feel like there's appetite at the Board level to initiate a dividend? And I guess how do you see kind of capital return evolving ,given you're going to be closer to net debt target of $3 billion by year end? Thank you.

Lourenco Goncalves
Look, it's a possibility and this Board has been with me, almost everybody, for nine years. So, they have been through everything that you have been through as well. You have been around for a long time. You are one of the ones that have been following us for all the nine years. So, we see the difference. And--but this Board has been extremely supportive of everything. And it's not like we don't want to return capital to the shareholders.

We actually, we are. If you look in the last two years, Curt, our share count was reduced by 12%. Two years ago, our share count was 585 million shares; now it's 514 million shares. So, we're buying back a lot of stock. So, we're returning a lot of money to the shareholders. A dividend will come at the right time and the right time is getting closer, every quarter. I don't want to commit with anything, but we are making all the right moves in the right direction with the very high speed. So, we're going to get there, soon.

Celso Goncalves
Yeah, just to add to that too. I think the way to think about it, Curt, if you look at the recent quarters, we have allocated sort of like 80% of free cash flow towards debt repayment and 20% towards share repurchases.

As we get closer and closer to that $3 billion of net debt target, this kind of breakdown of 80-20 can shift more toward capital returns to shareholders and less toward debt reduction. It doesn't mean that we're going to stop paying down debt once we get to the $3 billion, it's just the allocation will change a little bit and it will be more skewed toward capital returns.

Lourenco Goncalves
One last thing, Curt, on this issue of the dividend. We have been allocating money to buy back. That's clear. Why we are allocating money to buybacks? Because every now and then, our stock price goes on sale. Then we go ahead and buy. There's one way for us to expedite the dividend; stock price needs to follow the results.

As soon as the stock price starts reflecting the reality of what Cleveland-Cliffs has been delivering quarter after quarter, year after year, we will be more excited about the dividend. And I promise you, as soon as I'm excited, my Board will be excited.

But we need to see the stock price to be consistently higher for me to consider that the best way to return money to the shareholders is through a dividend and not through a buyback. Because the buyback is a sure way to return capital to the shareholders in a stock that artificially continues to be inflicted volatility that we don't deserve.

Curt Woodworth
Yes, agreed. Alright. Thank you.

Lourenco Goncalves
Thanks, Curt.

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

Lucas Pipes
Thank you very much, operator. Good morning, everyone. Lourenco, really good to hear about the push out of the reline at Burns Harbor and I wondered if you could update us on the reline schedule kind of across the fleet. And then you mentioned hydrogen hubs in your prepared remarks, and I am hearing more about those. And I wondered what role exactly Cliffs could play in the development of those. I think you mentioned Indiana and Ohio. Would appreciate your comments on that, as well. Thank you.

Lourenco Goncalves
Okay. Cool. Thanks, Lucas, for the question. Look, Burns Harbor, Burns Harbor blast furnace C is the next in line to be relined. We continue to monitor the furnace. We continue to operate the furnace. And every time we release some information is based on updated operational information. So, until last quarter, our worst case scenario would be a relining in 2025 for blast furnace C at Burns Harbor.

Through this quarter, we are--our conviction that the furnace is in great shape increased enough for us to be 100% sure that a postponement to 2026 is perfect. So that's why now the time is 2026. After that, we'll see. Our biggest blast furnace Indiana Harbor number 7, finished in 2021. So, it's very recent.

We just finished Cleveland last year. So theoretically, the next one in line would be Middletown. But Middletown is not going to happen before 2027. It's not going to happen. But there is--don't take the 2027 number to the bank because we will continue to monitor, we will continue to improve operations at Middletown, and this 2027 might become 2028 or later. So, that's what we have at this very point regarding blast furnaces.

Regarding hydrogen - hydrogen, there's a chicken and egg thing with hydrogen. Industries--first of all, one step back. Hydrogen is the solution if you really want to knock down CO_2, because carbon will be in touch with oxygen and we will produce CO_2, unless we remove the carbon. So, the best way to remove the carbon is to replace with something else that doesn't have carbon. That's hydrogen.

So, when you combine H_2 with the O_2, you generate H_2O. That's great. That's water. That's vapor. So, that's not CO_2. But the problem is companies that operate with gases don't build plants to produce massive amounts of hydrogen in scale to reduce the cost because there's no demand. And then there is no demand because the gas companies don't build the big plants.

So, we are, we at Cleveland-Cliffs, we are breaking this chicken and egg conundrum by committing with off takes to the hubs. So in Toledo, the hub that's being proposed there and the leading company is Linde, our main supplier of gases throughout the footprint, is 100 tons per day. Our off take there is 50 tons per day. We are taking half of their capacity and leaving the other half for other industries to use, which other industries are there?

Among several other possibilities, automotive. There are serious OEMs right now, considering hydrogen powered cells to propel cars as an alternative to battery electric vehicles. And I believe that this is a great solution, not to replace, but to add to the battery electric vehicles route. So, in Toledo, we are promoting that.

Same thing in Northwest Indiana. In Northwest Indiana, the hub is BP Constellation hub. So, we met yesterday here at Cleveland-Cliffs with management of BP. So, we landed our support not only to the hub, but anything BP is doing on their own to produce more hydrogen in Northwest Indiana and the hub itself is enormous, ten times bigger than the hub in Toledo. It's a 1,000 tons per day. But because we have Indiana Harbor and Burns Harbor over there, my off take there, my commitment is 200 tons per day.

So that would make for us to be the enabler of having the automotive industry building stuff in Northwest Indiana to produce hydrogen cars if the OEMs really pursue this route. So, that's the state of things. And I'm so confident that our trial at Indiana Harbor #7 will be done with a pipeline that will be permanent.

Just waiting for hydrogen to come in a normal basis, and then we're going to be able to use it like we use HBI, today. At that point, instead of Cliffs H, we'll be talking about Cliffs H2, because Cliffs H is only HBI, it's only $40 per ton. Cliffs H2 will have two H's, HBI and hydrogen, and that will be a little more expensive for the clients.

Lucas Pipes
Lourenco, this is very helpful and very exciting.

Lourenco Goncalves
Thanks, Lucas.

Lucas Pipes
As a follow-up, I wanted to ask about the amount of coal that you expect to purchase from third parties in 2024. Just a rough range, then I can apply my own price assumptions on that. So that would be helpful. And then separately, U.S. steel demand in 2022, I think was still down about 7% per capita versus pre-COVID level. So, I'm wondering what your view is more broadly for steel market in the U.S. for the second half of this year, but also as we look into 2024. Thank you.

Lourenco Goncalves
Okay. So, our typical purchase of coal is 7 million to 8 million tond, including what goes through SunCoke, plus our own production at Princeton. What was the other question, Lucas? I'm sorry.

Lucas Pipes
Your demand outlook, especially in view that per capita steel demand in the U.S. is actually still been down versus pre-COVID level.

Lourenco Goncalves
Yeah, I don't have any views of per capita, right now. I was very good at that when I was in Brazil because, per capita, it was a factor, but here in the United States, in a mature market, I don't focus on that. But I will tell you about demand in our markets, the demand that matters for us.

This will be the first year since COVID that automotive will get close, not at, but close to a normal level. And because automotive is so big for us, this is a game changer for us, not only makes us to produce more steel to supply the automotive industry that's doing better, but also makes us to produce less steel to go out and compete with more commodity type players that bring price down with no problem.

We will also start to see what--we're actually seeing right now--the impact of the Infrastructure Bill, the Inflation Reduction Act, the CHIPS act is coming soon. We are going to see that in the coming quarters.

So, we are in good shape in terms of demand in this country. What's happening right now in terms of this resurgence of manufacturing here in the United States is completely underappreciated.

We spent the last 25 years convincing ourselves that we could produce everything in China, in India, in Vietnam, in Indonesia and place like that. Guess what? We can't. We have to produce here. And I'm glad that this concept is starting to percolate.

The next thing we need to start convincing our younger people that this is reality, that working is not staying home behind a computer and joining Zoom calls, but there is life in manufacturing, there's life in engineering. We need to produce things in this country; otherwise, we're going to lag behind.

And that's a thing that parents and grandparents need to start educating our people because there's the will, there's the money, there’s the willingness to invest here, but we need the people.

We have been blessed. We have been very successful in hiring new people and retaining younger people. We have an entire group of people inside our company that's being trained almost, completely trained to replace the ones that are retiring this year and next year. But that's not the overall picture in the country.

So, that's also part of the equation. We need people to support this effort of redoing what the last generation destroyed, bringing manufacturing back to America, being able to bring strength back to this country.

Lucas Pipes
Lourenco, I really appreciate your comment. To you and your team, continued best of luck. Thank you.

Lourenco Goncalves
Thanks, Lucas. I appreciate it.

Operator
Thank you. Our next question comes from the line of Carlos De Alba with Morgan Stanley. Please proceed with your questions.

Carlos De Alba
Thank you very much. Good morning, Lourenco and Celso. Just a question that I've been getting a lot recently in the discussions is that there is this perception or discussion that Cliffs may have lost some share.

And you sort of addressed that a little bit, Lourenco, earlier in your comments, but I wonder if you can give us a little bit more detail on what has happened with your shipments, your share on auto sector, given your push for higher prices. So, I wanted to hear from you how do you see that.

Lourenco Goncalves
You said a perception of market share loss in the automotive?

Carlos De Alba
Right.

Lourenco Goncalves
Look at our volumes; they are up, year-over-year. We just report a quarter that has been record volumes. So, people say a lot of thing, but you know what, reality is in the numbers. We continue to gain market share, without buying market share.

The only differentiation between us and everybody else in automotive is that last year, in the last cycle of price renewals, we were able to increase prices by $115 per net ton. And everybody else, in their quest to gain market share gave away the farm and gave reduced prices. I thank them for that because, all in all, the OEMs are good because we increased price, they reduced price, they probably stayed even because we supply half.

So, everybody together, supplying the other half and giving them a price discount, good for GM, good for Ford, good for Toyota, good for Stellantis, good for--keep going. You got the picture.

So, that's fine with me. I produce the steels that they need, we deliver on time, we are the ones that when push comes to shove, they come to us to deliver new models. And we stop the

bleeding with aluminum, we stop the bleeding with mini-mills, we can produce exposed, but this BS, mini-mills cannot produce exposed parts except for exception of the exception of the exceptions.

Other than that, it's on us. And by the way, we use HBI, and we are charging them $40 per ton and they are paying because if they don't pay, they don't get the steel.

I hope you understand my point, Carlos.

Carlos De Alba
Yah, no, I did. And presumably, it's fair to assume that these dynamics will continue in the second half of the year, right?

Lourenco Goncalves
You bet—you bet. They will continue and Cliffs H is now, Cliffs H2 is when you get some hydrogen to enrich our natural gas. Because you know, we inject a lot of natural gas in our blast furnace. And our natural gas is a mix of 96% CH4 with 4% of others like C2H6, C3H8, C4H10-all hydrocarbons.

But when we enrich with hydrogen, we are doing a good thing to reduce CO_2 emissions. So, when I have enough hydrogen to enrich natural gas, we'll go from Cliffs H to Cliffs H2.

And one day, hopefully still within this decade, we're going to have enough hydrogen to replace natural gas and then this is a stage we call Cliffs H Max, because we're really injecting hydrogen. And at that point, our coke rates will be to the minimum theoretical just to keep the furnace in vertical position with the burden, because the coke inside the furnaces are reductant, but it's also mechanical support for the body.

So, we're going to be to the theoretical minimum at that point. But that will be 2029, 2030. I'm talking about 2023, 2024, 2025.

2023, 2024 is Cliffs H type. By late 2024, early 2025, I hope that I'll have enough hydrogen to go to Cliffs H2. And at that point, others will be talking about gaining market share. No, they're not gaining anything. They are buying at the edges.

They are buying market share. We're going to say buy because they drop prices and they entice the new purchasing manager that was just moving into the spot that the other one that was fired. And then this new guy believes or girl believes that he or she will reinvent the wheel.

Then they got the reality, and reality is a beast. If they need the steel that they say they need, they have to deal with Cleveland-Cliffs. We are not in the business of gouging anyone, we just want to get paid for what we do. We have been paid for what we do. We appreciate the

support of our partners in the automotive industry, and this will continue into the latter part of 2023 and 2024. I hope you got your answer, Carlos.

Carlos De Alba
Lourenco, I did for sure. And then coming back to capital allocation, several companies in the mining and steel sector have been signing capital allocation frameworks, where they sort of allocate a fixed percentage of the free cash flow generation in whatever form or shape you want to measure it to return money to shareholders. Do you think that this is a possibility in Cliffs, and if not, why don't you believe it? Why don't you believe on that?

Celso Goncalves
Yeah, hey, Carlos, it's Celso. No, it's a construct that I actually like, and it's something that we're considering at the right time, right. As I stated earlier, we've allocated 80% of our free cash flow toward debt repayment and the rest towards share repurchases.

Once we get down to that--and that's what we're going to continue doing, until we get to that $3 billion of net debt.

Now once we're there, once we're at the $3 billion of net debt, all other constructs are on the table, including what you're mentioning, making it more of like a formulaic capital return to shareholders, will still be a very strong free cash flow generator, and the majority of the cash generated will go to the shareholders as opposed to paying down debt at that time. Not to say that we'll stop paying down debt entirely, but it will just be a higher weighting towards either buybacks or dividends at that time.

Carlos De Alba
All right. Excellent. Well, thank you very much, Celso and Lourenco.

Lourenco Goncalves
Thanks, Carlos. Just to--one more thing, but I already talked about that, but I would like to make abundantly clear - in Q2, we paid a lot of debt. We paid down a lot of that. We could have paid even more, $94 million more, if we had not purchased in stock. But we did purchase stock because it was on sale. So, these things go all together. These things go all together. We are not going to use every last penny to pay down debt just because we said that we would be paying down debt.

We want to pay down debt. We will pay down debt. But if the market gives the gift of shares for free, I will buy back stock. And that will create postponements on accomplished whatever date to start a dividend.

So there's only one solution for this thing, is our stock price goes up, reflects the real value of the company, reflects the real value of what I'm doing, and then we can start a dividend.

Otherwise, we are kidding ourselves. I am a shareholder. I think like a shareholder. By the way, that's a thing that very few CEOs, particularly in our space, can brag about.

I have never sold a single share that I acquired in the open market or that was given to me as compensation. So, I think like a shareholder, I like dividends, I'm a 65 year old man. One day, that's far away in the future, I will retire and I'm going to live off dividends from Cleveland-Cliffs. So, I need the stock price to go to the right place before I really commit with a dividend date. Think about that, please.

Operator
Thank you. Our next questions comes from the line of Bill Peterson with J.P. Morgan. Please proceed with your questions.

Bill Peterson
Yeah, hi, good morning, Lourenco and Celso. Thanks for letting me ask a question. I wanted to continue on discussion of this Cliffs H. So, it sounds like you've already begun shipping, just want to make sure, but also looking ahead, I guess, how broad is that demand from automakers? In other words, is it across the board automakers? And then you alluded to the mix on this, but how should we think about the mix of Cliffs H as a portion of your auto steel demand, over the next few years?

Lourenco Goncalves
Cliffs H is what we produce--good morning, Bill, by the way. Cliffs H is what we produce in our integrated footprint. Everywhere we have a blast furnace and we produce steel to the automotive industry, we are producing Cliffs H.

Cliffs H is a differentiating factor for companies like the ones that have plants here in the United States and plants in Europe, plants here in the United States and plants in Japan, plants here in United States and plants in Brazil. There are several that can follow this description.

Well, these companies in Europe cannot get steel for their automotive needs that has lower CO_2 emissions associated to. Because they use sinter in pellets, we use only pellets and because we use HBI and they don't. So that's Cliffs H. That's a concept. Our steel that we sell to the automotive industry is all Cliffs H. So, we are negotiating with all of our clients.

We already have clients signed up to pay the $40 per ton and we appreciate the early support from these folks. But over time, everybody will pay because it's everything we produce in our integrated footprint. And then you may say, oh, but your emissions through the integrated route are higher than the emissions of the mini-mills.

Yes, try to build a car with rebar. It's not going to work. Yes, but try to build a car with wide flange beams. It's not going to work. Yes, try to build a car all with flat-rolled steel produced in flat-rolled mini-mills, it does not work.

I challenge that. If that would be the way to do it, they would be doing in Japan, they would be doing in Korea, they would be doing in a lot of places that have a lot of scrap. So, there's no way. That's the concept. You got it, Bill?

Bill Peterson
Yeah, yeah. Well understood. All right. Thanks for that. Maybe sticking with the carbon theme. So, I wanted to see if you had any thoughts on the ongoing negotiations between the U.S. and the EU on the carbon tax structure, which is looking like a standard that may not be met by the October deadline. I guess, what is your thoughts on a feasible solution? And do you see any upside risk to prices that the Section 232 tariffs are reinforced against EU? Just want to get your thoughts on that.

Lourenco Goncalves
Yeah, look Section 232 already play the role that they have to play. We believe that the market will continue to support fair trade. It's time for us to stop believing that what the foreigners coming here for is to help the market. No, they are just diluting their fixed costs by using our demand. So, I think these items regarding Section 232 have been--have been addressed, over time. I don't know if there's any specific that you really would like me to talk about.

Bill Peterson
No, really it's related to the carbon tax structure, and we can take it offline.

Lourenco Goncalves
Yea, the carbon tax structure, we support because we are so much better here in the United States. The mini-mills, I just gave them the reality check on exposed parts, but there are mini-mills in the United States made enormous advancement in producing automotive steels for other uses and no exposed parts. And then they have a decent participation in automotive.
So, we--not in some areas that are really exclusive to our steels.

But we are so much better in terms of everything than the Europeans and the Japanese and the Koreans. That's just fair to have a carbon tax adjustment. And then we have a resemblance of a level playing field when compared to steel produced in the United States with steel produced somewhere else. And that includes Canada, by the way. Canada is part of the rest of the world, not part of the United States.

And because we are talk about Canada, I have to talk about Mexico, the transshipment capital of the world. These ones are setting themselves up to be dumped from the USMCA. We're not going to stand still with Mexico acting the way they are.

Bill Peterson
Yeah. Well, appreciate the insights and look forward to following the progress. Thank you.

Operator
Thank you. Our next questions come from the line of Lawson Winder with Bank of America. Please proceed with your questions.

Lawson Winder
Great. Thank you, operator, and good morning, Lourenco and Celso. Thank you for fitting me in. You mentioned that you've worked through, effectively, all of the higher cost inventory left over from the days of elevated repairs and maintenance and lower production volumes. And I wanted to ask what that means for potential further working capital reduction in the second half just in terms of rough magnitude? Thank you.

Celso Goncalves
Yeah, hey, Lawson. It's Celso. So in Q2, as it relates to working capital, we had a nice release as you can see, mostly driven by inventory. We moved a lot of that higher cost automotive inventory out of the system and replaced higher cost with lower steel cost. We expect an even further release here in Q3, mostly driven by AR and further inventory. So it should be a positive impact in Q3, working capital release and then sort of neutral in Q4, if that helps.

Lawson Winder
Yeah, that helps. And if maybe I could ask one more, with what time we have remaining or what time you have available. You've talked about strong auto demand. You've talked about an expectation for strong demand from low inventories in the supply chain. What about some of the other end markets? Thanks very much.

Lourenco Goncalves
Yes. Look, I believe I addressed at least partially, during my prepared remarks. But things related to the infrastructure bill and Inflation Reduction Act are already starting to percolate. I'm very impressed with two things. One is solar. Solar is amazing, right now. It's demand, real demand.

We are starting to make things internally to accommodate more and more demand coming from solar. The biggest impact is now galvanized. And the other one is electrical steels. We continue to increase our capacity to produce more electrical steels. And there are initiatives from competitors to produce more electrical steels. These are welcome things--moves because the demand is enormous here in the United States.

Keep in mind, less than three years ago when I acquired AK Steel, they had already decided to shut down their plant that produced electrical steels. And we kept that plant on because we saw this coming. And that was a very important decision. And now, we're investing to increase our capacity. And we still have demand to accommodate this increased capacity at Cleveland-Cliffs and the competition, and we still have more to come.

So, the demand is very promising. Automotive will have a normal year, close to normal year, not real normal, but close to a normal year for the first time since COVID. So there's a lot going on and it's all positive. Okay, Lawson.

Lawson Winder
Okay. That's fantastic. Thank you both. Keep up the good work.

Celso Goncalves
Thanks, Lawson. Appreciate it.

Operator
Thank you. We have reached the end of the question-and-answer session. I'd like to hand the call back over to management for any closing comments.

Lourenco Goncalves
Thank you, everybody, for being here with me today, and there's more to come in three months. I'll be more than happy to talk again. You guys have a great day and girls, thanks a lot. Appreciate, bye now.

Operator
Thank you. This does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a great day.