Cleveland-Cliffs, Inc.
Third-Quarter 2023 Earnings Conference Call
October 24, 2023

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

Q&A Participants
Lucas Pipes - B. Riley Securities
Carlos De Alba - Morgan Stanley
Timna Tanners - Wolfe Research
Bill Peterson - J.P. Morgan
Tristan Gresser - BNP Paribas

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' Third 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 yesterday.

At this time, I would like to introduce Lourenco Goncalves, Chairman, President, and Chief Executive Officer.

Lourenco Goncalves
Thank you, Daryl, and thanks to everyone for joining us this morning. Before Celso starts the discussion of our Q3 results, I want to provide another brief disclaimer. Back in August, we

announced a potential exciting and transformational opportunity for Cleveland-Cliffs. Since then, restrictions have been put in place on what we can say or disclose and, therefore, for the time being, we cannot discuss the issue. So, before you start wondering why you'll not hear anything about it, that's why.

With that out of the way, I'll turn the call over to Celso.

Celso Goncalves
Hi. Good morning, everyone. In Q3, we generated revenues of $5.6 billion, adjusted EBITDA of $614 million, and GAAP earnings per share of $0.52. Total shipments reached 4.1 million net tons and despite the UAW strike impacting three of our clients in the automotive sector, aggregate shipments to all of our automotive clients, collectively, were higher in Q3 than in Q2. Steel shipments from Cleveland-Cliffs to the automotive sector in Q3 were actually a quarterly record.

During the quarter, we generated free cash flow of $605 million. As planned, we used the majority of that cash to pay down our ABL, bringing our net debt down to $3.4 billion and boosting our total liquidity up to an all-time high of $4.4 billion. We also returned approximately $60 million to shareholders by buying back 3.9 million shares, during the quarter.

With our ABL balance down to only $325 million, we now have a capital structure comprised primarily of low-cost fixed coupon debt instruments with no upcoming maturities until 2026. Since acquiring AcrcelorMittal USA in December 2020, we have reduced our net debt by nearly $2 billion and eliminated another $3.5 billion in pension and OPEB liabilities. That's a 60% combined reduction in net debt and post-retirement liabilities in less than three years. Over the last couple of years, we have also reduced our diluted share count by 13% from a high of 585 million shares to only 509 million shares today.

Elaborating further on our Q3 results, shipments remained resilient, despite slowed service center sales during the quarter. The maintenance activities we performed last year have paid off for us as our operations have been running reliably, affording us the ability to achieve these strong shipment levels, all year.

As I said before, notwithstanding the UAW strike, steel shipments to automotive clients actually increased sequentially in Q3. This outperformance in automotive steel shipments and the lower service center shipments helped to mitigate the change in average selling prices quarter-over-quarter with a richer mix, holding strong above $1,200 per net ton, even after the drop in overall index prices during the quarter.

Our cost reduction performance was also very good during Q3, improving by $31 per net ton, quarter-over-quarter. This came in less than our previous guide, only due to this mix factor, but we were happy to take that trade off, due to much higher prices associated with better mix.

We expect cost to fall by another $15 per net ton during the fourth quarter. Since Q3 of last year, we have reduced unit costs by a total of $165 per net ton, year-over-year. That is roughly $2.7 billion in savings at an annual run rate. This solid performance in costs is expected to continue into next year.

We are happy to report that our annual metallurgical coal buy will result in a $250 million reduction in 2024 coal costs. We executed these 2024 annual contracts during Q3, and our negotiations were very well timed as global met coal prices rallied, shortly thereafter.

Among other savings, we have also locked in an additional $150 million in savings for fixed natural gas costs in 2024.

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

Lourenco Goncalves
Thank you, Celso. As you may recall, we had to sacrifice production and shipments last year to bring some of the steel mills acquired in December 2020, from ArcelorMittal USA to a reliable level of performance. Automotive is our biggest market, and we were anticipating much higher demand for automotive steel coming into 2023 versus 2022.

Fast forward to Q3, our demand forecast has been confirmed, and we have absolutely taken advantage of that. Q3 was our third straight quarter with total steel shipments above 4 million net tons, even in a business environment where service centers sat on their hands and were not actively buying for most of the quarter.

The automotive business in the United States is extremely competitive. Automotive is an industry that every steel producer wants to serve. When we negotiate our annual deals, we are competing against offers from countless other suppliers, including Korea, Japanese, German, other European, as well as against Mexican joint ventures and Mexican trans-shipments. We also have seen growing competition from EAFs and the ongoing threats from aluminum substitution. There is no unfair advantage we have from that standpoint.

The United States is, by far, the largest importer of steel in the world, importing more than 30 million net tons of steel in 2022, alone. No matter what change with the market structure of integrated blast furnace/basic oxygen furnace operations in the United States might happen, these competitive forces are there and will continue to be there.

What sets Cliffs apart in automotive is our excellence at serving the clients. We are just better at meeting our customers' need. In a detailed-driven and customized business like automotive, reliable quality, customer service, and meeting just-in-time needs are paramount, and Cliffs does that better than anyone else.

We have been willing to sacrifice throughput to serve the wide variety of parts each one of the clients need. We have to reserve our valuable capacity to align with their production forecast, and we hold inventory for our automotive clients.

As I have said before, a steel buyer for a given car manufacturer can replace Cliffs with another steel supplier just to buy cheaper steel from them for a little while. But history tells that they will come back to Cliffs after the buyer or the decision maker above him or her, or both the buyer and the boss, are replaced with someone else. We have seen that happen time and time again.

Cliffs' position in automotive has been earned, not given, and we continue to fight these numerous competitive forces every day, to maintain and improve this reputation based on excellence.

As a direct result of increased automotive production volumes, we actually set a new company record for direct automotive shipments during the third quarter, surpassing the previous two healthy quarters, even in the midst of model year changeovers and all the uncertainty before the strike was called by the UAW.

So far, the strike affecting a number of plants of the Detroit Three has not impacted us materially, on a direct automotive basis.

As of right now, the impact of the current outages on Cliffs are less significant than what we felt from the microchip shortage and other supply chain issues the entire automotive sector went through in 2021 and 2022.

Also, important to say, the majority of our automotive shipments do not go to the Detroit Three, and that's particularly true for our largest customer, which is not one of the Detroit Three.

In fact, we have seen much better demand from these other automakers. As a result, we expect total shipments in Q4 to remain around the 4 million net ton mark, even if the UAW strike continues for a while.

Conversely, the service center sector was the one creating in Q3 the most negative impact associated with the UAW strike, not the automotive OEMs themselves. As expectation of a strike kept picking up steam in July, service centers did what they always do when they face uncertainty; they destocked and sat on the sidelines.

However, the strike has not had nearly the impact these folks anticipated, and they got caught flat footed, again. The best evidence of that is how quickly our two recent price increase announcements gained traction in the marketplace.

As for our annual automotive negotiations, our October 1st renewals, which represent about 30% of our total annualized auto volumes, were another success. We held onto important volumes and did not take any price decreases.

In fact, in these negotiations, we're successful in implementing the “Cliffs H “surcharge that we discussed, last quarter. As a reminder, “Cliffs H” represents the premium we charge for supplying our customers in the United States with steel produced with close to 30% scrap in our base oxygen furnaces and using HBI in our blast furnaces. Our clients in automotive and other sectors, as well, cannot get that in Europe or in Japan or in Korea or in India or in China.

As a consequence of our operating practices utilizing HBI and maximizing scrap, Cliffs is among the lowest carbon intensity blast furnace/basic oxygen furnace operations in the entire world, and certainly much better than any of the current top 10 largest steel producers in the world.

While “Cliffs H” is a very important first step in decarbonizing the production of sophisticated grades of steel, earlier this month we saw the most consequential step forward in advancing to the “Cliffs H2” phase in which we will implement the use of hydrogen as reductant in our blast furnaces.

On October 13th, as part of the Bipartisan Infrastructure Law, the White House and the U.S. Department of Energy announced the plan to commit $7 billion toward clean hydrogen hubs across the country including, among the chosen locations, Northwest Indiana, the most critical region for Cleveland-Cliffs.

As you have heard me say in the past, it's not where the ball is right now, it's all about where the ball is going to be, and where the ball is going to be is hydrogen. Hydrogen is the future. Effectively, all of the current carbon emissions in our footprint are a result of the use of fossil fuel-based reductants or energy sources, where there is no economically feasible alternative.

Hydrogen can, and ultimately will change that. Cliffs' commitment to buy a large portion of the output from the Midwest hub helped get this location selected by the Department of Energy. Furthermore, our commitment of a significant offtake ultimately makes the hub viable, as we solved the chicken and egg dilemma.

The very existence of the hub should attract other sectors and other uses, including the viability of production of hydrogen fueled vehicles as a clean and viable alternative to battery powered EVs.

Most steel companies have decided that spending billions of dollars in building new EAF based capacity to recycle scrap with growing residual copper content is the way to go. Unlike taking that path, we at Cleveland-Cliffs prefer the higher steel quality that comes with blast furnace/basic oxygen furnace steel making.

In addition, if hydrogen is available and cost competitive, and you already have blast furnaces, the use of hydrogen is very minimally capital intensive. Only minor additions are needed, like the new pipeline we are currently installing at our Indiana Harbor plant.

Our decision to use hydrogen as our decarbonization path set us apart from the crowd, and that will be accomplished in a much more cost effective and quality driven manner.

On that note, I want to emphasize one more important point. We appreciate the value that the Biden Administration places on projects and investments that sustain and grow good-paying middle class union jobs. Regulatory authorities have been strict on fighting M&A deals that harm workers, and rightfully so.

Most of you have followed Cleveland-Cliffs for years and are very familiar with the way in which Cleveland-Cliffs works, collaboratively, with our union partners, in particular, the USW, the UAW, and the International Association of Machinists. I'm grateful that President Biden's administration is aligned with us in our long-term collaborative approach with the unions and has taken notes that Cliffs puts workers at the center of our strategic decisions and growth objectives.

Last but not least, one person who would have been excited about these great opportunities is the late International President of the USW, my dear friend Tom Conway. We shared the same views on a vibrant middle class in the resilient American manufacturing sector. We at Cleveland-Cliffs mourned the loss of Tom Conway, but our relationship with the USW will continue into the future, stronger than ever.

We congratulate Dave McCall on his well-deserved election as International President of the USW. Dave has been the key leader within the USW in building our Cliffs USW partnership, which has been a model for other companies and for other sectors of the American economy. We look forward to continuing to fight for our people together with Dave McCall.

With that, I'll turn it back to Daryl for Q&A.

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 your questions.

Our first 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, and congrats on a great quarter. Lourenco, really appreciated your comments on hydrogen, and good job there. And I wondered if you could maybe expand on that hydrogen route on a couple fronts. Well, first, where would the carbon intensity go, or where would the coke intensity go, once you fully converted a blast furnace to the use of DRI and hydrogen usage?

And then secondly, more strategically, does that change how you kind of think about the attractiveness of blast furnace assets? You mentioned in your prepared remarks others are betting on EAFs, you don't seem to go that direction. And obviously that would be really interesting to hear how you think about that in the current context. Thank you very much.

Lourenco Goncalves
Thanks for the questions, Lucas, and thanks for the kind words. Let's talk about the carbon intensity, first. It's very easy to understand where the CO2 is generated in a blast furnace. We load in a blast furnace as part of the burden, coal in the form of coke. And coal in the form of coke is actually C. That C, in a super saturated C environment in the presence of a ratified O2, will generate a lot of CO. And that CO, that monoxide of carbon is the reductant that takes the oxygen out of the pellet to create the iron metallic. So--and then when that chemical reaction happens, CO2 is generated.

So, the more you take coke out of the blast furnace, the least you are going to be generating CO2, as simple as that. Hydrogen follows an alternative chemical reaction to remove the oxygen. Instead of combining to produce CO and then CO2, hydrogen will combine to produce H2O, and H2O is water in the form of steam.

So, instead of generating massive amounts of CO2, you are going to be generating massive amounts of steam. So, the more you replace coke with the hydrogen, the more you are going to take CO2 out of the picture. And the use of direct reduced iron in the form of HBI in a blast furnace is for a simple reason, when you load HBI, you are no longer loading an oxide, you are loading iron metallic. Vast majority is FE, not FEO. So, we don't have oxygen to be removed from that portion of the burden that is loaded in the form of HBI.

So that, per se, already reduced the needs of coke. And that's the reason our coke rates are so low as of today, even without hydrogen, because we load massive amounts of HBI. So, we are loading a lot less O inside the blast furnace, so we need a lot less carbon. With hydrogen, we're going to need even less carbon.

How much less, time will tell, because we only have one trial, so far, in our smallest blast furnace in our fleet, that's Middletown, which was a big success. And the next one will be a trial in Indiana Harbor 7. But that one we are going to do with a lot of hydrogen because we're building a pipeline for that. So, we are going to be the first ones in the world to adopt hydrogen as reductant, and that will be a new route.

Will that change the EAFs? No. EAFs will continue to generate less CO2 than the current route, but EAFs cannot aim for a number that we're going to get with hydrogen, among other things because the electrodes of the EAFs are made by graphite and graphite is C.

You cannot make graphite with hydrogen because graphite is solid. That's why the electrodes are on graphite and hydrogen is a gas. So, I would say that EAFs are limited in their ability to produce certain grades. They will be limited on reducing CO2 emissions beyond what they produce, today. And the possibilities with hydrogen are, at this point, a lot more interesting for the next 10 to 20 years.

One more thing, now that we are completely convinced that we're going to have hydrogen, Cleveland-Cliffs during Q4 will adopt a path to net zero and, certainly, will be way before 2050. We're working on that. We'll release that during 2000--during the Q4 of 2023.

Lucas Pipes
Lourenco, thank you very much for that and congrats on that. Two quick follow-ups. The first, the right to bid under USW's basic labor agreement, which you received on August 17, does that right extend to the totality of U.S. steel or would non-union assets such as Big River Steel possibly be excluded from that?

And then secondly, on the auto contract negotiations for annual 2024, if you could maybe just share some thoughts about negotiating in the current environment. Thank you very much.

Lourenco Goncalves
Yeah, let me start for the one that I'm going to be able to respond; that’s the auto contract. We already said in our prepared remarks that we didn't take price decrease. So, we're able to keep our prices in good shape, and we implemented “Cliffs H.” That's all we're going to disclose. And we're not going beyond that on the other portion of your question, Lucas.

Lucas Pipes
Understood. Lourenco, thank you very much for all the color and to you and the team, best of luck.

Lourenco Goncalves
Thank you.

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

Carlos De Alba

Yeah, good morning, Lourenco and Celso. Just on the hydrogen discussion. Maybe a couple of follow-ups. How much do you expect the CapEx to be as you convert, or you increase--yeah, you convert your blast furnaces to be able to be hydrogen ready? What is investment per blast furnace or per ton of steel?

And second, is there a limitation? And if so, what more or less is the range of to which you can substitute coke with hydrogen in your blast furnaces?

Lourenco Goncalves
Yeah. The first portion, the investment, like I said in my prepared remarks, when you already have the blast furnace, you have the valves, everything in place, we are going to have to build a pipeline basically to bring the hydrogen from where the generation is, usually outside the fence, all the way to the blast furnace.

We are doing that, as we speak, for Indiana Harbor 7, and we are doing Indiana Harbor 7, because that will be our high watermark. It's the biggest blast furnace, the one that can use the most in terms of hydrogen because of its size.

And it's also because it's our flagship, for instance, our biggest, the biggest in the Western Hemisphere and we are going to use as a demonstration plant for how to use hydrogen.

But it's basically it. It's a pipeline and a couple of valves. So, we are estimating the cap--this CapEx to be less than $9 million, as we speak. So, it's very, very minimal. And also, don't forget, we are not doing this for free.

We are going to pass this cost to the clients in the form of the “Cliffs H2,” like we're doing the “Cliffs H.” If clients really want green steel, and I believe they do, they should be willing to pay, and they should be willing to pass along to the consumer or their end users, whatever. We can't just keep talking about this thing as theoretical exercise. It sounds like everybody's praying for this thing to just go away. This thing is not going away.

So, if you're going to have to tackle, if you're going to have to fight it, you're going to have to fight it the right way. This is a business; we are incurring costs. They are not, as far as hydrogen, how we see it. It's not going to be massive costs, but whatever costs we have, we're going to pass along in the form of Cliffs H.

The other part of the question, I promise that I forgot. Can you repeat, Carlos?

Carlos De Alba
Sure. It is just, what is the technical level or limit of to which you can replace coke with hydrogen?

Lourenco Goncalves

Yeah. That's a question I don't have an answer yet, because the coke in the blast furnace plays a couple different rules and, of course, the most important one is to generate the reductant.

The reductant is CO, like I explained before to Lucas Pipes. But it's not just the fact that the coke generates the CO, that's the reductant. The other role that the coke plays is as a source of heat for the--inside of the furnace. Remember, you are melting solids and transforming liquids. So, that coke has that role. Hydrogen will play both roles, reductant and source of heat. So, from these two standpoints, hydrogen is perfect.

But there's one third role that coke plays inside the blast furnace that hydrogen cannot replace. Coke is responsible for sustaining the burden inside the blast furnace in a way that the gases can traffic inside the furnace. And then the chemical reactions can happen. You don't have pellets touching pellets by and large. You have pellets touching coke. And that structural role inside the furnace is extremely important.

We can minimize that. We have been doing that by reducing our coke rate, and we will continue to do that with more HBI and with less coke, but we don't have a limit yet. This will be the object of several trials as we start using. We know it to be a lot less; I don't know how much.

Carlos De Alba
All right. Great. And just to clarify, sorry. The $9 million investment or less than $9 million of the investment in the pipeline is per plant and it is for the inside the fence pipe, right?

Lourenco Goncalves
Yeah. It's a pipeline that to run from the fence to the furnace.

Carlos De Alba
To the plant furnace. All right. Yeah.

Lourenco Goncalves
Yeah. For a plant of that magnitude, it's an enormous plant. We are talking miles, So, it's not a small feat. It's a long pipeline.

Carlos De Alba
All right. Got it. And then--

Lourenco Goncalves
--But just a pipeline, it's not a complex technological facility or anything like that. It's a pipeline, but it's a long pipeline and the pipeline that will carry hydrogen. So, it has specifications. It's a pretty well-defined type of steel that they're going to be using for that pipeline.

Carlos De Alba

All right. Fair enough. Understood. Thanks for those clarifications. And just for--another question if I may, on the auto price negotiations. So, you mentioned October. Any color that you can provide in January? Have you started those conversations, or are they going to start only once the auto strike ends?

Or given that most of your clients are not the Detroit Three, would you start negotiations, have you started negotiations with the other OEMs? And when would you expect to complete those?

Lourenco Goncalves
No, the negotiations are ongoing, Carlos, and there's no bearing on what happens with the strike. And by the way, my position with the strike is very clear. This strike has passed the midpoint by a lot. It's not something that will stay, forever. I don't believe that we are going to have this strike going beyond Q4.

These things have a beginning, have a peak and must have an end. Otherwise, things go nowhere and it starts to destruct, not to build anything. So, we are a lot closer to the end than to the beginning of this strike. But it has no bearing in our negotiation. Our negotiation is ongoing and is going extremely well.

Carlos De Alba
All right. Thank you very much.

Lourenco Goncalves
Thank you.

Operator
Thank you. As a reminder, if you would like to ask a question, please press "*", "1" on your telephone keypad.

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

Timna Tanners
Yeah, hey, good morning, guys. I hope you're well. Wanted to ask a bit more about the Q4 outlook. I know you said the $15 per ton cost savings. Just talk a little bit about some of the auto contracts that kick-in in the October timeframe, but anything further about mix or how to think about some of the other components.

Lourenco Goncalves
Well, Q4, we are going to have a bigger impact on the shipments to automotive than we had, so far. Remember, the strike started September 15th, and it has been picking up steam since then. Now that we are on October 24th, we are now with more than a month. So--and 24 days of the quarter have been affected by the strike.

So, we're going to have a difference in mix in Q4 in comparison with Q3 because we are going to be somewhat affected by the fewer shipments to automotive.

That said, think about the service center. Service centers have been not buying. They passed Q3, without buying. They were the doctors that can't touch blood, they can't touch steel. So, now they need to touch steel. They need to buy. That's why they got a price increase of a hundred bucks.

Check the box, then they got another one of fifty, check the box. And there's more to come and it's better for them to start to buy. They have already started by the way, buying a lot more now because otherwise, they'll buy a lot more in Q1 and it'll be a lot more expensive. That's the color I would like to give. Celso wants to say something.

Timna Tanners
Okay. Okay.

Celso Goncalves
No, I was just going to compliment just to round out the conversation, Timna. As we guided, costs are going to be down $15, quarter-over-quarter. And this decrease in cost will help partially offset the decrease in average selling price. But from a shipment standpoint, we'll be around that 4-million-ton level again in Q4.

And then from a mix standpoint, we'll have less kind of the value-added product. But working capital should provide us a nice tailwind from a free cash flow standpoint.

So, I think the way to look at it is Q4 will be sort of a trough in terms of EBITDA, but we'll generate a lot of cash, perhaps even more cash than EBITDA during the quarter, which will support our ongoing capital allocation priorities and deleveraging continue to pay down debt. We'll use some of the cash to pick up some shares if the price remains at these discounted levels. So, I think that's the way to think about Q4.

Timna Tanners
Okay. Great. You answered some of my next question, which is going to be on an update thinking about capital allocation. So, I'm not sure if I need to ask that, but any further comments would be great. Anyway, the other question I had was just, I know there's smaller parts of your mix, but we were kind of surprised to see stainless and electrical volumes down.

I assume that stainless, since electrical has been sold out and you've got more tons there. And also on the plate side, would be great getting an update on those markets, please.

Lourenco Goncalves

Yeah, look, we are seeing in our--actually it is a good point, good point. You caught on a very interesting point. The electrical steel situation here in the United States, right now, is pretty much in flux because you are still in an American market that consumes GOES, not NOES. The consumption of NOS will pick up when the production of electric vehicle speaks up. And this is still in talking mode, but not in execution mode. So, we are prepared, and we invested to produce high performance NOES we call MOTOR-MAX.

And we are selling, but we are not selling a lot because the biggest producer of electric vehicles in the United States doesn't produce here in the United States, produce in China, produce in Germany, but doesn't produce here. So, we don't sell to them in China, we don't sell to them in Germany. Maybe one day we will, but they're not at this point. So, we're waiting for the real Americans to start buying more of our MOTOR-MAX. That's the NOES portion.

The GOES portion continues to be way under supplied because we need a lot. But the problem is that our clients have all kinds of problems with hiring people, supply chain issues, the ability to handle the tonnage. We have actually one client that has been able to overcome these things that everybody else is running behind.

So, it's about the downstream of the plant, not about the plant. The plant is able to produce more now because we're able to move NOSE to Zanesville. So, the Butler plant, that's the plant that produce electrical steel, is now able to be totally focused on grain oriented electrical steels. The demand theoretically is there, but the clients need to be able to digest the higher tonnages. It is not on us, it's on them.

Timna Tanners
Okay. That's helpful. Thanks very much.

Lourenco Goncalves
Thank you.

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

Bill Peterson
Yeah. Hi, good morning and thanks for taking the questions. You've spoken a lot about decarbonization in auto. I was hoping if you can provide some color on some demand outside of auto and in particular, how you're thinking about the demand showing up for the various buckets of policy support, whether it be IRA, maybe as it relates to solar business or Chips Act and how those various pipelines could evolve in the--how they have evolved since the start of the year and how they could evolve into next year.

Lourenco Goncalves

Yeah, look, the biggest thing, so far this year, has been military. And in a world that is now with wars in two fronts and the potential of a third front in Asia, that's always looming in the background between China and Taiwan and the South China Sea. We have a lot of demand for military uses. We can't discuss too much. We are a big supplier of military steel for the DoD, So, we're not going to be able to elaborate much on that. But it has been a very, very important portion of our business here at Cleveland-Cliffs.

Infrastructure is started to pick up and things related to alternatives, clean sources of energy as well, particularly wind and solar. Solar panels have been one of our greatest bright spots in our mix of sales. And if I want to elaborate a little more in terms of demand, I will emphasize one more time that demand coming from service centers is coming back, will come back because they don't have it, or they'll go out of business. That's another option for them, too.

They are starting to become more and more irrelevant for the supply chain because they don't carry inventory. When prices are going down, they don't carry inventory when prices are going up because price will go down after they go up.

So, that's a pretty difficult position to be in. So, I have serious questions if we really need service centers. We are having service center coming to us and asking for us to expedite orders. That's outrageous. That's beyond ridiculous.

So, anyway, this is a group of companies that need to take some type of religion and change the way they do business. And I believe they will because I'm a very optimistic person. And I believe that that will be a big source of supply coming into Q4 and even more in Q1.

Bill Peterson
Yeah, thanks for that color. Another kind of bigger picture question. So, we've read recent reports that the U.S. and Europe are discussing the EU tariffs rate quotas and may potentially allowing more imports. But I guess, how do you see this impacting the U.S. steel market? What is your kind of view on that topic?

Lourenco Goncalves
Yeah. I think that ship has sailed for now. The discussions didn't conclude with a solution for the request of the European Union. The situation has been maintained. The TRQs, the tariff rate quotas are still in place. And the alternative to the TRQs are Section 232, and Section 232 has not been revoked.

What we need in the world Bill is more free trade, but we need more free trade both ways. The United States need to export some steel to Europe. You have a highly subsidized European steel industry, like for example the UK that is controlled by an Indian company and a Chinese company.

And we only hear about more and more money being given by the government to decarbonize the bridge steel industry and do this and that. It's just the government subsidizing the replacement of equipment with replacing blast furnace, BOFs with the EAFs, firing two-thirds of the workforce and claiming that they are decarbonizing and greening the steel.

It's all BS, and this is all Chinese taking advantage of the bridge. So, I believe that, earlier rather than later, we'll be able to export some steel to the UK and high-quality steel and create a free trade the other way from the U.S. to Europe. That's my plan.

Bill Peterson
Yeah. Great. Thanks for that color.

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 questions. The first one is on capital allocation. I think for a number of quarters, the focus has really been on deleveraging and then returning cash to shareholders and sometimes, both at the same time.

What has really changed in your view of the strategy to look more maybe favorably at large M&A? How should we think about Cliff moving forward regardless of the bid? Is the priority now more towards growth? If you can discuss a little bit the strategy there, that'd be great.

Celso Goncalves
Yeah. Sure. Hey, Tristan. We've been pretty clear in terms of our capital allocation priorities. And we've reduced debt by a large amount. And we feel like we're in a position now that we have the flexibility to go in other directions. Whether that be accelerating share buybacks at the right time or introducing a dividend. We won't stop paying down debt, but we have the flexibility with the capital structure that we have to go in different directions.

From an M&A standpoint, the flat-rolled market remains fragmented. There are many avenues that we could pursue toward further consolidation. We've been very successful in M&A in the past. We've executed well-timed acquisitions that we haven't overpaid for. And that's what we're going to continue doing, going forward.

Our net debt target of one time through the cycle EBITDA will remain, regardless of what we do from an M&A standpoint. But we feel good where we are, right now. We've paid down--we've got back-to-back quarters of $500 million of net debt reduction. You can look through Q4 and see how much cash we're going to generate. We'll continue using that cash toward paying down debt, toward buying back shares, when appropriate, and being aggressive and opportunistic with M&A opportunities.

Tristan Gresser
All right. That's very clear. Thank you. And maybe a second question is a bit more bigger picture on aluminum. I think you mentioned a little bit the threat and the growing market share that aluminum is having against flat-rolled. Yeah, we'd like to have your thought on the debate around the future of steel intensity in cars, notably versus aluminum. Yeah, that's my question. Thank you.

Lourenco Goncalves
Yeah. Look, aluminum has been a threat for steel for a long, long time. And with the mixed results, mixed successes, keep in mind, beverage cans, one day, were all tinplate and now they're all aluminum. So, check that box for can making. They won. On the other hand, for cars, they have penetration, but it's not that big success that people talk about.

We have situations like the F-150 that was supposed to bring then the F-250, the F-350, the Explorer, the Expedition. And so far, it's only the F-150. And even the F-150, we at Cleveland-Cliffs have a huge participation of the F-150 on high strength, low-alloy, structural steels and everything that's inside the car and beyond the hood. So, with my intention with the F-150 is taking aluminum out and I believe I will, so going forward.

So, it's a fight and we'll continue to fight. It's another competitive threat that we have to continue to take seriously. And now we even have a steel company that's building an aluminum company, So, building an aluminum mill to compete against us right here in the United States.

So, I don't believe that this will be a homerun, but I don't take these things lightly. We are going to compete and we're going to win, but we're going to have to fight. It's a competitor and we will compete.

Tristan Gresser
All right. Thank you. Thanks a lot for the color.

Lourenco Goncalves
Thanks.

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. Thank you for taking my follow-up question. Lourenco, I wanted to ask a little bit about cost reductions for 2024. Great job on the coal side. You mentioned there are cost reductions including coal, and I wondered if you could maybe expand

a little bit on the other cost drivers that may move to your advantage in 2024. Thank you very much.

Lourenco Goncalves
Celso will take that, Lucas. Please go ahead, Celso.

Celso Goncalves
Yeah, sure. Hey, Lucas. Yeah, I mean, we expect further cost reductions next year, as we'll see benefit from this new coal contract and lower natural gas prices for the hedge portion. We have lower inventory starting points in 2024, as well.

Specifically, as it relates to Q4, the $15 a ton quarter-over-quarter reduction that we guided to, that's going to be largely driven by mix with less automotive and higher volume of less value-added product, driven by more service center demand, that's going to have an impact on costs. And this impact will ultimately run through inventory. So, as we look forward, you can kind of see how we'll have continued cost reductions here in Q4 and into next year.

Lucas Pipes
So, that's helpful. So, would it be reasonable to kind of take a Q4 starting point and then for the reduced energy cost, gas and coal off of that base?

Celso Goncalves
Yeah. That's the right way to think about it.

Lucas Pipes
Thank you very much, Lourenco and Celso. Again, best of luck.

Lourenco Goncalves
Thanks, Lucas.

Celso Goncalves
Thanks, Lucas.

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

Carlos De Alba
Yeah. Thanks. Also, staying on cost. So, beyond the very, very large savings on coal and natural gas next year, I don't know, Celso or Lourenco, can you talk about other initiatives that you may have more on productivity or more efficient labor deployment, or any other changes on how you do--how you make steel besides the savings on raw materials that you can point to? And if you have any quantification of those that would be really interesting to get any color.

Lourenco Goncalves
Yeah. Look, well, our work done back in the second half of 2022 when we deliberately reduced throughput in order to fix the equipment that we bought from ArcelorMittal USA, that was in much worse shape than the equipment that we bought from AK Steel. We did that knowing that our results would take a hit.

The results took a hit and since then, we are demonstrating that good equipment and good people, good union labor force can produce a lot of steel. So, three quarters in a row, in an environment that's not the most vibrant I have ever seen, for sure, we have seen better than that, we are delivering more than 4 million, shipping more than 4 million net tons of steel three quarters in a row. So, so far-so good.

Productivity has been achieved and it's not productivity, just producing commodity hot roll. We produce all kinds of very sophisticated products for a very demanding customer base that is, primarily, automotive and other OEMs.

So, we are very satisfied with our level of productivity. So, other cost initiatives are all related to the fact that we are a big buyer of everything like we did with coal. Big buyers tend to have good treatment from the suppliers, particularly if the big buyer knows how to buy. We nailed with coal. Let's face it.

We close our deal at the perfect timing because remember, this was a mining company before; we understand commodities, So, we know how to negotiate these things. So, I'm not going to elaborate beyond that, Carlos, but that's basically what we do. Celso wants to complement something.

Celso Goncalves
No, just to quantify it a little bit right, Carlos. So, when you take everything into account, the normalized repair and maintenance, the lower input costs, the higher productivity, these lower costs that are going to bleed into 2024 will more than offset any kind of increase we see in labor. And if we had to put a number on it, cost should return to that thousand dollar a ton range for 2024.

Carlos De Alba
All right. Thank you very much. I appreciate the color.

Celso Goncalves
Thank you.

Lourenco Goncalves
Thanks, Carlos.

Operator
Thank you. We have reached the end of our question-and-answer session. I would now like to turn the floor back over to Lourenco Goncalves for any closing comments.

Lourenco Goncalves
Thanks, Daryl. As always, great pleasure discussing Cleveland-Cliffs with you. Now we're going to take the longest gap in our sequence of conference calls because the next quarter to discuss will be Q4.

It will be the end of the year, so we'll probably only be talking with you in February. And we're going to have lots of things to discuss in February. So, stay tuned and keep paying attention, because we move fast, even though not everybody does the same, but we still keep pushing.

I really appreciate your interest in Cleveland-Cliffs, and I wish you guys have a happy Thanksgiving and because we're not going to be talking between now and then, Merry Christmas. All the best. Bye now.

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.