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X.N - Q4 2021 United States Steel Corp Earnings Call

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OVERVIEW:

Co. reported 4Q21 adjusted EPS of \$3.64.

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PRESENTATION

Operator

Good morning, everyone, and welcome to United States Steel Corporation's Fourth Quarter and Full Year 2021 Earnings Conference Call and Webcast. (Operator Instructions)

As a reminder, today's call is being recorded. I'll now hand the call over to Kevin Lewis, Vice President of Investor Relations and Corporate FP&A. Please go ahead.

Kevin Lewis - *United States Steel Corporation - General VP of IR and Corporate FP&A*

Thank you, Tommy. Good morning, and thank you for joining our fourth quarter and full year 2021 earnings call. On behalf of U.S. Steel, I'd like to wish everyone a happy and healthy 2022.

Joining me on today's call is U.S. Steel President and CEO, Dave Burritt; Senior Vice President and CFO, Christie Breves; and Senior Vice President and Chief Strategy and Sustainability Officer, Rich Fruehauf. This morning, we posted slides to accompany today's prepared remarks. The link and slides for today's call can be found on the U.S. Steel Investor page under the Events and Presentations section.

Before we start, I'll remind you that some information provided during this call may include forward-looking statements that are based on certain assumptions and are subject to a number of risks and uncertainties as described in our SEC filings and actual future results may vary materially. Forward-looking statements in the press release that we issued yesterday, along with our remarks today, are made as of today, and we undertake no duty to update them as actual events unfold.

I would now like to turn the conference call over to U.S. Steel President and CEO, Dave Burritt, who will begin on Slide 4.

David Boyd Burritt - *United States Steel Corporation - President, CEO & Director*

Thank you, Kevin, and thank you, everyone, for joining us this morning. 2021 was an exceptional year. It puts us on a path for another strong year in 2022. We delivered for our stakeholders in 2021, achieving record performance across nearly every part of our business, record earnings, record

EBITDA, record EBITDA margin, record free cash flow and record safety, quality and reliability performance. Collectively, we are pursuing best here at U.S. Steel, and 2021 is a great example of our progress.

But this is just the beginning. Our progress will continue in 2022 and beyond. While the market is certainly looking for every reason to be negative about the prospects for this year, we remain overwhelmingly positive. As expected, the first quarter will be seasonally weak, including the normal impacts of our mining operations, but we believe this is just temporary. While markets continue to self-correct, the macro backdrop is favorable. Supply chain issues will ease, inflationary pressures will abate, saving rates remain high, cash remains on the sidelines and demand remains pent up for the markets we serve.

This is a recipe for success in steel, and we are optimistic that 2022 demand will accelerate. We have, after all, double through cycle prices. Clearly, a great place to be. We know about the risks, the Fed taking rates up too fast, unexpected changes to import restrictions, geopolitical risk, existential risks. The risks are many but we've seen it all before. We know where we're headed, and we know how to get there. When you are in pursuit, constant pursuit of best, you are never satisfied and challenges will always remain. We are taking the necessary steps to become less capital and carbon-intensive. We are executing on strategic investments to expand our capabilities, capabilities that will make us a better, not bigger steel company. And we are going to move faster, not slower in 2022 because as we like to say, we can't get to the future fast enough. This isn't your great, great grand pappy's U.S. steel anymore. U.S. Steel's future is incredibly bright.

The solution remains the same, execute our Best for All strategy by constructing a second mini mill greenfield facility and expanding finishing lines through our investments in an electrical steel line and coating line at Big River while returning capital to stockholders. When we execute, we expect to unlock \$850 million of additional through-cycle EBITDA through state-of-the-art mini mill steelmaking and finishing line capabilities. And we will have further differentiated our sustainability advantages by customers as we continue to deliver against our responsible steel and 2050 decarbonization objectives while growing our offering of sustainable steel solutions, including verdeX.

We know you know this. Sounds good, right? We think so. But we clearly know this is a show-me story. So we will keep our heads down, remain focused and disciplined and we will continue our progress toward our Best for All path forward. Because after all, we have to keep showing our stakeholders what Best for All means. It's about continuing to reimagine how steel gets made more sustainably like efforts earned by Big River facility Daimler's 2021 Sustainability recognition award.

And it also means continuing to innovate to accelerate and further our Best for All progress. Just this week, as an example, we announced a strategic investment and partnership in Carnegie foundry, a leading robotics and artificial intelligence studio in Pittsburgh, supported by Carnegie Mellon University. We look forward to beginning our partnership together as we work to accelerate and scale industrial automation to find new ways to serve our customers. Our customers are seeing and embracing the transformation that's taking place at U.S. Steel, and we are pleased to be a like-minded regional partner for them. We look forward to deepening our partnerships to create unique solutions that build on our long-term relationships, industry-leading innovation and constantly increasing focus on products our competitors haven't imagined.

For our employees and communities, Best for All means investments in their future in our recent announcement that we have selected Osceola, Arkansas as a home for our second mini mill, means jobs. It means a commitment to that community. It means a more secure future for the region, and it means a more responsive U.S. steel to meet the needs of our customers. Osceola is our newest home and we continue to invest in regions that have supported U.S. Steel throughout our history, integrated mills and mini mills, our Best of Both enabling our Best for All future. And for investors, Best for All means increasing our future earnings power while returning capital to stockholders. We don't believe the market is rewarding us yet for continued strength in 2022, improved through-cycle earnings or for the long-term value, our Best for All strategy. So we will continue to buy back our own stock and are pleased to announce an incremental \$500 million authorization. We are generating excess cash, and we have an obligation to reward stockholders.

As I said before, this isn't our great, great grand pappy's with U.S. Steel, and we look forward to continuing to show all our stakeholders the power of Best for All.

Let's get into the agenda for today's call on Slide 5. On this morning's call, we are going to cover 3 topics before heading into Q&A. First, we will spend some time recapping our 2021 performance and strategic milestones. Second, we will provide some additional context on why we are

confident. And third, we will spend some time providing definition on our capital allocation framework and key priorities, priorities aligned with showing our stakeholders what Best for All means for them.

2021's record performance has fundamentally changed our business. As you see on Slide 6, our record performance in safety and environmental, in customer and operational excellence and in our financial performance, is a direct result of executing our strategy over the past several years. Take Safety and Environmental as an example. Safety is and will always be first at U.S. Steel and is at the core of our steel principles. We delivered our best safety and environmental performance on record and continue our progress towards our ambitious 2030 and 2050 carbon reduction goals.

We also demonstrated exceptional quality and reliability performance when it mattered most to deliver for our customers in 2021. We also delivered record financial performance in 2021. We acted boldly in 2020 to announce the acquisition of the remaining stake in Big River Steel, just as the market was gaining momentum. We moved quickly and our well-timed acquisition allowed us to capture the remarkable earnings power of Big River Steel in 2021, including nearly \$1.4 billion of EBITDA and 39% EBITDA margin.

Our flat roll in U.S. Steel Europe segments also delivered record financial performance. Our integrated operations continue to run well to drive what is expected to be another impressive year in 2022.

Before we pivot to 2022, let me turn it over to Christie to provide some more context on 2021's record financial performance. Christie?

Christine S. Breves - *United States Steel Corporation - Senior VP & CFO*

Thank you, Dave, and good morning, everyone. I'll begin on Slide 7. As Dave mentioned, 2021 was a year of record financial performance. We ended the year with adjusted EBITDA of approximately \$5.6 billion and an adjusted EBITDA margin of 28%. This translated into record free cash flow generation of approximately \$3.2 billion, including over \$1 billion in the fourth quarter alone.

We expect to generate meaningful levels of free cash flow in 2022 as well. Adjusted EPS in the quarter was \$3.64 per share and was significantly impacted by a noncash year-end true-up to our tax valuation allowance. Excluding this impact, we outperformed expectations on EPS just like we did on revenue and adjusted EBITDA.

Our strong performance in 2021 allowed us to transform our balance sheet by repaying over \$3 billion in debt in the year and ending the year with 0.7x leverage.

This type of financial performance allows us to enter 2022 from a position of strength. The remaining debt on the balance sheet is manageable with over 80% due until 2029 and beyond. Our pension and OPEB plans are overfunded. We have no mandatory cash contributions for the foreseeable future and have already derisked a component of the plan to further strengthen our balance sheet. And we're also ending the year with nearly \$5 billion of liquidity, including over \$2.5 billion of cash.

Before I hand it back to Dave to expand on our 2022 opportunities, I'll spend a few minutes on our segment performance on Slide 8.

In our Flat-Rolled segment, we delivered record EBITDA and EBITDA margin in 2021 of over \$3.1 billion and 25%, respectively. In the fourth quarter alone, we generated over \$1 billion of EBITDA and an EBITDA margin of 30%.

It was a similar scenario for our Mini Mill segment. 2021 delivered record EBITDA and EBITDA margin of nearly \$1.4 billion and 39%, respectively. This included \$406 million of EBITDA in the fourth quarter and an industry-leading 41% EBITDA margin.

The fourth quarter marked the second consecutive quarter of \$400 million plus of EBITDA and over 40% EBITDA margins. Our European operations also posted record EBITDA and EBITDA margin in 2021. EBITDA was nearly \$1.1 billion for the year or 25% EBITDA margin.

Lastly, our Tubular segment reported nearly \$50 million of EBITDA in 2021, including \$42 million in the fourth quarter alone. We are leveraging new trade actions where we can and continue to expect the Tubular segment to be a more meaningful contributor to our financial performance in 2022.

Dave, I'll turn it back to you to provide more context on 2022 and our balanced and disciplined approach to capital allocation.

David Boyd Burritt - *United States Steel Corporation - President, CEO & Director*

Thanks, Christie. We remain bullish for 2022, and Slide 9 highlights just a few items that support our point of view. At its core, consumer demand remains very good. As I mentioned in my earlier (technical difficulty), there is a lot of cash sitting on the sidelines with saving rates at elevated levels, but supply chain issues have prevented the full potential of consumer demand to shine through.

In auto, pent-up demand continues into 2022 and easing supply chain pressures are driving increased auto production expectations. Auto builds in North America are expected to increase by 2 million units in 2022 and accelerate as the year progresses. This is a significant improvement for 2021 with room to run as broad supply chain issues are resolved.

In appliances, production in 2022 is expected to be on pace with last year's record output. And these expectations are materializing in our order book.

In the U.S., we're seeing the auto and appliance original equipment manufacturers or OEMs order book increased each month in the first quarter. Many of these OEM orders carry new, higher-fixed contract prices to begin the year.

Also, the Tin Packaging business is expected to remain strong in 2022. This is a market we are uniquely positioned to serve and where pricing was also negotiated significantly higher for 2022. Make no mistake, the success we had on fixed-price contracts has generated significant year-over-year uplift on our fixed book of business.

On steel market pricing, recent price movement still positions spot indices at 2x historical averages. Demand is in line with normal seasonality and auto and appliance activity keeps us bullish for (technical difficulty) consumer demand.

Meanwhile, the import arbitrage is starting to fade and lead times are normalizing, which we believe are precursors to increased spot market activity and positive price momentum.

In Europe, pricing has already stabilized close to \$1,000 per ton and our order book has been steady. We expect order entries to accelerate into the seasonally stronger second quarter and are on pace for another strong year from our European operations.

In Tubular, rig counts have increased, supported by higher oil and natural gas prices. This is driving increased demand and higher pricing for our OCTG products. Demand is expected to accelerate in 2022 and our EAF and proprietary connections will continue to support higher earnings in 2022. We are enhancing the customer experience and are seeing tangible results for 2022. The customer is core to everything we do. We recently partnered with Norfolk Southern and Greenbrier to develop a railcar that utilizes U.S. steel proprietary grades, resulting in a stronger, lighter and more capable railcar. Through collaboration with U.S. Steel, Norfolk Southern and Greenbrier are able to extend the useful life, improve their sustainability and increase the efficiency of each gondola railcar. This type of product innovation create sustainable solutions is just the latest example. We are focused on continuing these mutually beneficial partnerships in 2022.

Our transformed balance sheet is another reason we're excited for 2022. Today's strong balance sheet fully funds the strategic projects we've already discussed, creates a clear path to strategy execution and is a foundation for our balanced and disciplined approach to capital allocation, including direct returns to stockholders.

Yesterday, in our earnings press release, we announced a new \$500 million stock buyback program. This is in addition to our existing \$300 million authorization announced in October 2021, of which approximately \$200 million has been repurchased to date under the existing authorization. We will continue to repurchase our own stock, especially when it is trading at what we believe is a significant discount.

Before I detail our enhanced capital allocation priorities, Christie will provide an outlook on our first quarter performance.

Christine S. Breves - *United States Steel Corporation - Senior VP & CFO*

Thanks, Dave. We are on pace to deliver another strong performance in the first quarter. Slide 10 outlines some key considerations for first quarter performance. Our Flat-Rolled segment is expected to report increased shipments and higher selling prices from reset annual contracts versus the fourth quarter. As you know, the seasonality of mining will impact the first quarter, along with higher coal and natural gas costs, which will more than offset the commercial steel tailwinds.

Recall, each year, the locks on the Great Lakes close from mid-January through the end of March. This not only limits our ability to ship pellets to our own operations but also to ship to third-party customers.

Given our increasing presence as a merchant seller of iron ore, the seasonal impacts of our mining operations have increased from historical levels.

In our Mini Mill segment, the shifting hot-rolled coil pricing dynamic in the U.S. will be more fully reflected in our average selling price. We expect temporarily lower volumes due to more hot-rolled coil product mix than our Flat-Rolled segment.

Last year, U.S. imports of sheet steel increased over 70% to a 6-year high. This quarter, we continued to monitor surges of low-priced imports and their impact on the market and on our operations.

In Europe, steel prices and volumes are expected to be similar to the fourth quarter, while raw material and energy costs will be likely headwinds. In Tubular, higher prices are increasingly being reflected in our performance as well as lower scrap costs for our Fairfield EAF. As a result, we expect Tubular's EBITDA to improve again in the first quarter.

Dave, back to you.

David Boyd Burritt - *United States Steel Corporation - President, CEO & Director*

Thanks, Christie. Over the past year, we've talked a lot about our strategy and the continued progress towards our Best for All future. With each passing quarter, we have transformed the balance sheet, announced an advanced critical capability and sustainability-related strategic projects to improve our through-cycle earnings power and reduce our capital and carbon intensity and enhance our direct returns to stockholders.

Today, I want to reinforce some important messages and provide more definition around our business priorities and capital allocation framework on Slide 11. A framework that we believe will create long-term stockholder value.

As we've discussed this morning, achieving our strategic ambition requires clear priorities and disciplined execution, and the framework we have developed provides the principles we will use over the coming years to (technical difficulty) our strategy. The major theme should be familiar to you. We will maintain a strong balance sheet. We will invest in capabilities, not to become bigger, but to become better, and we will return capital to stockholders as the business continues to perform exceptionally well.

Let's discuss each component of our capital allocation framework in more detail. First, we consider a strong balance sheet to be foundational to the success of our strategy. We are pleased with the significant progress we've made to reduce our debt, extend our maturity profile, lower our debt service costs and improve our credit ratings. As we continue to execute our strategy, we are targeting a through-cycle total debt-to-EBITDA leverage metric of 3 to 3.5x.

Based on the progress we've already made to delever the balance sheet and the improved through-cycle earnings power of our integrated and Mini Mill business model, we are confident that our mid-cycle performance capability more than support this target. We will continue to evaluate more modest near-term opportunities to repay debt and optimize our capital structure.

Second, we believe the highest value-added use of our cash is to fund the announced investments that will transform our earnings profile and increase the consistency of our free cash flow. U.S. Steel is executing from a position of strength, a position that we've earned through operational and commercial excellence and record-setting EBITDA and free cash flow performance. It is a position that is tremendously valuable and is a catalyst to advancing our strategy, which our customers demand from us.

As we accelerate our transition towards Best for All, we will protect the successful execution of Mini Mill #2 and the strategic investments we are making in non-grain-oriented electrical steel and galvanizing capability at Big River Steel by maintaining a cash position no less than our next 12-month CapEx. This will ensure that our strategic investments will be fully funded by existing cash and free cash flow while preserving our ability to maintain a balanced and disciplined capital allocation strategy.

Third, as you would expect, we will continue to evaluate investment opportunities to further our Best for All strategic transition. As we seek to lower the sustaining capital requirements of the business, we are sharpening our focus on the types of projects we may pursue in the future. For us, Best for All starts with enhancing our focus on expanding our competitive advantages: low-cost iron ore, mini mill steelmaking and best-in-class finishing capabilities and by returning and by delivering returns of at least 15%. There are no additional capability investments to announce at this time as our focus is on completing the announced projects ahead of schedule and under budget, something our Big River Steel team has demonstrated they are highly capable of doing.

Lastly, an important component of our capital allocation framework is stockholder distributions. Last quarter, we were pleased to announce our restored \$0.05 per share quarterly dividend, and our first priority for direct returns is to maintain that dividend policy. We plan to supplement our commitment to a quarterly dividend by returning excess cash through measured and opportunistic stock buybacks. This allows for direct participation in capital returns for our investors as we successfully deliver our strategy.

As mentioned earlier, I am pleased to say that our Board has authorized a new and incremental repurchase program of \$500 million. Our Best for All future has never been clearer, and we believe the framework described today provides even more definition on how we will advance our disciplined approach to creating stockholder value. We believe our Best for All strategy and capital allocation framework delivers a compelling investor proposition, a proposition that balances financial strength, investments that sustainably advance our competitive advantages and long-term through-cycle value creation by increasing our earnings power, improving our free cash flow and distributing capital to stockholders. I'm pretty pumped up about where we are today and what our future holds.

With that, let's get to Q&A.

Kevin Lewis - *United States Steel Corporation - General VP of IR and Corporate FP&A*

Thank you, Dave. (Operator Instructions) Operator, can you please queue the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And we'll get our first question on the line from David Gagliano, BMO Capital Markets.

David Francis Gagliano - *BMO Capital Markets Equity Research - Co-Head of Metals & Mining Research and Metals & Mining Analyst*

Okay. Great. I did want to just clarify a little bit on the near-term commentary. I think I missed some of the commentary. So can you expand a little bit on the Flat-Rolled prices up, volumes up? And then also on the mini mill side, because I was a little confused, the price is up, volumes up in Flat-Rolled, but offset, I think, by iron ore. So if you could just talk a little more about that. And then again, on the mini mill side, can you talk about a little more detail on why you expect things to roll a little bit harder in that business.

David Boyd Burritt - *United States Steel Corporation - President, CEO & Director*

There's a lot in that, David. I think what you're asking for. Near-term first quarter commentary where we are and where we're headed in the near term because there has been some noise. Am I right in assuming that's where you're interested in because I can tell you, we remain bullish on 2022, and the strong demand continues. So we still feel the fundamentals of a super cycle, they remain intact, and we don't believe we're overreacting to anything in the short term. So I think you got a good question here. But let me just kind of expand on that a bit because I think it's important to provide some context before getting into some of the specifics.

The steel industry is on quite a run. So it's easy, I think, to forget just how far we've come. Q3 and Q4 2021 represented all-time best performance for the business. We're talking about, what is it, \$4 billion of EBITDA generated in the second half of last year. So frankly, we do expect to be a modest step-down from Q4. That's for sure. But this shouldn't surprise anyone. We fully expect Q1 2022 to be our third highest EBITDA quarter in the past decade plus and represent another quarter, frankly of significant EBITDA and free cash flow generation.

But I think a couple of things that everybody needs to remember related to U.S. Steel that maybe folks forget about Q1. There are seasonal impacts within our mining operations, and they're significant and have become increasingly more material as our presence as a merchant pellet supplier has increased. Historically, we've said seasonal mining headwinds ranged from something like \$50 million to \$100 million, but we could see \$150 million in the first quarter of this year.

And this headwind will reverse in subsequent quarters and be more than offset through the firm and contract volumes in place for 2022. But there's obviously these puts and takes with North American flat roll. But once you adjust for the impacts of our mining operations, we expect the rest of the segment to perform similarly to the fourth quarter.

Now you mentioned the Mini Mill segment. In our Mini Mill segment, we are navigating these seasonal impacts on demand as nimbly as we can and are optimizing our order book and operations to satisfy the demand. And we're seeing and doing that in the most profitable way possible. But let's not forget. Big River is a segment within our business with the most hot-rolled coil exposure, which has been a huge benefit for the business over the past year. And while they are more heavily impacted in the near term in this quarter, we expect them to be well positioned to participate in what we see as an inevitable snapback. And it's also worth noting that investment (technical difficulty) as we speak to further enhance their value-added mix with the NGO line and the incremental galvanizing capability.

So the EBITDA contribution for Big River will be down, no doubt quarter-over-quarter, but this is an extremely cost-effective and efficient operation, and we don't expect a material change in their margin profile in Q1.

And then maybe a little bit on Europe since Christie mentioned in her remarks, we expect a modest step down primarily for energy and raw material headwinds. But again, our operations in Europe are highly cost competitive and the first quarter should be one of our best quarters in history. You didn't mention tubular but since I'm covering the segments here I do think we need to look at the tubular business and you know the trend is our friend and expect Q1 to be higher than Q4 and we expect the segment to continue to benefit from the electric arc furnace that we dutifully put in place and is running well and the momentum we're seeing in the energy sector is very good.

So while we're not running this business for the next quarter, we certainly appreciate the interest in how things are developing. Against the softness, seasonal softness now, but it will be coming back, near-term noise, but we believe it will be coming back and coming back strong.

David Francis Gagliano - *BMO Capital Markets Equity Research - Co-Head of Metals & Mining Research and Metals & Mining Analyst*

Okay. That's very helpful. Just a quick follow-up on some of those comments. Just on the flat-rolled side. Obviously, there's a mix between contract and spot and following through in the first quarter. I'm just trying to get a sense as to how much of the volume in the first quarter is expected to be sold under contract versus spot.

Kevin Lewis - *United States Steel Corporation - General VP of IR and Corporate FP&A*

Yes, David, this is Kevin. So I think as the auto supply chain issues ease, you'll see particularly the automotive order entries accelerate through 2022. I would say that it's manifesting itself here in the second half of the first quarter, and we expect it to continue to accelerate in the second quarter and beyond. So probably a little bit more spot index exposure in the first quarter. But as those markets like appliance and autos continue to kind of break through the supply chain disruptions. We should see them become even more meaningful percentages of our shipments. Tin packaging remains very strong and that reset will certainly benefit the first quarter and each subsequent quarter in the year.

David Francis Gagliano - *BMO Capital Markets Equity Research - Co-Head of Metals & Mining Research and Metals & Mining Analyst*

Okay that's helpful thank you very much.

Emily Chieng - *Goldman Sachs Group, Inc., Research Division - Senior Analyst*

Maybe my first question is around that fixed price contract resetting. Have you finished the discussions now? What's the last in, any color -- are you able to provide any color around the magnitude of uplift that you're seeing there?

Kevin Lewis - *United States Steel Corporation - General VP of IR and Corporate FP&A*

Yes. So we are -- our annual fixed-price contracts that reset at the beginning of the year, I believe many those have all been successfully completed. We feel like we were tremendously successful in how we negotiated those contracts for the year. We continue to expect, as we mentioned on an earlier call, our average selling prices in 2022 for North American flat roll to reset higher than 2021 as a result of the successful negotiations. So I would say, if anything, we're even more confident in the value that we've locked in year-over-year related to the fixed-price contracts, right? tin products, auto products, appliance products, all seeing meaningful uplifts year-over-year. There's additional upside potential in April. We have some other fixed-price contracts coming due on auto that we're in the mix of negotiating now with our customers and those offer yet another opportunity to create some year over year uplift so as you've heard us talk about were deepening the relationships we have with our customers and we're deepening the partnerships we have with our customers and that, combined with the strong market we find ourselves in, is really allowing us to be successful in fixed-price contracts.

So I know it's a bit of a repeat, but I think it's stronger for conviction. And we're really pleased with where we see the packaging, the auto, and the appliance book for 2022.

David Boyd Burritt - *United States Steel Corporation - President, CEO & Director*

Yeah you kind of look at where we negotiated a year ago I guess where the contracts were and the prices were a much lower level but we clearly find ourselves in a lot better position on these contracts. Christie do you have something to add here?

Christine S. Breves - *United States Steel Corporation - Senior VP & CFO*

I think Kevin covered it.

Emily Chieng - *Goldman Sachs Group, Inc., Research Division - Senior Analyst*

My second question is just around the volume outlook for big river steel. You provided full year 2022 guidance, maybe even backing out for the impact of intercompany shipments it looks like utilization rates may be a little below 90%. Is there an opportunity to get that higher within that 90% plus range consistently?

Kevin Lewis - *United States Steel Corporation - General VP of IR and Corporate FP&A*

Yeah I think 90% utilization Emily is the right way to think about utilization at big river, I think that's pretty consistent across the mini mill operations. We'd certainly look to push that higher to the extent possible.

But as you rightfully pointed out, this full year shipment guidance we gave for 2022 is that third-party external customer shipments. So you have to keep in mind that some of the synergies of the Big River acquisition was leveraging their melt and their high-quality substrates to serve our North American flat-rolled finishing line capabilities. So there is intersegment movement of materials that wouldn't be reflected in those third-party shipments.

So we are running Big River at the highest level of utilization we can based on the order book that we have and how it fits within the footprint. Obviously, the first quarter, as we mentioned, is going to be seasonally weak. But we feel pretty good about the full year prospects for our entire operations, including Big River.

David Boyd Burritt - *United States Steel Corporation - President, CEO & Director*

Yes. I think it's important to punctuate that or highlight that because we do believe it's temporary, and we expect Big River Steel shipments, the third-party volumes in 2022 to 2021 record level. So we remain bullish with Big River. And again, we're sorting through some seasonality, I think, as everybody is right now.

Operator

We will proceed with our next question on the line from the line of (technical difficulty) Seth Rosenfeld with Exane BNP.

Seth Rosenfeld - *Exane BNP Paribas Research Division - Senior Analyst*

If I can ask 2 questions, please. First, I guess, on the cost side. In Europe, I believe you flagged that there will be a decrease in your carbon costs in 2022. Can you walk us through the drivers of that despite the sharp rise in carbon credit prices in the spot market in Europe.

David Boyd Burritt - *United States Steel Corporation - President, CEO & Director*

Yes. Christie, why don't you take that one?

Christine S. Breves - *United States Steel Corporation - Senior VP & CFO*

Okay. Yes, we -- it's a couple of different things that are affecting the carbon costs. One, we have a higher free allocation this year because of the production level that we ran at last year. So that's a significant offset, the free allocation. And we also -- also, we have been hedging CO2 costs and so going out and buying CO2 carbon credits in advance also has impacted our average cost and we also have lower emissions. So that's also impacting the overall CO2 costs.

Seth Rosenfeld - *Exane BNP Paribas Research Division - Senior Analyst*

Okay. And then over in North America, can you touch on the outlook for annual coal contracts? Any sense of the scale or cost pressure or the year-over-year increase in price per ton we can expect for your coal procurement?

Christine S. Breves - *United States Steel Corporation - Senior VP & CFO*

Yes, I can comment on that. Yes, this year, we've seen extreme price increases in the coal market. And we feel like we have a very strong position because of our ability to blend coals. We can acquire coals then and hit the same properties, but are lower (technical difficulty) of coals because of our coal blending capability. We also have what we consider to be optimal sourcing through a mixture of long-term and short-term contracts. And all of those things together, we believe our pricing is advantaged, about a 53% increase versus a market increase of 150% or more.

Operator

And we'll now proceed with our next question on the line from the line of Michael Glick with JPMorgan.

Michael Adam Glick - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Just on the financial side, how should we think about working capital in 1Q and moving through the year? And could you speak to the potential for asset sales during the year?

Kevin Lewis - *United States Steel Corporation - General VP of IR and Corporate FP&A*

So I'm happy to start on working capital. I think in the first quarter, we would expect working capital to maybe be a modest source of cash with working capital for the full year being kind of a modest full year source of cash as well. So I think working capital will be a tailwind to cash flow throughout the course of the year beginning in the first quarter, and maybe I'll hand it over to Dave and Rich to talk about any non-core asset divestiture opportunities.

David Boyd Burritt - *United States Steel Corporation - President, CEO & Director*

Yes. (technical difficulty) That same point there. I mean, there's cash conversion cycle, and Christie spends a bunch of time every week with our team on making sure we continue to have the leading cash conversion cycle. Now as far as the non-core asset sales, we've -- as you recall, we had Transtar this last year. We have a whole portfolio of things that we look at from a -- from time to time. And Rich, if you could give us an update.

Richard L. Fruehauf - *United States Steel Corporation - Senior VP and Chief Strategy & Sustainability Officer*

Yes. Thanks, Dave. So as Dave said, we do have real estate and other non-core assets, and we are continually looking at those to see whether they do or do not fit within the Best for All strategy. I'll not get into any specifics, obviously, but there are always processes that we're looking at. As we say, everything is for sale at the right price. We get inquiries all the time for some of our assets. And I think what I would say is we're not afraid to transact when it makes sense. As Dave said, over the past couple of years, we've done the deals with Transtar. We did the Stelco option in our Minnesota ore. We announced the Keystone Industrial Port Complex real estate transaction. And so I think you should just assume that we continue to look at those kinds of opportunities going forward on a regular basis.

Michael Adam Glick - JPMorgan Chase & Co, Research Division - Senior Analyst

And then on demand, I get the near-term noise on the hot band side but would love to get more color just on what you've seen in recent weeks on the automotive side.

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

Well, we -- on the automotive side, our folks report that there's more inquiries and I'd say, more optimism as we go ahead. Obviously, there you've got the supply chain issues that have been there for a while. But the thing that's amazing with auto is just unfulfilled demand. The inventories are so low. And it's -- I mean, it's just a math it's not, I think, if it's when. I mean people are wanting to buy cars, and there's a lot of money in folks' pockets as we talked about the savings rate.

So we're encouraged about where we are again, softness in the first quarter, but I think it's going to come back. I mean all these risks, these things kind of swirling around right now with the Fed and the rate increases. We have to remember some of these things are just noise. It wasn't that long ago where the Fed said they weren't going to take rates up until 2024, right? And now we've been hearing the 4 times. One thing is for sure is that it's rare that what they say ends up being what happens because they are nimble and they're going to watch what's going on here.

So a lot depends on some of those actions that are being taken. But again, we're optimistic. I mean the auto guys are cleaning up their supply chain. And while it won't be probably completed here with the chips and things like that, it's -- the demand is so strong that I think it's -- again, it's not a matter of if, but when, and we'll participate greatly in that.

Operator

We'll get to our next question on the line from Karl Blunden of Goldman Sachs.

Karl Blunden - Goldman Sachs Group, Inc., Research Division - Senior Analyst

Just interested in the capital allocation updates that you provided around the 3 to 3.5x leverage target. Interested in your thoughts on how you arrived at that and any steel price assumptions that we should bake in for that target?

Where I'm coming from here is, when you think about your EBITDA floor going forward, the asset improvements you've made, that's I think, significantly higher than it was in prior cycles. So potentially that implies a bit more debt for the business as you make this transition? Just interested in any thoughts there.

David Boyd Burritt - United States Steel Corporation - President, CEO & Director

Well, thanks for the question. As you can imagine, we put a lot of time in thinking through this how to better reward stockholders and provide more certainty as to how we're thinking about this. So there's a whole lot of research and study that goes into each one of these lines on that capital allocation with the 3 to 3.5 leverage ratio as an important one, right? Because we are a cyclical business. And you ask, how do we think about the through-cycle number when we do our modeling.

And while we get, of course, input from rating agencies, banks and other folks to help us hone in on all these things. But as you look through the through-cycle, we looked at the last -- the average of steel prices on a very conservative basis, which was something like \$616. I personally don't think it's going to go that low for a whole host of reasons we could get into a longer discussion. But we try to look at things in a conservative way so that we have some optimism to manage the flows through this.

So when we look at the strength of the balance sheet, we think that's a good level for us to get through a full cycle. And then as far as the investments that we've already identified, Mini Mill 2, the galvalume, the NGO, all those things are identified, and we're going to get through those. And then

if there's other opportunities at 15%. We can pick and choose on those as we go forward. But we don't have anything else that we see that we're ready to talk about to announce that we have to raise money or get additional debt. We're heads down executing this Best for All strategy and making sure that when you're flush with cash and the obligation is and when you're confident on where you are, the obligation is to return to stockholders. That's with that additional \$500 million is. So there's a lot of modeling that went through all this. We tried to condense it down to its simplest form that we think should be able to resonate with you guys as you do your analysis and also the folks that are buying our shares. And we hope people see that we're spending a lot more time on that and rewarding stockholders more. Kevin, do you have something to add?

Kevin Lewis - *United States Steel Corporation - General VP of IR and Corporate FP&A*

I think the only thing I would add, Dave, and Karl to follow up on your question is, I think in the near term, there's probably some opportunities to further repay debt. As you know, there's some debt within the Big River capital structure that we can chip away at on an annual basis. And we'll look to do that, obviously, as it makes sense.

To your point about increasing debt, as Dave mentioned, really something we're not going to be focused on in any material way in the near term throughout the execution horizon. As you've seen us do in the past, though, we do like to look at project-specific financing that's long-dated costs to the extent that may be complementary to any of the projects that we're pursuing, particularly the 3 strategic projects that will generate \$850 million of incremental through-cycle EBITDA beginning in 2024 or ramping in 2026. Those could make sense. But the goal is certainly not from the balance sheet strength we've been able to deliver throughout 2021, and we want to maintain the strength that we've worked so hard to build over the last 12 months.

Karl Blunden - *Goldman Sachs Group, Inc., Research Division - Senior Analyst*

Still very helpful some of the cases you made for the higher steel price floor and well noted, Kevin, you anticipated my follow-up about preferential, if you will, financing at the additional mill at Big River because you do have really good terms on some of your bonds there.

Operator

We'll get to our next question on the line from Timna Tanners with Wolfe Research.

Timna Beth Tanners - *Wolfe Research, LLC - Analyst*

I wanted to ask first question about Europe. I had in my notes and this could be old, 5 million tons of stated capacity I know last year you did around 4.3 and guiding to 4.3 as the high end seemed a little light. So I was wondering for some color on that. And then to understand the \$80 million favorable change in purchased CO2 credit cost, is that like through the year? Or is that lumpy in terms of realization?

Kevin Lewis - *United States Steel Corporation - General VP of IR and Corporate FP&A*

I mean, I think the \$8 million on the credit cost, you can just assume is kind of spread out throughout the year, probably no particular reason why it'd be particularly lumpy in any given quarter. 5 million tons of stated capacity at USSK is kind of the nameplate capacity. But as you know, like targeted utilization rate for an integrated facility, think about it somewhere in the kind of 80% range, on maybe a little bit higher at USSK. So I think that we feel like demand and shipments there are going to be quite strong and continue to be strong in 2022. There's no reason for any different to shipment volume. We did complete an outage in the month of January. So that could weigh down shipments a bit in the near term.

Timna Beth Tanners - *Wolfe Research, LLC - Analyst*

Okay. And then my second question is just thinking commercially about the first quarter versus the fourth quarter. I know you had said that the fourth quarter volumes were a little light because you didn't want to chase lower prices. But the prices still are even lower than they were in the fourth quarter. So I'm just trying to understand how we should think about shipments relative to market conditions. Like do you think that the destocking is complete already and that will help first quarter volumes? Or how do we think about volumes quarter-over-quarter in light of the current lower steel prices and flat roll?

Kevin Lewis - *United States Steel Corporation - General VP of IR and Corporate FP&A*

Yes, I think we could -- we would expect to see shipments slightly up in North American flat-rolled quarter-over-quarter with the first quarter being higher than the fourth. But I think we could see volumes in our Mini Mill segment maybe take a modest step-down and then relatively flat in Europe and in Tubular. So I think we're navigating the domestic sheet market the best we can and then we'd expect shipments to then accelerate in the second quarter forward to get to our full year guidance targets.

Operator

Now I will now turn the call back to your CEO, Dave Burritt, for closing remarks.

David Boyd Burritt - *United States Steel Corporation - President, CEO & Director*

Thank you for joining this call this morning. We are just beginning to show the potential of our Best for All strategy and look forward to proving the power of the strategy over the coming quarters and years. We know that U.S. Steel has the right strategy for the long-term future, but we know that to achieve Best for All, we need the best from all and that includes strong support from the United States government to support a sustainable steel industry through trade enforcement and support for innovation and decarbonization.

To our U.S. Steel and Big River Steel employees, thank you for delivering a year for the record books. You didn't get distracted by record steel prices. Instead, you stepped up your game to deliver record levels of quality and reliability to amaze and delight our customers, and we're so pleased to reward you with record profit sharing and incentive pay, and you did it all by continuing to work safely for yourselves and your colleagues, but we're never satisfied until everyone who enters our facility returns home safely.

We truly have a world-class team at U.S. Steel and it's great to see it increasingly recognized. Earlier this year our compliance team was recognized as a best compliance and ethics program by Corporate Secretary. And just yesterday, we were awarded a perfect 100 score on the 2022 corporate equality index for a third year in a row recognizing U.S. Steel as a best place to work for LGBTQ+ equality. We are pleased to work with such talented and diverse individuals and are fostering an inclusive environment for all our employees to thrive.

And of course, to our customers, your challenges are what drive and inform our strategy. We are creating a U.S. Steel that will be part of a greener world and part of your solutions to meet your own decarbonization challenges.

Thank you for your continued partnership in pursuit of our shared customer planet Earth. Now let's get back to work safely.

Operator

Thank you very much. And that does conclude the call for today. We thank you for your participation (technical difficulty). Have a good rest of the day, everyone.

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