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X.N - Q2 2022 United States Steel Corp Earnings Call

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OVERVIEW:

Co. reported 2Q22 revenue of nearly \$6.3b.

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PRESENTATION

Operator

Good morning, everyone, and welcome to United States Steel Corporation's Second Quarter 2022 Earnings Conference Call and Webcast. As a reminder, today's call is being recorded. I'll now hand the call over to Kevin Lewis, Vice President, Investor Relations and Corporate FP&A.

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

Thank you, Tommy. Good morning, and thank you, everyone, for joining our second quarter 2022 earnings call. Joining me today 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. These can be found on the U.S. Steel Investors page under the Events and Presentations section.

Before we start, let me 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 good morning to everyone joining us today. We appreciate your continued support of U.S. Steel. I am bullish on U.S. Steel's future because we are executing. And most importantly, we are executing safely. We are on pace for a third consecutive year of record safety performance as measured by days away from work and building on our already industry-leading position, which is second to none. We take our role as the industry leader in safety very seriously. At U.S. Steel, safety is always first. When safety is great, our operations are great. Thank you to our employees. We appreciate you for your continued focus and commitment to our shared safety goals.

As we continue to execute our Best for All strategy, we are progressing towards a less capital and carbon-intensive business. We are pleased to share an update on our latest sustainability disclosure later in our prepared remarks. The rapid progress we've made demonstrates our continued commitment to become the best.

To become the best, we are expanding our competitive advantages by leveraging our unique competitive advantage and lowest cost iron ore, combining highly capable integrated assets with low-cost and technologically-advanced mini mills and investing in finishing capabilities that best serve our customers. As we've said before, to become the best for all, we need the best from all.

I want to take a moment to recognize the continued trade enforcement by the current administration. We are very pleased with the ITC's recent decision to continue all nine of the anti-dumping & countervailing duty orders on corrosion resistant steel and eight AD/CVD orders on cold-rolled steel for another five years. Continued strong trade enforcement from the United States government supports our national economic security and gives the domestic steel industry the opportunity to advance actions that make steel more sustainable.

The United States remains the leader in sustainable steelmaking as many in our industry have embraced the electrification of the steelmaking process, which is the most sustainable way to make steel. We are doing what is best for all because our customers, our employees and our stockholders are counting on it. As geopolitical and macroeconomic impacts shift, our Best for All strategy remains constant.

We'll spend the next few moments highlighting 3 key messages shown on Slide 5: our record second quarter performance, our differentiated strategy, and our balanced capital allocation framework, supporting both profitable growth and direct returns to stockholders.

Let's get started on Slide 6. 2022 continues to be another year of exceptional financial performance for our company. We reported our best ever first quarter in April and are pleased to deliver another quarter of record-setting performance. Over the past 4 quarters, we've generated EBITDA of \$6.7 billion, free cash flow of over \$4 billion and returned nearly \$850 million of capital to stockholders. We delivered record second quarter adjusted EBITDA of \$1.6 billion with each operating segment contributing meaningfully to the enterprise performance. We also continued translating our earnings into cash by generating another \$642 million of free cash flow in the quarter. This strong performance contributed to our quarter ending cash balance of over \$3 billion and nearly \$5.5 billion of liquidity.

Last quarter, you heard us say when we do well, you do well, and I want to continue that drumbeat today. In April, we committed to meaningfully increasing direct returns in the second quarter, and we delivered on that commitment to stockholders. In the quarter, we returned approximately \$400 million of capital to stockholders, and we've continued our direct returns in July, exhausting our \$800 million program in less than a year. Since October, we have repurchased approximately 13% of our stock. We continue to see tremendous value in repurchasing our own stock and are pleased to announce another \$500 million program that will further reduce our share count and gives us the opportunity to acquire more of the best-valued steel company, U.S. Steel. We are confident that we are the best value because of our differentiated strategy.

Today, we will discuss on Slide 7, the structural improvements to our business that are improving our through-cycle resiliency, the decarbonization of our footprint and executing towards our 2030 and 2050 decarbonization goals, and the unique metallic strategy we're advancing to expand our lowest cost iron ore advantage.

Let's get into the details on Slide 8. The well-timed Big River Steel acquisition has outperformed expectations. Since its inception in first quarter of 2021, our Mini Mill segment has contributed EBITDA of nearly \$2 billion. The Big River acquisition has already more than paid for itself. Our new Mini Mill segment now represents nearly 30% of our domestic flat-rolled steel EBITDA. It's lowering our capital and carbon intensity and is expected to deliver more consistent results.

While the acquisition of Big River Steel has transformed our business model, we've also transformed our balance sheet. Specifically, we strengthened our balance sheet. Last year, we repaid over \$3 billion of debt and cleared the maturity runway to complete strategic projects with confidence. We have no significant upcoming debt maturities until 2029 and an overfunded pension plan. As of the end of the second quarter, our net debt is 0.2x.

A stronger business enables stronger customer relationships. We're closer to the customer than ever before and have exposure to the diversified end markets like automotive, construction, appliance and tin packaging. Importantly, we are uniquely positioned to serve the resurging energy

market from our Flat-Rolled, Mini Mill and Tubular segments. We continue to see growth in today's order book for energy product while investing in capabilities to serve growing markets in the future.

The electrical steel market is expected to grow at a compounded annual growth rate of 9%. The world-class non-grain oriented, or NGO, electrical steel line that we're constructing will position us as the leader in NGO steels in North America. We will produce thinner and we will produce wider NGO electrical steels through this brand-new asset to become the supplier of choice. We are developing the next generation of electrical steels that will be required to support the continued electrification of the automotive market.

We're also expanding our coating capabilities at Big River, notably on GALVALUME. With improved capability, coupled with our strong customer relationships, we are well positioned to profitably grow our participation in this expanding market.

While we are investing to support our customers' sustainability strategies, we are also making progress towards our own decarbonization goals. Last week, we issued our sustainability report, which highlights the steps taken in 2021 to improve our carbon footprint and advance our ESG programs.

On Slide 9, as an enterprise, we're executing on our 2030 and 2050 targets. Our greenhouse gas emissions intensity has been reduced by 16% since 2018, and we are well positioned to achieve our 2030 target of 20% reduction in GHG emissions intensity. We also remain committed to achieving net zero greenhouse gas emissions by 2050. As we expand our low GHG emissions electric arc furnace footprint, raw materials will be a key differentiator.

On Slide 10. We continue to expand our lowest cost iron ore to advantage our Mini Mill segment. While 10% of our metallics are in-sourced today, that number could increase to 40% by 2024 with addition of pig iron at Gary Works and the proposed Granite City pig iron facility in collaboration with SunCoke. We look forward to finalizing agreement with SunCoke to provide a mutually beneficial transaction that is a win-win for U.S. Steel and SunCoke, securing 500 good Union jobs while transitioning to a more sustainable future.

We're also expanding our metallic strategy by upgrading our iron ore pellets. We're investing to upgrade our capabilities at Keetac to make direct reduced grade pellets. Keetac's high-quality ore body and long mine life makes it the best choice for DR-grade pellet capabilities. We will have the ability to produce both blast furnace and DR-grade pellets at Keetac in the future. These actions will allow us to become increasingly self-sufficient to feed our mini mill segment with key metallics.

Access to virgin metallics is what keeps our mini mill competitors awake at night. We are making full use of our compelling competitive advantage at our iron ore mines right here in the U.S.A., onshoring our supply chain, an advantage that will be very difficult for our competitors to replicate.

Our final topics shown on Slide 11 is our disciplined and efficient approach to capital allocation. Our capital allocation priorities are guided by 3 main considerations, which are balance sheet strength, announced Best for All investments and direct returns. These capital allocation priorities are on track. The balance sheet remains very strong and then -- and better than our through-cycle adjusted debt-to-EBITDA objective. And our ending cash balance remains well beyond our next 12 months CapEx, ensuring our Best for All strategic investments are fully funded.

With those capital allocation objectives met and the completion of our previously announced stock repurchase program, we are pleased to have a new \$500 million authorization in place as we expect positive free cash flow to continue into the third quarter.

We now have an industry-leading Mini-Mill segment that we didn't have in the past. Our balance sheet is rock solid, and we have a record cash and liquidity to complete our investments. By 2026, we expect those Best for All investments to deliver \$880 million of run rate through-cycle EBITDA and position our Mini Mill segment to contribute \$1.3 billion annually. Supported by less than \$100 million of sustaining CapEx, we expect our mini mill segment to have differentiated cash generation capabilities, an attribute that will significantly increase the EBITDA multiple of our business.

Now before I turn it over to Christie, let me take a moment to acknowledge her tremendous contributions to U. S. Steel over the years, especially in her latest role as CFO. This will be Christie's last earnings call, but we are extremely fortunate that she will be remaining with us through year-end as Executive Vice President of Business Transformation to continue supporting our Best for All initiatives. Christie's knowledge, leadership and

superb insight have contributed greatly to today's record performance. We would not be the same company today without the benefits of her efforts.

We're also excited to welcome Jessica Graziano as U. S. Steel's new CFO beginning on August 8. I'm excited for you to get the chance to speak with her directly once she has settled into her new role.

With that, I'll turn it over to Christie to cover the financials. Christie?

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

Thank you, Dave, and thank you to the whole team at U. S. Steel, our stockholders, our Board and our customers. It's been the highlight of my career to serve as CFO of this iconic organization. To be a part of this company's incredible transformation has been an exciting and rewarding experience. I can't wait to see how the progress we've made to date and the strategy underway delivers for all of our stakeholders. I'm confident that you, Jessica, and the rest of the team will succeed in getting U.S. Steel to its best for all future.

I'll begin on Slide 12. We delivered a record second quarter adjusted EBITDA of over \$1.6 billion generated from revenue of nearly \$6.3 billion. Our 26% adjusted EBITDA margin represents another strong quarter of profitability.

At the segment level, Flat-Rolled EBITDA was \$902 million or 23% EBITDA margins in the second quarter compared to \$636 million and 21% in the first quarter. Higher volumes and the absence of first quarter iron ore mining seasonality were partially offset by raw material inflationary headwinds as well as higher steelmaking additions costs. Higher utilization rates and the related efficiencies also helped to improve our Flat-Rolled segment margin performance versus the first quarter.

In our Mini Mill segment, we delivered EBITDA of \$309 million and EBITDA margins of 31% in the second quarter. Higher volumes were more than offset by the combination of lower average selling prices and the higher metallurgical costs.

In Europe, our Slovakian operations again overcame significant geopolitical hurdles to deliver EBITDA of \$302 million and EBITDA margins of 22% in the second quarter compared with the \$287 million and 23% in the first quarter. Higher average selling prices more than offset rising raw material costs in the second quarter.

And in Tubular, we reported a strong quarterly performance. EBITDA totaled \$119 million in the second quarter. The flow-through of higher steel selling prices and the benefits we're starting to see from pending trade cases outpaced higher scrap costs, resulting in continued improvements in profitability.

Our second quarter EBITDA translated into free cash flow of nearly \$650 million to contribute to our record cash and liquidity. This performance gave us the confidence to accelerate our stock buybacks in the second quarter, returning another \$413 million of cash to stockholders, including our quarterly dividend payout. We repurchased over 17 million shares in the quarter and have repurchased another 7 million shares in July. We have completed our authorized share buyback program and are pleased to announce another 500 million share repurchase program. Our business continues to perform well above through cycle averages and remains on track against our clearly defined capital allocation priorities.

Unsurprisingly, the declining steel price environment through much of the second quarter and into the third quarter has kept some buyers on the sidelines. This is expected to result in sequentially lower EBITDA for our Flat-Rolled segment. Conversations with customers and recent customer inquiries suggest end market demand is healthy. Customers are just waiting for the right time to re-enter the market.

In our Mini Mill segment, greater market-based monthly contract exposure versus the Flat-Rolled segment is expected to accelerate the flow-through of lower steel selling prices. We also continue to work through more costly inventory and therefore expect meaningfully sequentially lower EBITDA at Big River Steel in the third quarter.

In Europe, the conflict in Ukraine and the negative impact on raw material and energy prices are reducing industrial and manufacturing demand. As a result, in the third quarter, our USSE segment is experiencing significant margin compression as steel prices have softened while raw material costs remain elevated.

Lastly, our Tubular segment continues to capture higher selling prices and is running at elevated utilization rates to meet strong customer demand. With the support from the ongoing OCTG trade cases, we expect another meaningful increase in segment EBITDA in the third quarter.

Spot prices falling from high levels over the past several months are expected to negatively impact results in the third quarter. Our diverse end market exposure and increasingly flexible operations are expected to business more resilient than in the past with EBITDA in the third quarter expected to be just under \$1 billion. Opportunities in working capital in the third quarter are expected to keep cash from operations resilient and the business continuing to generate free cash flow while also advancing our strategic projects as planned.

The market remains dynamic, and we can't stand still. That's why we're taking advantage of the temporary slowdown by moving a planned outage originally scheduled for October to September at Mon Valley. This decision allows us to be better prepared for the anticipated recovery as steel prices bottom.

Dave, back to you.

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

Thank you, Christie. Before we get to questions, let me summarize today's remarks on Slide 13. Record second quarter performance was a result of continued execution across each of our operating segments. For U. S. Steel, we must execute, execute, execute a differentiated strategy, and we have.

Sure, the economic environment is uncertain, but we know and you know that this isn't the same U. S. Steel from just a few years ago. We now have industry-leading mini mill operations, a rock-solid balance sheet and record cash with liquidity of over \$5 billion. All of these factors support our Best for All strategy execution and are expected to deliver an additional \$800 million of run rate through cycle EBITDA. We are delivering on our objectives and capital allocation priorities and look forward to earning a re-rating of our stock.

Kevin, let's move to Q&A.

QUESTIONS AND ANSWERS

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

Thank you, Dave. Our first 2 questions today come from Say Technologies. The first question, Dave, we received several questions about domestic steel demand, our outlook across key end markets. Can you share your perspectives on our markets and customers?

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

Thanks, Kevin. I can see how that's top of mind for so many people that as -- that line of questioning. I'd break it up in a couple. The near term, of course, there's a lot of uncertainty. And the growth we're talking about growing capability, creating profitable growth.

In the near term, there's different dynamics across many of the markets we serve. But our order book and end market diversification, it's a great advantage. We're not dependent upon just one market. It's not just auto for us. We got multiple markets that we serve. Not one dominates. We're a lot more balanced.

As far as automotive and appliance, the supply chain issues are persisting. I'd say they're a bit less, but we're still going to have those challenges. The good news is mined, melted, made in the U.S.A. we basically find ourselves in a much more resilient position especially with strong trade enforcement.

Industrial construction and service centers, I'd say that we're seeing mixed or cautious buying. Just saw the inflation headline here. Obviously, that's an impact on everyone. But while we saw GDP negative in the first quarter and second quarter, that doesn't mean that U. S. Steel is tied to those GDP numbers. What it means is we're more resilient than ever before, and we're preparing for the future and being ready for whatever markets we serve.

But the really bright spot here for us is in energy. It's a unique exposure and really strong demand for us today. The Tubular business, for example, is so very different than a year ago, and it's a much more meaningful contributor to EBITDA.

So as the near-term goals, the actions we're taking, we're managing the inventory, optimizing our loading plans, matching our production with the order books, and it's going fine. But there is a lot of uncertainty, and the third quarter will definitely be lighter.

As far as growth, profitable growth, it's about being low cost and/or high capability. Those are the things that we're pursuing with our differentiated strategy. And frankly, we're -- I'd say I'm more than just a little excited about the future here because the strategic market growth is outpacing overall market growth, and we're winning in the strategic markets.

There's growing demand for advanced high-strength steel. There's a higher interest in green steels. There's rapid electrification. And the infrastructure bill has been passed, and we expect to see the benefits of that come through sometime next year. And we know that we must win in these strategic markets, advanced high strength steels in automotive and the non-automotive applications. We're seeing many opportunities there.

And electrical steels, we've got the world-class NGO line that will be soon completed and we're just really excited about the potential there. Then, of course, green steel with our verdeX line of sustainable steels that we've come out with and the much lighter carbon footprint than we've had in the past. We're again performing very well.

So we're investing in capabilities, we're investing in talent, and we're making sure that we're investing in profitable growth in the markets that we serve and growing the strategic markets.

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

Okay. Thank you very much, Dave. The second question that we received is related to the adoption of green energy in our sustainability road map. So Rich, can you please provide your thoughts on that question?

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

Sure, Kevin. Thank you for that question. Well, first, as we say, U. S. Steel, we're committed to doing our part to address climate change and advance sustainable steelmaking technologies. We've issued just last week our latest sustainability report, so I encourage everyone to take a look at that on our website.

Look, there's a global race going on right now to decarbonize steelmaking, and we want to be part of the solution. That requires developing and deploying new technologies in collaboration with governments and other companies and communities.

So what have we been doing in this space? Let me start with -- in February, we announced an alliance with leading companies, the likes of GE, Power, EQT, Equinor, Shell, Marathon, Mitsubishi Heavy Industries for the Tri-State region of Ohio, Pennsylvania, West Virginia, who share our vision for a more sustainable industrial future. And that alliance, that partnership, we're looking for ways to create a national model for sustainable energy and production systems. And that includes things like hydrogen, carbon capture.

In the more immediate future, we are working with utility providers towards more renewable sources of energy. So for example, at our Big River Steel, Big River 2 complex in Osceola, our partner is Entergy for electricity supply. And they've already -- they are today, I guess, is the way I put it, they are today already supplying significant amounts of non-greenhouse gas, nuclear power generation to Big River. But they've also committed as part of our Big River 2 project development to supply more renewable power like solar. So we're looking forward to continuing that partnership with Entergy.

And at our Mon Valley Works, we have obtained emission-free energy certificates from our local utility partner. So that's -- those are some of the things we're working on. We have other projects in other parts of our footprint, looking at renewable power generation as well.

And then I would say on the customer side, we are playing an increasing role in making renewable energy possible by selling sustainable steels, for example, into the solar market. We have a new partnership with NEXTracker, which just last month opened a new facility here to make solar tracking systems. DOE Energy Secretary Granholm was there for the ribbon cutting. So we're really proud to partner with NEXTracker.

So what I would say is while we aren't standing still as a company, if we truly want to unlock the full potential of green steelmaking in the U.S, we need these kinds of partnerships across the public and private sector.

For us, it's about making profitable steel solutions. We need to be able to make money in these investments. But it also -- its clear action is required. It's not just about concept. So anyway, these are a few examples. So hopefully, that helps address the question. It was a good question.

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

Okay. Thanks so much, Rich. And thanks, Dave. So now, operator, if you may queue the line -- the phone line for questions. (Operator Instructions)

Operator

(Operator Instructions) And our first question on the line from David Gagliano from BMO Capital Markets.

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

Dave, my first question is regarding the capital allocation strategy and the buyback authorization just announced. Obviously, U. S. Steel generated a lot of free cash historically recently. But things are changing, heading into a transition period of very high CapEx and obviously results are coming down. So the cash balance, which is \$3 billion now, could get below that \$1.5 billion. It's not inconceivable. So my question is on the -- prior to buying back stock. My question is on the authorization. How aggressive will U. S. Steel be buying back shares in the near term, considering the changing environment? That's my first question.

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

Well, thanks for that question. And I think you know, David, that we're in this highly desirable position because of the purposeful execution of our strategy. So with \$3 billion of cash and well over \$5 billion liquidity, we have a lot of opportunities. And as you heard in some of the remarks, how bullish we are about being able to execute on the strategy.

You've seen our capital allocation framework. We put it in the deck. Again, we're committed to that capital allocation framework. We're going to be opportunistic. And you go through the individual pieces of that, we're guided by the balance sheet strength. The Best for All investments, we're going to make sure we get all those down; and then we have the direct return. So you kind of go through each one of those and you say. Okay, balance sheet strength, check. Strong cash position, check. Advancing the strategy that makes our business, our earnings and our free cash flow more resilient, check.

So we felt the authorization was a must. And so we're within that framework. We will be opportunistic. We're not going to commit to a certain amount by quarter, but we do feel very good where we are, and we'll see how the economy unfolds and we'll be, again, opportunistic within the framework. We're going to be as active as our framework dictates and executed a pace that maintains a high level of strength and liquidity to support our investments.

So we think this is a good program. Again, we've completely exhausted the \$800 million that we committed to really not that long ago within the last year. So we feel very good about where we are, and we'll see how the economy unfolds and stay committed to that capital allocation framework because we do need to get these strategic investments done, and we do need to make sure that we're providing rewards to our stockholders with stock buybacks and dividends.

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

Okay. That's helpful. My follow-up is a 2-part follow-up with regards to the European operation. My questions are, A, will Europe be EBITDA positive in the third quarter? And B, as far as the contingency planning that was kind of mentioned in the press release, is U.S. Steel considering either scaling back or shutting it down until things improve in Europe?

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

Well, I think you've seen the numbers with USSK. It's been a significant contributor to U. S. Steel. And obviously, there's margin compression over the last few months. And we've seen Northern European prices, where they reach a peak of about \$600, \$700 a ton, and now they've fallen by \$700 a ton. So we definitely have some margin compression. But we will be positive EBITDA, no doubt here. I feel very comfortable that USSK is going to continue to be positive EBITDA. This business, frankly, I think it's always been positive EBITDA, and it runs very well. There's a lot of uncertainty due to the war in Ukraine. And while prices have declined, the raw materials basket has only fallen about \$400 a ton.

So you think about that, and that is quite a squeeze. But we still feel good that USSK is going to continue to contribute, and the thing to remember here is that USSK comes down. And while tubular won't be able to offset all of that reduction, the Tubular business is continuing to perform extraordinarily well. And I think in the first half, it had EBITDA that was in excess of \$200 million, and the second half is going to exceed the first half performance.

So we feel good about that in terms of some offsets. And again, the diversified footprint helps us with that. But USSK is an excellent business. These people, our team over there knows how to run this very, very well. And when the Ukraine war hit, they bought ahead and made sure there were no supply disruptions. And so now they're carrying extra inventories. We typically target about 30 days inventory but have increased that target to 60 days, and we're currently a little bit higher than that.

So the softer demand is going to make the consumption of higher-priced raw materials longer. So yes, there's going to be some stress on that, but it's still -- it's a really good business in Europe.

Operator

I will now proceed to our next question on the line from Emily Chieng with Goldman Sachs.

Emily Christine Chieng - *Goldman Sachs Group, Inc., Research Division - Associate*

The first one I have is just around the Granite City Works granulated pig iron facility. Maybe could you help us frame the strategy behind the potential sale to SunCoke. And maybe help us understand what the technical and capital differences are between that granulated pig iron facility and the Gary Works pig iron unit which you will be constructing instead?

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

Emily, thanks very much for the question. I'm going to turn it to Rich, but just to punctuate again how important metallics are to our business, this is a sustainable, competitive advantage for U. S. Steel. Let's face it. They're not making the iron ore range anymore. God's not making the iron ore range anymore. So this is something that cannot be replicated. So we feel very good about the strategy and where it's headed. Rich?

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

Yes. Thanks, Dave. So Emily, yes, let's start with a little bit of context. So pig iron right now, pre the war in Ukraine, about 2/3 of the market for it was coming out of Russia and the Ukraine, right? So with the cutoff of that supply has put pressure on iron ore and HBI DR -- excuse me, pig iron HBI DRI. And as we know, you're talking 75% or more of your cost to produce a ton of steel and an EAF is your metallics.

So as Dave said, first and foremost, having these virgin iron ore metallics in our footprint and able to supply the EAF fleet is a huge advantage for us because then we won't be as exposed to the ups and downs of the scrap market or cut off of supply or price spikes in pig. I think pig hit close to \$1,000 a ton delivered to NOLA in New Orleans earlier this year as a result of the cutoff from Russia and Ukraine. So that's the basic issue we're addressing with it.

So with respect to Granite City, I mean, we already produced low-cost iron ore in Minnesota for our blast furnaces, and what we're working on doing here is pivoting that to be able to also supply the EAFs for the reasons I just indicated.

Now with respect to pig iron, pig iron trades are at a premium over DRI and HBI because it's exothermic. You get a value-in-use. What that means is it gives off heat in the furnace, which means you improve productivity by loading pig iron in your furnaces. You speed up the tap-to-tap times.

So having pig iron, whether it's at Gary or at Granite City is a huge win. Now the difference between what we're doing at Gary, which is what we'll call the sort of standard lumpy pig and the granulated pig iron at Granite City, granulated is sort of smaller pellets. It distributes more evenly in the furnace. And so you get a faster and a better melt, and so that's why we chose to go with the granulated pig iron at Granite City.

There's not a significant risk here. The granulated pig iron will be unique to North America. We're partnering with SunCoke because we think that's the best way to get this project underway as quickly as possible. As you know SunCoke is our coke supplier at Granite City. So I mean the basic model is moving the -- just doing what we're doing today, moving iron ore from Minnesota down to Granite City. But instead of turning it into steel, we're going to turn it into granulated pig iron and reap the benefit of having that vertical integration in our EAF fleet.

Emily Christine Chieng - *Goldman Sachs Group, Inc., Research Division - Associate*

And maybe just as a follow-up. To be clear, why was this decision for Granite City to be potentially sold to SunCoke instead of U. S. Steel executing on that capital project yourselves? Was it the fact that perhaps Granite City, the granulated pig iron facility might not have met your 15% IRR target? Or was there something else that sort of triggered that decision?

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

I think the main thing I would say, Emily, is we're already in a partnership today with SunCoke for Granite City because they're the on-site coke provider -- so running blast furnaces to make pig versus running blast furnaces to make liquid metal that gets turned into steel. We're already in a partnership with SunCoke and I think with respect to the path forward, we saw this as an opportunity to take that partnership with SunCoke to the next level.

So that's really what drove this. We think SunCoke is going to be a great partner, a good operator for making the GPI. And this allows us to focus on our core steelmaking talents and skills. And I think with respect to this, we really see this as a win-win for both companies. Because as I said,

we'll be able to benefit from our low-cost iron ore move through Granite City and then turned into pig. I mean, it's our iron ore that they'll be converting for us into GPI.

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

Yes. I maybe add, Rich, I'd say it win-win-win because not only is a win for SunCoke. A win for U. S. Steel, it's preserving 500 jobs that would ordinarily go away. I mean, I think people remember, what was it, March of 2018 when the trade tariffs came into place. That's when we opened up those blast furnaces at Granite City. And when the tariffs came off in Canada and Mexico with USMCA, that challenge demand, that challenges other aspects of the business. So this, I think, is the best we can do to preserve as many jobs as what we possibly can, and at the same time, make sure that we take care of the company and also, frankly, take care of SunCoke as well as the employees.

Operator

We'll get to our next question on the line Seth Rosenfeld with BNP Paribas.

Seth R. Rosenfeld - *BNP Paribas Exane, Research Division - Research Analyst*

I've got the -- first one please on the tubular business with very strong recovery in energy CapEx in earnings. How do you think about the capacity of this business? Obviously, in recent years, you've idled a great deal of Tubular capacity. Is there an opportunity to restart welded pipe facilities? On the raw material side, can you touch on how the new EAF within tubular is impacting your competitiveness versus past cycles? I'll start there, please.

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

Yes. Maybe first, I'll start with the EAF. It's being run extraordinarily well. Great safety performance there now, and we got some really strong talent that understands how to run the EAF. So that's a big improvement to us. The investments we made through the energy downturn are paying off significantly with that EAF providing about \$100 million in annual cost savings. So that's a big deal for us.

We now control the supply of rounds at Fairfield, and we're leveraging that wide range of seamless capabilities that we have. So the cost actions we've taken to invest in EAF capabilities plus the opportunity to continue to earn higher average selling prices in the second half, frankly, I'm very optimistic about the tubular business. But again, we're counting on strong trade enforcement so that we can continue to profitably serve the domestic energy market and create value for our stockholders. But I'd say this, there are no current plans to open anything up or increase that would be far too soon to suggest anything like that.

Seth R. Rosenfeld - *BNP Paribas Exane, Research Division - Research Analyst*

Okay. And the second question, please, with regards to the Mini Mill segment. In your prepared remarks, you commented on elevated raw material costs working through inventory. I think back in April, you discussed some efforts to derisk pig iron supply (inaudible) of Ukraine. Can you just walk us through what the impact of that spend with regard to potentially safety stocks? In short, is Big River Steel now sitting on particularly elevated inventories of pig iron or prime scrap procured at peak prices a few months ago? How should we think about that?

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

Well, I think -- this was an issue, obviously, when the war in Ukraine started. So we had to have surety of the supply. It's been critical. And so we secured new raw material sourcing from Brazil and India and have, of course, shifted away from the Ukrainian supply, especially the pig. And so

we have elevated pig iron and HBI inventory. And so that we do have to manage that out. And that, obviously, a high cost, and so we're going to have some compression on price there with the mini mill business and have to manage that very closely.

So on the good news side, we expect to release some working capital at Big River of about \$250 million, which would be a nice, favorable uplift. But there's no doubt with spot prices falling through the quarter, we expect EBITDA to be sequentially lower at the Mini Mill segment. But we'd expect similar volumes third quarter versus the second quarter.

Operator

It's from Michael Glick with JPMorgan.

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

On your raw material strategy going forward, beyond the pellet investment, how are you thinking about DRI fitting into the picture?

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

Yes. So I think, Michael -- this is Kevin. I think we've said that it's not a matter of if, it's when and where when it comes to DRI. So the investment that we are making at Keetac to produce DR-grade pellets, I think, further expand the optionality we have to advance a DR strategy in the future.

However, as Rich articulated, and as we laid out in our prepared materials, the actions underway, relatively capital-light actions underway, to advance the pig iron strategy meaningfully increased our self-sufficiency of metallics. So I think that is where our near-term focus will be on pig iron, no regrets decision to invest in DR-grade capabilities at Keetac, it's our best ore body. It's our longest life of mine. So a very logical choice to add that capability to their already kind of blast furnace pellet production capabilities, and that puts us in a great position moving forward to explore DRI.

But Rich, maybe anything else to add?

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

Yes, Kevin, I think you touched on it. I mean we're focused on pig first and foremost because of the benefit pig gives you versus DRI in the furnace. And we saw sooner opportunities -- sooner near-term opportunities to get those metallics converted into pig iron and into our EAF.

But as you said, DRI is an opportunity for the future. And with the announcement of the float plant at Keetac, that allows us to get started. I will tell you that we've had tremendous outreach to us once we went public with that. So we see a lot of commercial opportunity. And there, as Kevin said, potentials for partnerships that we might look at as well in the future when we think about DRI, which, as Kevin said, it's not a question of if, it's when and where.

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

I think the key word in all this, what I heard was optionality, that's what everybody should think of. We need to make sure that we have nimbleness, flexibility, adaptability. And right now, there's nothing in the CapEx related to DRI even though that wouldn't necessarily be a huge number because we have again, lots of options in terms of how to put that in and when we put that in. So we feel pretty good about where we are with our footprint and the CapEx that we've announced, and we need to make sure that we live to our capital allocation strategy and make sure that not only do we show up with good results on the bottom line, but we make sure that we take care of our stockholders, and that's why we issued this stock buyback program. That's important to us. We continue to reward stockholders.

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

Understood. And then in Europe, I guess just from a high level, how should we think about the longer-term strategic direction of USSK. I think in the Slovakian papers, it looks like there was a recent MOU on the energy side there. So just curious to get any of your thoughts there.

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

Well, USSK has been an awesome business for us. Again, as I said, we have great talent on this. These guys are Kaizen, progressive improvement experts. And obviously, right now, we're in transition with Ukraine just 60 kilometers from the border. We've been very fortunate that we haven't had any disruption over there. But this is one of those things that we have to get through the current geopolitical concerns. We have to manage this well, and then we'll figure out what that future is. Meanwhile, this business has always put up positive EBITDA, and we expect that to continue.

Operator

We'll now proceed to our next question on the line from Karl Blunden with Goldman Sachs.

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

Just wanted to focus on your CapEx number of investments in process right now. When you think about how things are running relative to your budget, your planning assumptions, I just wonder if you could comment on which elements are above or below? And give us a sense for what's still uncontracted, the major buckets that you're focused on there.

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

Let me just take the first part of that. One of the things that we really focus on is on budget, on time. And we're really pleased, frankly, with the work that's going on with the NGO, the GALVALUME and Big River 2. You think about all the inflationary costs that have come in, this team really knows how to work across our entire footprint, not just Big River, but it's the integrated folks, our procurement people and looking for creative ways to make sure that these things are on time and on budget.

And whether it be the NGO electrical steel, which I think was \$240 million or Big River 2, everything is on track, on plan. And the coating lines on plan, the metallic strategy, everything is on plan there. The pig iron machine is on plan. You go through each one of these things. It's on budget, maybe ahead of plan in many cases. We feel good about where -- the way the whole team is managing this. There's a lot of rigor.

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

Yes. I would just add, Dave, I think that team there. They -- long lead time items, they got that in quick and early. So they've been placed a long time ago as well as I think the team there just does an excellent job looking for multiple different suppliers of something so that they have some choices. They've done a good job widening the supplier base to create a little bit more competition, that team is just really on top of it there.

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

That's helpful. The second one is just a follow-up on a potential HBI investment. Is there a date we should think about as a not before date for that? Or could you accelerate that if you see good progress and enough cash flow to go after that? Or do you want to get some of the existing investments done and understand the optionality better?

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

Well, I think we need to go back to the capital allocation strategy and look at those individual pieces there in order to keep on the healthy balance sheet. We're going to take care of the investments that we've laid out, and that's what we need to get focused on. There's no commitment to anything else at this point. We're going to let the economy tell us what the solution is here, but don't look for anything big anytime soon. We feel very good about where we are executing the strategy and delivering value to our stockholders.

Let's face it. There's a lot of uncertainty. Some people say more uncertainty than ever before. I'm not so sure that's true. But we do know that these are different times, challenging times, and we need to make sure that what we say we're going to do, we do. And that's something that we haven't been always able to say, but we've got integrated assets that are running extraordinarily well, and the mini mill assets are running well. Europe is performing in spite of all the challenges there, and now the Tubular business is coming back. So I wouldn't look for anything here. We're again keeping optionality available. If there's a big opportunity here that adds a whole lot of value, of course, we do it, but there isn't anything committed to at this point.

Operator

We'll get to our next question on the line from Carlos De Alba with Morgan Stanley.

Carlos De Alba - *Morgan Stanley, Research Division - Equity Analyst*

So just coming back to the DRI strategy. Is there -- I understand that is an opportunity for the future and in optionality what you have created. But any color that you could add in terms of the potential timing of when you might exercise that option that you have now available?

And then my second question, if I may, has to do with a little bit more color on the end markets. You mentioned the consumer-related sectors like auto and appliances are a little bit soft. But could you comment on a little bit more on those 2, plus the other key end markets that you supply?

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

Okay. The first part, can I give more color on DRI? No. I think you got all the color we're going to give you on DRI right now because we talked about the metallic strategy. We say it's inevitable, not anytime soon, and so we'll just leave it at that.

As far as the actual markets, maybe I'll talk a little bit about each one of these. The auto -- maybe the auto rebound. We're staying very, very close to the customer and ensuring we're well positioned to what feels like an inevitable ramp-up in auto. We're not seeing like some might say the hockey stick increase, but we feel pretty good about what's coming. There's obviously the semiconductor shortages. This is a big bottleneck.

And by the way, we're very supportive of the CHIPS and Science Act from Congress. And reshoring critical industries, it's so important to national security. Everybody needs to get this. We need to make sure that we are self-sufficient in the U.S.A. If we learned nothing from the pandemic, it's that, we got to be able to take care of ourselves and we're big on mine, melted, and made in the U.S.A., as you well know.

But alleviating the semiconductor bottleneck is critically important. And it's taken longer, I think, than anybody imagined. And it's still going to take longer. There's a lot to be done. But we've seen in auto consistent order entry rates across the diversified domestic and foreign OEMs, and this is a steady pace of pull has allowed us to use some auto-oriented assets to service other pockets of accelerating demand to optimize loading. Kevin?

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

Yes, and Dave, along those lines and other pockets of demand, I would say, across the industrial space, we continue to see good pull rates and expect that to be stable in the second half.

If you look at the construction market, particularly the nonresidential value-added construction market, that's been quite resilient. Service centers, I would say, generally speaking, are mixed. We've seen good shipments out of service centers, but as we acknowledged earlier, more cautious buying.

So when you look at that type of relationship, that can't continue, that imbalance can't continue, where you have more shipments and less buys, meaning they'll have to start buying soon. So if you couple that with the energy, which is certainly, as Dave mentioned earlier, the brightest spot in our order book.

Big River, that facility is particularly well positioned to serve the strong OCTG demand that we're seeing. We've talked about it before, Gary Works and the unique capabilities there related to line pipe. And we've also addressed tubular today, which is performing extremely well and it's certainly a key area of differentiation, a big competitive advantage for us in today's market.

So given that balanced portfolio of products we have, there's certainly different dynamics manifesting themselves in different pockets, but I think we feel like the balance book that we have will provide us some resiliency here. So we'll stay focused on creating value together with our customers. We know they want partners who provide green steels, are willing to innovate for the future, and we look forward to continuing to build long-term and mutually beneficial relationships with them.

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

I think this diverse end market exposure really does keep us insulated from having too much dependence on just one set of customers. We got automotive with 30% to 35%. Construction, 15% to 20%. Tin, something like 15%. Appliance, 10%, energies, and line pipe to 10%.

So there's just a lot more diversity. And of course, with the footprint in USSK and then also with energy, this really bright spot with Tubular but also Big River. There's a strong OCTG demand there as well. And Gary, Gary line pipe. That's a good deal, too. So as Kevin said, the brightest spot in the book is energy.

And again, the short-term uncertainty, uncomfortable. But what better time to have \$3 billion in cash and over \$5 billion in liquidity? We can navigate through anything and still make sure we're pleasing the stockholders.

Operator

Thank you, and that does conclude the Q&A. I'll now turn the call back to U. S. Steel's CEO, for any closing remarks.

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

Thank you for your time this morning and your interest in U. S. Steel. It's been another incredible quarter, and we look forward to continuing to demonstrate the increasing power of our Best for All strategy.

None of this is possible, however, without the commitment and hard work of our employees who deliver for our customers every day. We were recently awarded a top score of 100 from the Disability Equality Index and are among the Best Places to Work for Disability Inclusion. We are pleased to see the recognition for and our commitment to a workplace that works for all. We appreciate our employees. Thank you for using your talent to drive our business forward and for doing it safely. When you do well -- when we do well, you do well, and we're pleased to continue to reward you with record pay to match record performance.

Of course, none of us could do this without our customers. Thank you for entrusting your products and reputations with U. S. Steel. You continue to deliver the quality steel you need to meet your own customers' demand. We look forward to growing with you towards a greener future.

And finally and importantly, to our investors, thank you for your continued support of our mission and strategy. We're aligned on executing the strategy while rewarding you with continued direct stockholder returns in line with our capital allocation priorities. We look forward to our shared success in becoming the best steel company together. Now let's get back to work safely.

Operator

Thank you very much, and this concludes the call for today. We thank you for your participation and ask to please disconnect your lines.

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