

ArcelorMittal (MT) CEO Aditya Mittal on Q2 2021 Results - Earnings Call Transcript

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Q2: 2021-07-29 Earnings Summary

SlidesPress Release

EPS of \$3.46 **beats by \$0.76** | Revenue of \$19.34B (76.23% Y/Y) **beats by \$280.53M**

ArcelorMittal (NYSE:[MT](#)) Q2 2021 Earnings Conference Call July 29, 2021 9:30 AM ET

Company Participants

Daniel Fairclough - IR

Lakshmi Mittal - Executive Chairman

Aditya Mittal - CEO

Genuino Christino - EVP and CFO

Simon Wandke - EVP and CEO, Mining

Conference Call Participants

Alain Gabriel - Morgan Stanley

Jack O'Brien - Goldman Sachs

Tom Zhang - Barclays

Luke Nelson - JP Morgan

Philip Gibbs - KeyBanc Capital Markets

Patrick Mann - Bank of America Merrill Lynch

Justin Cook - Exane

Alan Spence - Jefferies

Rochus Brauneiser - Kepler

Bastian Synagowitz - Deutsche Bank

Grant Sporre - Bloomberg

Christian Georges - Societe Generale

Carsten Riek - Credit Suisse

Myles Allsop - UBS

Philip Gibbs - KeyBanc Capital Markets

Daniel Fairclough

Good afternoon, and good morning everybody. This is Daniel Faircloth from the ArcelorMittal Investor Relations team. Thank you very much for joining today's call.

The focus is to discuss the results of the first half 2021 and the strategic progress of the team at ArcelorMittal. This was covered in depth in a detailed presentation published alongside our results this morning.

So as usual, the format of this call will be some opening remarks from Mr. Mittal and Aditya followed directly by a Q&A session. So as such, we should be able to complete this call in about 45 minutes to an hour.

First, some housekeeping. [Operator Instructions]. I'd also like to remind you of the disclaimers in our presentation, and also the fact that this call is being recorded. And with that very brief opening, I'll hand over to Mr. Mittal.

Lakshmi Mittal

Thank you, Daniel. Good day, everyone. Thank you for joining today's call. I hope you're all keeping safe and well. I'm joined on this call by Aditya Mittal, our CEO; Genuino, CFO and our Head of Mining, Simon Wandke. Today's an important day.

We have reported our best set of results since 2008, even keeping in mind the reduced scope, which is very satisfying to see. We have also announced a new target for the Group to reduce our carbon emissions by 25% by 2030. These targets are very important.

Turning first to our financial performance, as I mentioned, this was the best quarter since 2008 by some margin. Performance improved in all the steel segments. Net income for the first half was \$6.3 billion and includes a \$1 billion contribution from JV's highlighting strong performance at ArcelorMittal Nippon Steel India, and ArcelorMittal Nippon Steel, Calvert.

Now I will hand over the floor now to Aditya. Aditya?

Aditya Mittal

Great, thank you. And good day to everyone. I hope you're all keeping safe and well. Before I attend to our second announcement of the day, which is a carbon report let me first address our health and safety performance.

In the first six months of the year, we have reinvigorated our Global Health and Safety Council, which provides leadership and guidance to all our segments. We have done this because although we compare favorably with the industry, we're not satisfied with our safety performance. All segments are adopting new initiatives and I'm hopeful we will see improvement in our safety performance as time progresses.

Despite the COVID-related turbulence of the last 18 months, our actions to streamline and optimize our business and balance sheet put ArcelorMittal on the strongest footing it has been for many years and positions us well to address one of the biggest challenges the global economy has faced, decarbonization. As we talked about, at the time of our 2020 results in February, our ambition is to lead our industry's efforts to decarbonize. This, I hope is reflected in our second Group Climate Action Report, which we have published today.

The report details the new Group wide target of a 25% reduction in carbon emissions by 2030. We have also increased our European target to 35%. These are ambitious targets and it will be a big challenge. But there's a lot of positive engagement across the company to show the world what steel is capable of. As you know, engineers love a good challenge. And there's arguably no greater than this.

We estimate capital investments of \$10 billion to achieve these targets. Given the technologies that will enable these reductions are not yet competitive, we're looking for equal support through targeted policy that takes into account both the initial capital spend and the higher operating costs during the transition period. We're continuing to base our transition plans on the two technology routes we've talked about previously i.e., Innovative DRI and Smart Carbon. But as it stands today, the 2030 target will lead more towards Innovative DRI, particularly in Europe, where national governments are prioritizing the availability of green hydrogen at competitive prices.

This underpins our recent exceptional announcement that ArcelorMittal Sestao will become the world's first full scale zero carbon emission steel plant by 2025. There is a lot of information in the report about how ArcelorMittal will decarbonize, which I hope you will find useful. Steel is already the material of choice due to its lower carbon footprint and infinite recyclability. The world will continue to need ever increasing amounts of steel. That won't change. But the way steel is made will. We hope to be at the forefront of this change.

So in summary, we continue to enjoy strong market conditions, and are doing all that we can to ensure that we take maximum benefit from them, while simultaneously transitioning for longer term success. Thank you. We're happy to take your questions.

Question-and-Answer Session

A - Daniel Fairclough

Thanks Aditya. So we do have a queue of questions forming. [Operator Instructions]. And we'll take the first question please from Alain at Morgan Stanley. Go ahead Alain.

Q - Alain Gabriel

Yes, good afternoon, everyone. I have two questions. The first one is basically on your JVs and Associates. It seems that it doesn't matter how high the profits go, in India or Calvert, the market still chooses to ignore them. I guess the attributable EBITDA in Q2 annualized alone is around \$2 billion. It's not clear to me how you plan to convince the market to recognize the value of these assets. Would a partial listing be an option or maybe a buyout of your partners? What's your thinking there? That's the first question.

Aditya Mittal

Thank you. I appreciate the question. I think it's not just a matter of the JVs, right? If you look at the results today, the EBITDA performance, level of shareholder return or even our net income, I think, overall, we're being undervalued. So I think our improved disclosure on the JVs at least helps emphasize what the JVs are worth. But there is an overall value issue when you look at the company.

Alain Gabriel

Thank you. And my second question, is around your dividend policies. Should we expect the semiannual capital returns to become the norm from here onwards, and then comes the yearend will you be very close, if not net cash? Are you starting to think about an update of your capital returns policy somewhere above the 50% that you said? Thanks.

Aditya Mittal

Sure, thank you. We just announced the capital policy in February. There's no plans to change our capital return policy. I think it's quite effective. I think what we did in the second quarter demonstrates that we've also utilized the proceeds from the sale of AM USA and return that to shareholders. So as far as we're concerned, the capital policies is well-positioned, works well. Clearly, we have strong visibility of cash flows in the second half, and therefore we decided to prepone the dividend, but I will not read this into anything other than that. There's no plan to change the policy.

Alain Gabriel

Thank you. On the recurrence of the H1 or the semiannual dividends.

Aditya Mittal

Genuino?

Alain Gabriel

Is that a one-off?

Genuino Christino

Generally. Yeah, so Aditya just said, so we are not really reviewing the work date in the policy that. So our commitment as you know, is to distribute 50% of our free cash to shareholders. So that is not changing. Now the timing, I mean, as Adi just said, that we just felt that at this point in time, it's a knowing grant, given our expectations for acceleration of free cash flow generation in the second half. But as he said, I mean, you should not read that we are at this point in time changing our policy.

Alain Gabriel

Thank you.

Daniel Fairclough

Thanks a lot. So we'll now move to the next question please, from Jack at Goldman Sachs.

Jack O'Brien

Hi, good afternoon. Thanks for taking the question.

Aditya Mittal

Hi.

Jack O'Brien

[Indiscernible] contract you imply, as it stands today, a combination of the rent pricing last quarter and current quarter, and just interested based on the strength in the market, the extent to which you could amend your contract structure going forward such that it's more predicated on spot prices so that you don't leave dollars on the table.

Aditya Mittal

Genuino?

Genuino Christino

Yeah, Jack so our focus is really to make sure that when once these contracts come back on the table for renegotiation, then we can seek the spot prices that we are enjoying today, tight. I mean, I think it's fair to say and we have been discussing that this year, these contracts in terms of profitability, they were of course lower than what we could secure on the spot market. So you're absolutely right. So that will be our focus as we sit with the OEMs to negotiate these contracts.

I mean, I guess all we want is our products should be fairly valued. But having said that, at this point in time, we are not really considering changing the structure of the contracts. So that's not really high on our agenda at this point.

Jack O'Brien

Okay. Second question, thank you for detailed climate report updates, and fascinated to read all about your latest activities in Spain and what that will entail. You touched briefly, Aditya just on the fact that prices on a unit cost basis will be higher. Can you give any color there on what we should expect per ton?

Aditya Mittal

Sure. Thank you. Yeah, so we have not detailed that specifically. But I can give you a sense of the trends, so you can model it. I think the first thing I must emphasize is that it depends on geography, because it's highly dependent on energy prices and the cost of iron ore, etc., etc. So if you look at the European geography, when you convert a typical coal based blast furnace into a natural gas-based DRI facility, the energy cost increases, because natural gas used in steel processing is more expensive. You also have to use a different type of metallics. And then clearly, that also comes at a higher cost. And then on top of it, you're using electric energy to melt.

So those are the three input parameters, which change. That's just us assuming we use a simple DRI EAF natural gas route. Roughly, I think what we're suggesting is that when you look at the CO2 costs today, in Europe, the change in cost as a result of going down this new route is a wash. So there's no real benefit, based on existing CO2 pricing. So that gives you a kind of a guide. Clearly in some markets it's more favorable, if you have a smaller delta, etc., etc., but that gives you an order of magnitude of how these things work.

And then if you don't go down the smart carbon route, it's a different set of economics, that depends on what you get for your biofuels, or for your provision of chemicals, biochemicals, chemical sector, etc., etc. But fundamentally, when you look at these various routes to decarbonize, there is an increase in OpEx. And roughly speaking the CO2 benefit does not create significant net benefits.

Jack O'Brien

Thank you very much. And just one final question just on the carbon border adjustment mechanism. Would love to hear your thoughts on the pros and cons of that, as you said today?

Aditya Mittal

Yes, so fundamentally, the carbon border adjustment is critical, because it creates a level playing field. And the steel industry needs a level playing field to remain competitive. So if you look at the discussions that are ongoing in Europe, that is the intent. Clearly as the allocations reduce, there will be a carbon border adjustment, which will match the reduction, so that there's a level playing field. And this is important, because then there is an incentive to decarbonize, there's a market structure to decarbonize, otherwise producers, which do not have a carbon cost can obviously undercut companies which are decarbonizing.

On a macro basis I think this is good. It's a good development, because it forces other regions and other countries to also implement carbon plans and similar systems like, that exist in Europe, so that they can be -- they can have access to the European market. We see some developments, like I think China has announced that they now have a carbon price. And so I think the carbon border adjustment achieves two objectives, not only creating a level playing field on a regional basis, but also motivates others to accelerate their carbon -- decarbonization plans.

Jack O'Brien

Okay, thanks very much.

Daniel Fairclough

Thanks, Jack. So we'll take the next question now from Tom at Barclays. Go ahead, Tom.

Tom Zhang

Hi, everyone. Thanks very much for taking my question. I've got two if that's okay. I'll take them one by one. First of all, just on the decarbonization, you were talking a bit about differences in geography. I was wondering if you could comment a little bit about your plans outside of Europe. Maybe a breakdown of the \$10 billion costs sort of what is your, what is rest of the world and just sort of your thoughts on the level of government support that you might expect? Because I think in the presentation, in the appendix, you only specified Canada [ph] is somewhere where there's a there's an active regulatory environment.

Aditya Mittal

Sure. So, Tom, we have not detailed out the CapEx by region. But I can give you a sense that fundamentally, the majority of the CapEx will be in Europe, as a majority of the savings embedded in the report are in Europe. Other than that, when you look at the regulatory environment, I will discuss two areas. One is obviously you mentioned, Canada, but there's also Europe. And if you look at the legislation in Europe today, they have these various programs, whether it's IPSAY or the Innovation Fund, there's also a change in state aid legislation. And the intent is that there needs to be some level of support for hard to abate industries to decarbonize and steel is one of them.

I think there's a recognition that today the capital spent has limited returns, and therefore there needs to be fiscal support to motivate and accelerate this capital spend. At the end of the day, I think regulators and industry players like us have a shared goal, which is to decarbonize and we are sitting across the table and figure figuring out how best to do that. Based on the discussions we have had so far, I'm quite constructive, I'm quite optimistic that we will find a path to share the cost of decarbonization.

Tom Zhang

Okay, very clear. And maybe second, just, if you wouldn't mind giving an update, I want to regionally for order books, particularly interested on CIS where there's a little bit a little bit more weakness in spot pricing, and whether or not we might expect to see that already in Q3 or if it's more of a Q4 phenomenon. Thanks.

Genuino Christino

Okay. So let me take this one. So why don't we talk a little bit about the drivers for Q3 overall? I mean, not only CIS is that maybe that is helpful for everyone. So starting with shipments, so our speculation is that we should see shipments in Q3 relatively stable, slightly higher at Group level. We are not really seeing -- we don't expect to see a lot of seasonality in Europe, as typically we've seen a recovery year, such as this year 2021. So CIS continues to do well, I mean, in terms of shipments, and we actually saw a nice recovery, also in our South African operations this quarter.

So we don't expect weakness in terms of shipments in CIS. The rest of the division is also doing quite well. Brazil as we continue to run full and also NAFTA. Prices as you know, because of lags, we expect prices continue to rise. And it should be the case in all of our segments. But at the same time, cost is also rising. But when we put all together, obviously the expectation is that profitability should expand. Of course, you have to take into account also the disruptions that we had in our mining division, that we don't expect to reoccur as we move into Q3.

But on the flip side, you probably saw that we had a positive result in our segment orders. And this is primarily linked to the fact that we had the disruptions in our mining divisions, as some of the inventories that we have in our steel division, of course got consumed and not replenished by supplies coming from mines Canada and Liberia. So as operations come back to normal, then we would expect that also to reverse as we move in to Q3 and Q4.

Tom Zhang

Okay, thank you. And just to follow very quickly with Europe and NAFTA, are you booking now well into Q4, what length of books looking at specificity?

Aditya Mittal

Yeah, order books continue to grow as we speak. And so we don't see signs of weakness in our order book. We are booking well into Q4 in Europe and in NAFTA.

Tom Zhang

Okay, great. Thank you. I'll turn it back.

Daniel Fairclough

Thanks, Tom. So we'll take the next question please from Luke at JPMorgan.

Luke Nelson

Hi, thanks for taking our question. First on decarbonization, and obviously the detail around the \$10 billion CapEx to decarbonize by 2030. If I just think about the 2025 target, where around 35% of that \$10 billion is planning to be spent. Can you give us a bit of a framework around how that CapEx will be deployed? Can we sort of think around a sort of divided by four years remaining, so \$800 to \$900 million per annum run rate, obviously, on 100% share, assuming, and whatever the government spends will be a benefit to that> But broadly around that level.

And then historically, I think you said \$3 billion, CapEx, or sustaining was the base, in line with D&A. So should we be thinking \$3 billion plus \$800 million to \$900 million? So towards \$4 billion? Is that sort of relevant level, obviously, again, before any governmental support? And that's my first question.

Aditya Mittal

So Luke, let me take this question. So as you know, I mean, it's not really our policy to guide to annual CapEx beyond the currency, right? But I can help you frame your expectations. So I think number one, so you have as a basis, our CapEx guidance for this year, right? 3.2 billion. So this is basically covering the sustaining CapEx as well as the strategic projects that we have underway. We have also provided, as you know, our strategic CapEx envelope. It's \$1.5 billion through 2024. So basically, four years. And for that, we expect about \$0.6 billion in EBITDA benefits.

The projects as you know, talked about completion of the hot strip mill in Mexico, our project in Brazil and the expansion of Vega, Liberia, but we do have some interesting high return CapEx opportunities within the portfolio. So our expectation is that this envelope will not get smaller as we complete Mexico. We will have some other projects. So in reality, I believe we can actually expect this envelope to be bigger. But as and when some of these strategic projects pass through the appropriate approval process, we will update you and explain the projects.

And then on top of this, I mean, clearly we have decarbonization CapEx and we have said this \$10 billion through 2030, of which \$3.5 billion to be spent through 2025. This is of course, a gross number as you said, so you should assume some of these are supported by public funding, but we will update you as and when this is approved. So I think in conclusion, you should not expect CapEx to be declining. So we have to fund the decarbonization transition, and we have some interesting high return opportunities within the portfolio.

Luke Nelson

Okay, great, that's really useful. And then just on to the prior question on the sort of certifiers and carbon border adjustment mechanisms and changes to the ETS. With these decarbonization framework now to 2025, and then ultimately to 2030. How should we be thinking around exposure to carbon and carbon costs? I think in the past, you'd indicated over the very short term, there was a minimal impact from pricing, or carbon

costs increasing from current levels. But now, given the sort of more aggressive change in targets in Europe, does that in any way affect how we should be thinking about that exposure to CO2? Thank you.

Lakshmi Mittal

That's really the challenge that we have in front of us, right. So -- and that's why we are very much focused on progressing with our decarbonization. So you're absolutely right. As we progress and the free allowances reduce, that puts pressure on us to also reduce our emissions so that we can offset this impact, right. I mean, that's the challenge. That is also -- a lot yet has to happen, right. So this proposal just came out and we expect a lot of debate discussion. It's probably a little bit too early, but we know that what is the direction right? So we know that it's the second phase of Phase 4, who will see and will experience declines in free allowance.

So it's up to us to accelerate as much as possible our emissions so that we can offset that. I did talk about also, you cannot look in isolation the free allowances. I think you have to also take into account the border, as Adi just said. It's all about having the right level playing field. So looking at aggregate, looking what we have in terms of plans, we feel confident that we're going to be able to navigate through this transition phase.

Luke Nelson

Thanks a lot.

Daniel Fairclough

Thanks, Luke. So we'll move now to Phil at KeyBanc.

Philip Gibbs

Thanks very much. My question broadly is just on automotive. Obviously, there's been some production costs and some expectations that have been more muted as the years gone on given supply chain challenges. And what are your expectations for that end market moving ahead?

Aditya Mittal

Yeah, thanks for the question. I think Genuino talked about it, right. We're very focused on getting fair value for our products. These contracts have been very painful this year, because they were negotiated when the price environment was very different for what it is today. We still have these contracts in our business, some of it is coming off in the second half. We have contract lag effects in the second half. But our focus means -- focus remains to get fair value for our business as we enter these negotiations.

Philip Gibbs

More so the question was just on the demand side in terms of what you're seeing, not necessarily on contract pricing.

Aditya Mittal

Sure, thank you. So on the demand side, there's some impact of this chip shortage. But overall, automotive volumes clearly are better than they were last year. The visibility remains limited into 2022, because everyone is still working through the chip shortage, and it's slightly different OEM to OEM. But fundamentally, the trends remain very strong.

Philip Gibbs

Thank you. And if -- and if I could do one more here, just on the net working capital side. I know that's a little bit of elusive because the market keeps evolving. But is the expectation in the third quarter that you'll see a similar build that you saw in the first half in terms of rate, or should we anticipate that that rate slows?

Aditya Mittal

Phil, I mean, as you know, I mean, we don't really provide very specific guidance, [Indiscernible] guidance. But as we have been saying, I mean, the message is basically the same. So we continue to -- before we are focused on making sure that we retain our efficiencies that we work very hard to achieve in 2020. So far in H1, as I'm sure you saw \$3.5 billion of investments, and this is really a function of the higher prices, high shipments, high raw material price. So we see it as a good investment in business [ph] right.

So going forward, I mean, it really depends on your assumption. So if you have high EBITDA in the second half, then I think we should assume that will continue to be investments in working capital. But clearly, as we know, the last part of December, because of the holidays, typically we have some lower levels of activity. So you have to take that into account. But if your assumption is high EBITDA levels in the second half, then you should expect investments in working facilities.

Philip Gibbs

Thank you.

Daniel Fairclough

Thanks, Phil. So move to the next question, please, from Patrick at Bank of America.

Patrick Mann

Good day, everybody. Thank you very much. I just wanted to follow up maybe on the capital allocation and the share buyback question from earlier. So you brought forward a \$1 billion from 2022 for this quarter. Is it possible that, at Q3 you could look at how the

business is doing and possibly look at something like that again, to smooth it out, or is -- this a you know, this is it till the end of the year now?

Aditya Mittal

Yeah, Patrick, so I think it's -- so we have a lot now on our plate, right? So we just announced this \$2.2 billion program. It's much higher than the previous four programs that we have completed. So we are giving ourselves five months to complete this new program. So we should not underestimate the work that we have in front of us, right, especially because we have some technical limitations in terms of the volumes that we can buy and the prices that we can buy. So it's not that straightforward.

So it's early to talk about launching new buyback in q3. Let's see how we progress, how we do, how fast we can complete this one. What is the situation, but as a data set at the beginning, should not read that this is a change that we're going to be announcing this on a quarterly basis.

Patrick Mann

Got it. Thank you. That's very clear. And then just one more follow-up please, on the otters outlook. So there's a bit of a narrative around that maybe the OEMs are still taking delivery of steel, even if production is being slowed down because of chip shortages. And so when they rebound, or the chip shortages, ease, there might not be the kind of increased volumes from steel that we might be expecting. Have you seen any evidence of kind of the autos companies stocking up on steel? Or, you know, should we think about it that the volumes out of you are exactly matched to kind of what the OEM's production profile are?

Aditya Mittal

Yeah, thank you. So it's exactly matching. We have just in time delivery systems. There are EBIT interfaces, we're connected to specific platforms. So it's a, it's an integrated supply chain almost. And so to build inventory in the system, to try and achieve that is very difficult. And so we have not seen any evidence of that.

Patrick Mann

Brilliant. Thank you very much.

Aditya Mittal

Thank you.

Daniel Fairclough

Thanks, Patrick. So we'll then move now to Justin at Exane. Go ahead.

Justin Cook

Yes. Hi. Thank you for taking my question. Regarding the guidance, you don't expect demand to deteriorate, you see positive momentum in spreads and less severe seasonality. How should we really interpret that? So do you believe the market right now? It's maybe in a more sustainable footing as of today as in the past, and that maybe the metal spread and margins can be higher than in the past? How do you view a bit the sustainability of this cycle?

Aditya Mittal

Sure, thank you. So I think it goes back to the first question, which was on valuation of JVs, and I responded by just look at the fundamental valuation of ArcelorMittal. In terms of market dynamics, look, today, demand is robust in all the markets in which we operate. We issued revised apparent steel consumption numbers. I know we sent you guys a lot of information this morning. But for anyone who's interested, it's on page 30 of our presentation, where you can see double digit growth in almost all the markets in which we operate and global apparent steel consumption excluding China growing at 12% to 13%.

The question was asked on automotive inventory where because we don't see any build up the same is true, more or less across the board, we have not seen the restocking of inventory. So these apparent steel growth numbers match well with real steel demand growth. And I think it was a lot of discussion. As a business we have not seen the full impact of spot pricing. The contract lag effects will come in the second half.

On the medium term to macro look, it's always dangerous to expect it to forecast. But fundamentally, if you look at a macro snapshot, if you look at the past 10 years, and you look at the next 10 years, I think there are three changes that are worth mentioning. The first has been the change in China. There has been real action to eliminate the export VAT rebate. It was first just on hot pan. This morning. It's also been announced on cold roll and hot dip. There's a lot of chatter in China on reducing export of steel because why have excess carbon production within China and export the steel chatter on export taxes.

Russia has done that actually they have implemented Russia export taxes. So the change in the Chinese steel industry I think can be very significant, over the next five to 10 years. Simultaneously, we spent a lot of time talking about our decarbonization plans with which clearly we want to leave the steel industry we have the capability to do that. But there are also effects on the demand supply balance of the global steel industry. We see new pockets of demand. This is renewable energy, whether it's wind or solar, but also I think the whole energy infrastructure will have to be rebuilt. And clearly, that's a positive for steel demand.

And in terms of supply, I think there's limited interest of anyone to just grow steel capacity. I think clearly their focus is to decarbonize, as you see from our announcement this morning. So I think that's another positive trend. And I think we all saw post COVID, the amount of stimulus funding that has been -- that has started in various markets. And

clearly again, as you know, steel is very tied to infrastructure. So we see a lot of investment infrastructure. Again, that's positive for overall steel demand.

So that just provides an overall perspective, where we think that the next 10 years should be better than what we saw the last 10 years. And clearly, the market environment presently remains very strong.

Justin Cook

All right, thank you. I just have a quick follow up, changing topics and going back to EPS. There are some peers in Europe that have started to implement carbon surcharge. And it's something also you would be considering?

Aditya Mittal

Yeah, I think that's a fair question at this point in time. We have not come to a definitive decision. Clearly, at this point in time we're not doing that. Our focus is not so much as a carbon surcharge. But our focus is how do we decarbonize our business effectively. And that's what we are trying to achieve with the report this morning. For example, in Europe, we have accelerated our ambition, from 30% by 2030, to 35%. And that includes scope two as well before closure of scope one. So scope one and two, 35% reduction off a 2018 baseline.

We also are in the market with various XCarb products. So an XCarb product fundamentally, is moving towards carbon neutral steel. We have two products, one is green steel certified where a customer buys a green steel, a steel product from us, which is certified to be carbon neutral. So they get the benefit of their scope 3 emissions. And we have recycled and renewable steel. And based on all the discussions we were having with our customer base across various segments, I think there is a very high level of interest. And we have been very positively surprised by the interest that the market has in the products that we have to offer.

Justin Cook

Right. Thank you.

Daniel Fairclough

Thanks, Justin. So we'll move now to Alan at Jefferies. Go ahead Alan.

Alan Spence

Thanks. Just have one left, it's on the hot strip mill in Mexico that going to be wrapped up pretty soon. The guidance you've given around \$250 million contribution after ramp up I'm assuming is under more normalized spread assumptions. That was operating now. What do you think it can generate?

Aditya Mittal

Yeah, so I think you guys know the price of hot band, you guys know the price of slab, so the margin would be quite significant. And so we're focused on getting it up and running. It's a great project and not only for this market environment, but for the foreseeable future, because not only for the EBITDA that we will create, but it will change the profile of our Mexican flat business. We did that successfully in Tubarao in Brazil. So if you looked at our business in Brazil, 10, 15 years ago, it was primarily a slab producer. Today it is amongst the largest domestic players.

So from a 2.5 million tonne slab producer today's it's 7.5 million tonnes slab producer with a hot strip mill with capability of 5 million tons. It has automotive capability. And clearly we are an important player in the domestic market. And the same applies to Mexico apart from the EBITDA. I think it was a strategic change. Because what we're doing is we're changing the profile of the business from an export or semi-finished steel to a downstream finishing manufacturer.

So but I get what you're saying. And if it was six months earlier, we'd be even more thrilled.

Alan Spence

Okay, thank you very much.

Aditya Mittal

Thank you.

Daniel Fairclough

Excellent. So we'll move now to Rochus at Kepler.

Rochus Brauneiser

Yes, thanks for taking the question. I have -- first one question on the EBITDA outlook for Q3. I think you explained most elements. What I'd like to understand to what extent you have been benefiting from windfall gains in your distribution business in the second quarter like most of the peers, and how shall we think about directionally whether -- to what extent this number will be lower in the third quarter?

Aditya Mittal

Rochus, this is a little bit too specific. So I think in my message, trying to help you guys to model quarter 3, we talked about the big drivers, right. And the fact that our expectation is that profitability should continue to improve, right? We are not really seeing any significant impact in our distribution business, and in the overall picture of the group. That doesn't make such a large impact to change how you model the [technical difficulty].

Rochus Brauneiser

Okay, fair enough. And then can you also update us on the overall envelope for your cash needs on taxes and others, as obviously the tax expenses will go up? And can you remind us on your kind of normalized tax rate we shall consider for 2021?

Genuino Christino

Yeah, yeah. So we talked about the CapEx, right. So that's one change. And then we are not really changing our guidance for the interest component. That remains the \$300 million. And then really, the only other moving part, of course, is taxation, as you said, and we continue to believe that for the year you should assume that our ETR should be in the range of between 15% to 20%, right. And in the past, we have always said that, for the extra EBITDA that you take compared to last year, you can apply as a rule of thumb, 15% to 20%, that is in line with our expectations for ETR this year.

Rochus Brauneiser

Okay, great. And coming back to the \$10 billion CapEx you're flagging in context just to decarbonization. Can you give us a rough split how that applies to the investments into HTRI? And how much will be reserved for [indiscernible], could be reserved for smart carbon and other elements? And in that context, can you give us a sense about the timeframe you expect until a regulatory framework is in place, which would allow you to start with the actual CapEx you're considering?

Aditya Mittal

Yeah, sure. So in terms of the CapEx, I think the most CapEx intensive is really the DRI EF. So a significant part of the CapEx is DRI EF. The other benefits of our investments are electric furnace capability, or scrap processing capability, where we can enhance the use of scrap. And then we also have solutions, which don't require that much of CapEx to decarbonize.

In terms of smart carbon, it is part of the overall CapEx envelope, but it's not as significant, clearly as the DRI EF route. And again, that's driven by the maturity of those technologies, the value that we can create out of those technologies and the regulatory support as well, surrounding those technologies.

In terms of when we can start, look, we're very focused on hitting the ground running. We talked about 30% to 35% of the CapEx in the first half of this decade. We talked about style where we want to be ready with a full scale zero carbon emission steel facility by 2025. So we're working with all key stakeholders on that timeline.

Rochus Brauneiser

Okay, and is it possible that you share with us kind of a rough figure to what extent the 35% decarbonization target for 2030 is being achieved by the usage of HTRI, and other tools?

Aditya Mittal

Yeah, so that's a fair question. So just for everyone else on the call, the global number is 25%. And the European number is 35%. So that [multiple speakers] yeah, just to make sure. If you go through the carbon report, I know it's quite extensive, and we just published it this morning. But there is a nice waterfall and it's also in our investor presentation, I think on page nine. And where you can see the key initiatives that we have, which basically show the global 25% carbon reduction.

So a significant portion of this is steelmaking transformation, which is primarily DRI EF using natural gas. We're not planning -- yes, of course, we will be using some hydrogen. But this plan is not based on -- the success of this plan is not based on hydrogen. It's based on the other initiatives that we have outlined on this chart. So this is clean energy, scrap use, energy transformation, offsetting residual emissions, as well as steel making transformation.

Rochus Brauneiser

Okay, thank you very much.

Daniel Fairclough

Great. So we'll move to next question, please from Bastian of Deutsche Bank.

Bastian Synagowitz

Yes, thanks gentlemen. Good afternoon, gentlemen. I only have two quick follow up for the decarbonization capital if I may. So if we look at your positioning as a company with presence in many countries, in my view, you got probably one big advantage with the PSES as a starting point, you can basically pick and choose and you can go in static urbanization wherever you see most support. And that obviously puts you with a whole lot of pressure on the governments wherever you operate and basically puts these governments also in competition.

So when you look at the \$10 billion program, is the funding support, which we should expect here for the decarbonization CapEx similar to what we're seeing at this point? Do you indeed expect the government to absorb their fair say 60% share, as we've seen in the past project?? I guess the visibility is probably better on the \$3.5 billion part, which you expect to be spending until mid-2025. But maybe you can give us your early view on the whole program, please? This is my first question.

Aditya Mittal

Yeah, sure. So maybe a few points, fundamentally, when you go through our carbon report, we have also broken up the regions into accelerate, regions which we think are accelerating and regions in which we're moving, which we define as move. And so a lot of our decarb -- carbonization CapEx intensive investments are in the regions which are accelerating.

On your second point, I agree with you, I'm convinced that ArcelorMittal can lead the way. Not only do we have the best talent in the steel business, they're diverse, committed, motivated, but we have been, and are the technology and R&D leader. We have size and scale advantage. And as you mentioned, we have a head start, right, we have launched our XCarb product suite. We have launched our XCarb Innovation Fund. We have investments under the smart carbon route. And we are the largest DRI producer in the world.

So we know how to run DRI, we also know how to run ES, 20% of our overall group production is to the electric furnace route. In terms of the regulatory support, I think you're right that we are starting off, and clearly there's greater visibility in the medium term. But we believe that based on the conversations we're having, that there's a shared interest. And there's a recognition that capital returns on decarb investment are limited, and therefore there needs to be appropriate regulatory support.

Bastian Synagowitz

But it's probably too early to say whether you will, on average basically get close to that 50% ratio.

Aditya Mittal

Our focus is 50% funding support. That's what you see in terms of legislation support or intent. And if you look at the renewable sector, I mean, for about 10 years, there was significant support provided to the renewable sector.

Bastian Synagowitz

Okay, thanks. Thanks, Aditya. Then my second question is a more technical one actually related but technical also. So the decarbonization CapEx obviously will flow through your CapEx minus the gross number and then separate to that you will have the funding support via grants, etc., as you just discussed, and that's obviously more like a mitigating item.

Where should we expect those mitigating items and the grants to flow through? And are they technically easing the CapEx burden in your FCF definition? Or will they possibly flow through your cash flow statement below that i.e. in the financing line? So maybe you can give us some early guidance here, because obviously that will determine your free cash flow probably would feel be handing back to shareholders as well?

Aditya Mittal

Yeah. Go ahead, Genuino.

Genuino Christino

But Aditya I was going to address. It's a technical question. So to the extent that you have the grants and grants, specific to that particular project, then most likely what

you're going to see is CapEx for -- in that amount. So you're going to have the gross minus the benefits. So it's going to depend a lot on the form of the grant. But our expectation is, as I said, to the extent that they're clearly linked, that you're going to see a net amount.

Bastian Synagowitz

Okay, so you net it out directly. Great. Okay. Thanks, Genuino.

Daniel Fairclough

Thanks Bastian. So we'll now move to Grant at Bloomberg Intelligence.

Grant Sporre

Hi, good afternoon. Thank you. Good afternoon. Yeah, going to change gears slightly, just slightly more detailed question. Just on the cost line in Steel Europe, I noticed you deconsolidated Ilva. And I would have thought that the cost would sort of go down. If you could just sort of maybe just give us a little bit more color on the dynamics of how the costs evolved in Steel Europe. That would be my first one.

And then the second one is just on the CapEx, I know it's a small number in the big scheme of things, but is that just simply to do for higher refurbishment and more sustaining capital because of the higher activity, or you are actually just -- are you adding a little bit or you're debottlenecking, certain areas of your production base. Thanks very much.

Genuino Christino

Grant, so on the first part of your question, on the cost in Europe, the dynamics that we are seeing, and if you go back, you will see that -- I don't know, prices continue to -- they have been rising now for a number of quarters, right. We saw also coal also moving up this quarter, scrap prices, energy. And that takes some time for the impact of these costs to impact our result, the same way as selling prices, right. So they are inventorized. So it takes a little bit of time. So what you see in Europe is pretty much similar to what you see in other parts of our business as well. So you have this high costs also flowing through our results, right?

In terms of terms of CapEx, so this is really -- it's not really a new debottlenecking or so based on our previous expectations, so we were not assuming that we would be running all of our facilities full all year round, right. And that's exactly what we see right now. So as a result, I think we have to allow some higher maintenance CapEx so that we can keep production stable, we can maximize production and try to benefit from this strong markets that we are enjoying right now.

Grant Sporre

Okay, thank you. So just on the costing in Europe. So basically, what you're saying is the cost benefit that you would have got from deconsolidating Ilva was totally overwhelmed by the increase in the raw material cost?

Genuino Christino

Well, I mean, you were in terms of costs, yeah. So that's probably a good way to see it. I mean, costs are rising, and they are rising across the board. So there is an offsetting element to that.

Grant Sporre

Okay, great. Thank you very much.

Daniel Fairclough

Great. So we'll take the next question, please from Christian at SocGen.

Christian Georges

Well, thank you. Genuino, just going on, on what you were just saying. If we look to NAFTA, there we seem to be seeing a quite impressive cost reduction. I'm talking about your costs, excluding raw materials where I'm seeing like 30% 40% in the second quarter. In that quarter, you had some specific elements which support a very low cost of activity? Or is this something we should be looking at as a new cost base, after you sold out the more expensive part of the business.

Genuino Christino

That's one aspect Christian, but that happened already in -- so I don't know what is the reference, so what are the periods that you are comparing? But in Q1, I mean, as we highlighted, we have some issues, because of the winter impacted our productions in Mexico. And at that point in time, we said that it was about \$30 million impact. So that is of course not reoccurring again. And NAFTA of course, they have some level of integration to, I don't know, especially Mexico, right, that we don't really have in Europe. So you will have that in CIS.

But that's really -- but then the other items, the units that are exposed to raw materials such as the [Indiscernible], that sort of trends will be will be similar.

Christian Georges

Okay, so that Q2 would be the normal kind of environment based on your --

Genuino Christino

I mean, -- so the same trends right? So it depends what happens to, I don't know price. So we closed Q2 with an average of 200. Let's see, we have seen prices going a little bit higher. Coal prices specifically higher though that should not really impact so much our

NAFTA operations this year because we have yearly contracts. But that's what you should take into account.

Christian Georges

Okay, and a separate question on DRI. So you're going to have one DRI in Spain, you kept one in the Hamburg, I think, one in Quebec. As you're saying you are the largest operator. You're going to get one for free I suppose in Italy. If we go forward in time, as you potentially convert more of your blast furnaces, is the idea that DRI should be located next to the electric furnaces, is that most cost efficient? Or should we expect you to have to either buy your DRI from outside or have another location where you can produce DRI for whatever needs you may have?

Aditya Mittal

Yeah, sure. So look, there are advantages of having the electric furnace next to your -- sorry, having the DRI next to the electric furnace clearly, like hot charging of DRI is one, that we do in some of our facilities where we have DRI right next to our EAF. And then you have to look at the energy balance as well. I mean, if energy is very expensive, where you're making steel, then maybe you situate the DRI somewhere else. And then thirdly, there's a market for DRI. So you can always enter the market and buy it depending on depending on your overall metallics requirement.

So I don't think, as you go down this path, there's one size that fits all. I think you look at your marketplace, you look at where your facility is located, you look at your logistics, you look at raw material availability, energy costs, and then you make the appropriate decisions.

Christian Georges

That's very clear. And then very, very last thing, Aditya, you seem to be, if I'm not mistaken, you've become a lot more positive on the outlook for Chinese interference in a world market on supply. I mean, once upon a time you were vacuum would be there and China would come in. So should we see that in the future, you got a great confidence that China would be a much lesser interference in global markets.

Aditya Mittal

I think if you look at the actions that China has taken so far, I think that's a safe conclusion, right? Because they removed the export rebate. They are -- there's a lot of discussion on reducing the level of steel production in China. There is a carbon market in China now that is developing. So I think when you look at the totality of what they're trying to achieve, I think there is a shift.

Christian Georges

And the ability to actually install capacity in other countries like Vietnam and Indonesia, and so on, seems to be a lot less clear than what they could do on the domestic market, right.

Aditya Mittal

Yeah, I think that potential exists, but now you'll have a carbon border adjustment. So it'll be very difficult for such new capacity to penetrate some of the markets in which we operate. On top of it, I think if those producers are used to sell steel into China, and then China expose their low carbon, I think fundamentally, that will also not work, because that would be trying to circumvent the legislation.

So I think finally, everyone has to play on the same basis, right. That's the concept of a level playing field. And legislation will evolve and improve to achieve that.

Christian Georges

Great, thank you. Thank you very much.

Aditya Mittal

Thank you.

Daniel Fairclough

Thanks, Christian. So we'll move now to Carsten at Credit Suisse.

Carsten Riek

Thank you very much. Two questions left. The one is just on taxation. Have you seen any increase in recent discussions with governments concerning tax increases to finance the COVID-19 bills? We've seen some governments coming forward already. So that's my first question.

Genuino Christino

Yeah, I think that taxation exists, right, because there's a significant carbon price that companies are paying. I mean, if you look at the European steel industry as an example, the allocation system is only providing roughly 85% coverage. So when you look at the 15% that is uncovered and you multiply that by volumes and the price of carbon, I mean, these are significant amounts of, we can call it tax or whatever, this carbon cost that exists in the system.

Carsten Riek

That was more on the general tax rate, because we have seen UK increase the tax rate.

Aditya Mittal

You know, I appreciate the question, but I think it's, let us see what happens so far. The mechanism to pay for decarbonization, I do believe is through either the cost of carbon or CBAN, maybe it's through higher taxes, but so far, at least my framework is that's how the system will work. Now could be different geography by geography. I appreciate that. But that's what we're seeing, at least in the European context.

Carsten Riek

Good. And the other question I have, what we see in China right now is actually that they lower their effective cost base for the manufacturers of steel goods. Could we not see a carbon leakage by China just exporting finished goods, cars, refrigerators, obviously ACs cetera, et cetera. And by that actually circumventing the carbon border adjustment?

Aditya Mittal

Yeah, I think those issues will remain right. And at the end of the day, the carbon border adjustment will evolve to ensure that such types of leakage or such types of circumvention is prevented, I think, we saw this in the past, right? We did -- we started the anti-dumping action, and then there would be circumvention of the dumping action through different mechanisms. And then the action would improve and capture that circumvention. So clearly, that will evolve and that will continue. But fundamentally, I think, if you if you think of decarbonization, it is also a function of technology capability, first mover, the ability to use size and scale. So I see no reason why we will not be competitive as a steel company, in decarbonizing our business.

Carsten Riek

Perfect. Last question, maybe Liberia, you had the shipment issue there. Is it solved? And maybe you can give us a quick update when those operations will be back to normal?

Aditya Mittal

Sure, Simon?

Simon Wandke

Yeah, thanks, Carsten. So in Liberia, after the rail incident, we were down a couple of locos and replacement locos have been procured. We expect those to be on site in early September and then back up to our normal capacity around 5 million tonnes per annum.

Carsten Riek

Perfect. Thank you very much.

Daniel Fairclough

Thanks, Carsten. So we'll move now to Myles at UBS.

Myles Allsop

Great, thank you. Just on the 25% global target for decarbonization. Are you going to tie that into management remuneration, is the first question?

Aditya Mittal

Yeah, absolutely. We will be releasing those details by the end of the year. But the idea is to tie it to executive remuneration.

Myles Allsop

Okay. Excellent. And then just thinking about sort of China cutting steel production and prioritizing decarbonization, do you think this could drive a decoupling between the iron ore price and the steel price and give you like non-Chinese steel mills, the potential to see a super, supercycle for spreads there if iron ore prices nosedive because of China, but steel prices stay high, because there's less imports? Is that -- how realistic is that potential scenario?

Aditya Mittal

I think today we see the decoupling, right, because there's a different price of steel in China, and there's a different price of steel outside. Clearly the world is changing. I think it's too early to sit here on the call and speculate as to how the world evolves. I think we should -- we can talk about the three trends that we're seeing. Clearly there's a shift in China. I think you have asked the same question others have as well. We see that as well. So I can confirm that.

Number two, decarbonization will throw opportunities as well, whether it's on the demand side or changes in the supply environment. I think that's a fair assumption and clearly the stimulus impact that is also flowing through the steel cycle is also very positive. So the next 10 years will be different than the last 10 years. And I think that's the exciting part. And as I mentioned earlier, and as we all talked about, I think ArcelorMittal has a key role, a strategic role to lead the industry, in terms of decarbonizing. We are a first mover. And I think that implies that we will build our competitive advantage.

And then finally, and that will mean better returns for all.

Myles Allsop

Thank you.

Aditya Mittal

Thank you.

Daniel Fairclough

Thanks Myles. So we're going to make time for a couple of follow-up questions. The first of which we can take from Phil at KeyBanc. Go ahead, Phil.

Philip Gibbs

Hi, thanks very much. Just to just follow up on the Mexico hot strip mill investment. It looks like it's coming on later this year and probably going to be helpful to next year. But is this just a pure mix change from your standpoint? Or should we assume that your volumes in NAFTA are going to go up as well. I just wanted to be clear.

Aditya Mittal

Yeah, in terms of NAFTA volumes, it's primarily a mix change, because you're moving from export of slab to domestic hot band. There could be some incremental increase in the throughput of our Mexican facility. So then you would have increase in production as well as in volumes.

Philip Gibbs

Okay. Thank you.

Aditya Mittal

Sure.

Daniel Fairclough

Great, so we can move to the final question, which we can take from, as a follow up from Luke at JP Morgan.

Luke Nelson

Hey, thanks for the follow up. Just a quick one on iron ore seaborne volumes. In the past you've given volume guidance for the mining division. I was just wondering whether you can give a sense of what volumes will be in for this year, and maybe whether you start bringing back the guidance.

Aditya Mittal

Luke? Yeah, thanks. Yeah, Luke, at this point, we're not giving any guidance. I mentioned Liberia, one point, AMC back on track post-disruption, rail disruption. And so I mean, the maths in terms of capacity in Canada. But at this point, no guidance for the balance of the year, but later.

Luke Nelson

Sure, thanks.

Daniel Fairclough

Great. Thanks so much. So that's our final question, Mr. Mittal. So, I will hand the floor back to you.

Lakshmi Mittal

Thank you very much. Thank you, Daniel. Thank you, Aditya and Genuino and Simon. And thank you, everyone, for participants that were participating. I saw very useful discussions, very interactive discussion on climate change, on our performance, and you also saw our excellent results. So thank you for joining and I wish you and families a happy and most importantly safe summer. I look forward to speaking with you soon.