

Alcoa Corporation

Goldman Sachs Global Metals & Mining
Conference

Wednesday, November 16, 2022, 9:45 AM EST

CORPORATE PARTICIPANT

William Oplinger – *Executive Vice President and Chief Financial Officer*

OTHER PARTICIPANT

Emily Chieng – *Analyst, Goldman Sachs & Co. LLC*

Alcoa Corporation
November 16, 2022
9:45 AM EST

Emily Chieng: Good morning, everyone and welcome back to our second fireside discussion of the day. I am joined now by Bill Oplinger, Chief Financial Officer of Alcoa Corp. Bill, thanks so much for joining us today.

William Oplinger: Thanks for having us.

Emily Chieng: Before we get into the Q&A, though, I might get you to start off with some opening remarks to set the scene, what's aluminum – and what's Alcoa – looking like these days?

William Oplinger: Sure. So, thanks again for inviting us to the conference. It's good to see everybody. I was reflecting this morning that six years ago, we were at this conference and it was right when we had started the company and we had spun out of Alcoa Inc. And reflecting over the past six years, it's amazing what has changed. And I'm sure many of you who've been following us over the years recognize the fact that six years ago, we had close to \$4 billion of proportional net debt. Today we're down to around \$1.2 billion - \$1.3 billion. The balance sheet has been significantly improved. We're now an investment grade company. So, before, when we launched, we were a BB minus. We've done a lot of work around the portfolio and have curtailed and in fact, in some places restarted some low cost capacity, and just done a lot of work over the last six years and the company's in significantly better place. It's fun to look back at six years ago being in this conference and we were probably within 30 days of separating out, so it's been a great time.

As far as today goes, really I'll just jump forward to what's going on today. Interesting times in the industry. Metal prices and alumina prices have come down sharply since their highs in the first half of the year. But at the same time, raw material costs have stayed stubbornly high. And you saw some significant margin compression in the third quarter. We had record first and second quarter results and then had a third quarter where margins had been severely compressed. We provided some guidance going into the fourth quarter and we'll just take that off the table, because a lot of times people are looking for me to give guidance again in the middle of the quarter. And I would tell you, related to EBITDA, our guidance is the same. So, we're not changing our guidance. At the time, we were saying that the Bauxite business would be up \$5 million, the Alumina business would be up \$20 million, the Aluminum business would be flattish. And these are irrespective of metal prices or excluding, I should say, metal prices and alumina prices. So, you've got to update your model for the most recent

metal and alumina prices. But holding to the guidance that we've provided at the beginning of the fourth quarter.

Emily Chieng: Fantastic. So, we'll definitely jump back into the cost side of the equation. But wanted to start really big picture. It's been, clearly, a very volatile space for aluminum and over the last several years. But things appear to have, maybe, structurally changed for the better, for aluminum, at least as it relates to longer term demand. Maybe talk about what you are seeing on the structural demand growth side for aluminum as it relates to its role in renewable energies, EVs, packaging, anything that you've seen change among your customer base over the last 12 months, that might suggest that those longer term growth rates that we were thinking about are accelerating or decelerating?

William Oplinger: So, the long-term growth of aluminum is a really good picture. Aluminum is a metal that's used in the energy transition. So, significant usage, about 100 kilograms per car difference between an electric vehicle and an ICE vehicle. Significant usage for solar expansions and for the grid.

So, when we look out, the growth levels of aluminum usage are strong, so overall we think they are probably at around three percent rate over the next decade. In our industry if you've been following it long enough, it's never really been an issue around demand growth. It's been an issue around supply growth. And one of the reasons why about a year ago we came out and provided a 'stronger for longer' viewpoint on aluminum is because we do think there are some trends in the industry that will constrain supply growth.

First and foremost, the Chinese have put a cap on their primary supply growth to 45 million metric tonnes. Today, we think they're probably running around 40.5 million metric tonnes on a run rate basis and we think they will get to around 42 to 43 million metric tonne operating production over the next couple of years and then, probably, stop growth on primary aluminum. We've seen them stick to that over the last couple of years. New operating capacity has needed capacity permits from existing operating capacity. So, we've seen them stick to that. And we believe, with the focus around the environmental side and the focus around decarbonization, they will stick to that.

The rest of the industry, with a focus around decarbonization of the process of aluminum, we believe will constrain capacity. And then on top of that, we've announced the ELYSIS™ project, which is a joint venture between us and Rio Tinto with some ownership from the Quebec government and the Canadian government. That is a process that completely eliminates carbon from the smelting process and our projection is that will be ready by

2024 in a commercial package. And we believe that a lot of competitors around the world are looking at that and trying to determine whether that will succeed or not.

Emily Chieng: And then bringing back maybe more nearer term in nature, there has been a lot of moving pieces around the world. In the last couple of weeks, we have seen potential that we could see a China reopening next year. But on the other side European demand has been quite weak. What exactly are you seeing around demand into the remainder of the year and any early insights into how 2023 might be shaping up?

William Oplinger: So, if I go around the world to some of the key markets, I'll start in China. Clearly, Chinese demand this year has been weaker due to the COVID lockdowns. It's been weaker due to some of the issues around building and construction. However, their supply, at least recently, has been constrained also. They've had to take a couple of million metric tonnes of capacity offline due to the energy situation in southern China. So, while the demand has been weak, the supply growth has not been huge. And what that means is that gets reflected in the Japanese premium. Japanese premiums have been down a little bit.

We then go to Europe. It's probably the area of weakest demand around the world for obvious reasons. We are seeing our customers shorten up their order books. So, instead of a 90-day order period, we're seeing our customers asking for about 30 days. They simply don't have the visibility into the strength of their end markets, at this point, to be ordering on a 90-day basis. That's largely in the building and construction business. So, we sell billets that end up in building construction and for obvious reasons, because of the war in Europe, we're seeing that weaker demand. However, at the same time we have seen about a million metric tonnes of supply come offline. We still think that there's maybe another million metric tonnes of supply that is under pressure with the high energy prices and high raw material costs. So, we'll see over the next six months whether that supply comes offline.

Then I come over to North America. North America is the area that we've seen pretty steady order volumes. Our value-add product premiums have been strong going into 2023. We think they'll continue to be pretty strong. Many of our customers have self-sanctioned off of Russian metal, and therefore, our order book has been pretty steady in 2022. Going into 2023, we'll see. We're in the contracting season at this point.

Emily Chieng: Fantastic. Maybe shifting gears and I know touched a little bit about European supply coming offline. But it does look like the number of curtailments has since stalled. What are you seeing globally around

potential for further smelter curtailments? I know a lot of smelters are under pressure. You've got maybe some high energy costs in China or lack of power there. Is there more potential for more capacity to come offline in the near term?

William Oplinger: I think there is. I mean, obviously, each of our competitors makes their own decision. They're looking at their own cost structure. But when we look at the industry in aggregate, as of September, I believe the numbers were the industry western world capacity, we believe that around 50 percent of that was cash negative and something like a quarter of the Chinese capacity was cash negative and that's on the smelting side. On refining in China, we thought around a third of the Chinese refineries are cash negative and my recollection is around 15 percent to 20 percent of the Western world capacity, on refining, was cash negative. What's causing that?

Aluminum prices dipped to \$2,200 a tonne. They've recovered now up to about \$2,400 a tonne. But coke and pitch prices have stayed high. Energy costs have stayed high. And so that's the smelting situation. In refining, alumina prices have come down to \$311, and yet caustic prices, which are largely disconnected from the alumina process, caustic prices have been very high. Now, your next question should be, are we starting to see some relief on that? We are starting to see some small amount of relief on calcined coke. Coal tar pitch has stayed significantly high and we're starting now to see a little bit of a reduction in caustic pricing. However, if you follow our company, that will take time to flow through the income statement. Caustic takes typically around six months. Coke and pitch takes roughly a quarter to flow through the income statement. So, lower caustic prices that we're seeing today will be reflected in our income statement towards the end of the second quarter of next year, early third quarter.

Emily Chieng: Maybe switching gears and talking about the portfolio, you've done a lot of work over the last six years into taking higher cost assets down, closing what doesn't make sense curtailing there. But you've also brought back some capacity as well. So, perhaps thinking about the world that we live in today, does it make sense to have brought back Alumar and Portland the small pieces of capacity there? And then maybe the second question is how are you thinking about greenfield growth?

William Oplinger: So, in the case of the plants that we've brought back online, I think we'll be very pleased over time. And just to give you a little bit of perspective on each of those, Portland is in Victoria, Australia. We had incremental pots that were at the facility that we just needed to electrify to gain additional capacity. And I think over time, we'll be pleased with that. In the case of Sao Luis, there is many factors that led us to restart that capacity that are still in place today. So, for instance we have got 100 percent renewable

energy contract that kicks in in 2024. That is a competitive renewable energy contract. That is kind of the basis for that restart. In addition to that, it's co-located with the refinery. So, you don't have transportation costs for alumina. We have got a great workforce that is in place there. We have got a strong U.S. dollar in comparison to the real. If you look historically, very strong U.S. dollar that helps us with our cost structure in Brazil. And then we've got some value added tax credits that we're able to monetize that were sitting on the balance sheet that really were unutilized, that now we can monetize over time. So, the restart of Alumar we're pretty pleased with. What was the second part of your question?

Emily Chieng: On greenfield growth.

William Oplinger: Greenfield growth, sorry. Interesting situation for us on greenfield growth. We have said two things very clearly. First of all, we're not going to invest in a new pot line that is Hall Héroult technology, whether that's a brownfield or a greenfield. We will creep our existing facilities. So, we're not saying we're going to underinvest in our existing Hall Héroult facilities. Where we have opportunities for creep, we'll do so. But we've committed to not building a Hall Héroult smelter. That means that our future is ELYSIS. And as I said, ELYSIS, a commercial package, our expectation, should be done by the end of 2024. That means between us or Rio, we should have first hot metal out of an expansion, either a brownfield or a retrofit in 2026. So, really towards the second half of this decade, we'll be looking at opportunities for either brownfields, retrofits, or, potentially, greenfields on ELYSIS.

Emily Chieng: Maybe sticking with ELYSIS at this point, are there any sort of financial metrics or operating metrics you can disclose as to the progress you've made there?

William Oplinger: So, the commitments that we have, the targets that we have in place for ELYSIS, are a reduction of capital cost, capital intensity versus Hall Héroult by 10 percent, a reduction of operating costs versus Hall Héroult of 15 percent, and a throughput improvement, on a footprint basis, of around 15 percent for ELYSIS versus Hall Héroult. Clearly, these are targets. This is an R&D project. We've had a couple of smaller cells operating in ELYSIS that have operated effectively. Us and Rio through, ELYSIS, are now building the extension of the Alma facility. That will be three ELYSIS pots that will occur in 2023. By the end of 2023, and these are going to be commercial sized spots of 450ka cells. By the end of 2023, we will have much better indication of how effective that will be and whether it will be able to hit some of those cost targets that we have.

Emily Chieng: Shifting gears and looking at a segment that's often overlooked, but very

important to you guys as well still is the Alumina segment. You do have a net long exposure there. But looking ahead, what does the outlook of alumina look like? It's a little different from the perhaps aluminum drivers that we are seeing now.

William Oplinger: So, the alumina outlook is different than aluminum. And I would tell you, it's probably different than what we've historically viewed it. And so, what has changed? First of all, let's put in perspective what we have in alumina. We do have a net long position. We've got a joint venture between us and Alumina Limited, 60 percent owned by us, 40 percent owned by Alumina Limited, for largely the Bauxite and Alumina segments. So, we have capacity of what, 12.5 million metric tonnes of alumina capacity across AWAC today, something close to 48 million metric tonnes of mining capacity across Alumina.

First quartile position in mining, first quartile cost position in refining. Also, the world's best carbon footprint for refining of any major refining system. We are the only ones that offer a low carbon alumina product to our customers. So, if a smelter wants to lower their carbon footprint, they can buy Ecosource™ from us. So, a really, really, strong upstream position and I just want to make sure that that's clear.

As we look forward, we think that the alumina industry may be a tougher industry than aluminum. That's changed over time. So, what has changed? As we look forward in aluminum, again our 'stronger for longer' view means that the Chinese will cap at 45 million metric tonnes. The green dynamics of aluminum, we'll be able to get a premium for aluminum. If we then go to alumina, as we look forward on alumina, where the barriers to entry we believe are probably a little bit lower than what they used to be. The Chinese have a lot of capacity that they can add in the alumina space and the green dynamics aren't as strong in alumina as they are in aluminum. Specifically, the Chinese don't have a cap on alumina capacity. And as we look forward, the next 10 projects around the world are going to be coal-based refineries. And it's hard to imagine that the world is going to build 10 coal based refineries, but those are the projects that are on the drawing board today. If we were ever to get a global carbon charge that was applied to the refineries, that would then put those refineries in a worse cost position. So, as we look forward, we're thinking that the economics are probably stronger in smelting than they are necessarily in alumina or bauxite.

Emily Chieng: Maybe switching gears and talking about San Ciprián right now. So, on the smelting side of the business, that asset has been curtailed at the start of this year and you've got a two year path for that to reopen. But maybe let's focus on the refinery first, which is still open at this point. Can you talk to

us a little bit about what are the energy cost pressures that you're seeing there? What you've been doing, and maybe what further can be done in this kind of an environment?

William Oplinger: It's a very dynamic environment. And the energy, given that we're exposed to spot gas prices for around half of the existing operating capacity in Spain, very dynamic environment. So, I'll start to start by saying that's very volatile and dynamic. What we've done, we've got around a 1.6 million metric tonne refinery in Spain. That equates to about 4,500 tonnes per day of operating capacity. We've curtailed that down to around 2,200 tonnes. We were seeing, given the spot gas prices, large losses in the refinery. I think it was around \$60 [million], \$70 million in the third quarter of losses in San Ciprián. We've curtailed it. Subsequently, energy prices have also come down, so that's a little bit of a tailwind. Hence the guidance that we provided back at the beginning of the month and reiterated here that we should see a benefit from some of the tailwinds.

On energy, we are down to about 2,200 tonnes per day, we will look at options around San Ciprián. Had energy still be sitting at \$35 a gigajoule, I'd be telling you "hey, we'd be looking at options for ways of potential further curtailment or passing on some of those costs to our customers." We're in the position where we have to really evaluate what's going on in the energy market. Energy is a lot better today, which gives that facility a little bit of breathing room.

Emily Chieng: Maybe coming back to that, as a follow up to that point that you just made there, that you could either look to reducing capacity further or you could pass on some of those costs to your customers. How willing have those two different discussions been? How easy is it to make those changes?

William Oplinger: It's not easy to make those changes, and we've had to make a lot of hard decisions in Spain. Certainly, decisions that are tough on our employees and tough on the plants and the communities. But the economics have been such that they've needed to be made. So, we tend to work with our unions, we work with the governments to try to make the best decision that impacts our employees the least.

Emily Chieng: And then maybe switching back to the smelter right now for San Ciprián and that's still currently offline, but you've made some good progress there on signing some renewable energy contracts. Maybe talk us through what's there and what's left before start up?

William Oplinger: So, we have a commitment to restart that facility starting in January of 2024. We have a commitment to spend about \$103 million on combined restart costs and some of the capital that needs to go into that facility to make it

more competitive. We have signed two long term deals that are wind-based energy contracts. They're both competitive for the long term. Those facilities need to be built. So, there is some permitting and work that needs to be done to get those facilities built. One is with Endesa, the other is with a company called Greenalia. And for the long term, that should position the San Ciprián smelter to be competitive and to be renewable based, which is critically important today.

Emily Chieng: And then coming back full circle to your energy portfolio, remind us, is there anything left on the electricity side that's still exposed to spot?

William Oplinger: It's small. So, I think the numbers are around 65 percent of our current operating capacity is powered by contracts that are LME based. So, they go up and down based on the LME price, which certainly helps us go through the cycles. Another 30 percent is fixed price and so around five percent is exposed to market.

Emily Chieng: And that exposure to the market price that's at Lista in Norway, is that correct?

William Oplinger: It's pretty much solely at Lista these days.

Emily Chieng: Now turning over to capital allocation then. This is what you've been focused on over the last several years. The balance sheet has changed significantly since six years ago.

William Oplinger: Right.

Emily Chieng: And so, as you think about the strength of the balance sheet now, if the macroeconomic environment does deteriorate further, how should we be thinking about how Alcoa is positioned.

William Oplinger: The balance sheet is in great shape. And it's been our sole focus of excess use of cash flow through the beginning of this year. We put a dividend in place in the fourth quarter of last year. And we started to do some fairly sizable buybacks in the first half of this year, but really have been focused on improving the balance sheet. And I would say the balance sheet today is where we want it to be. We're investment grade. So, what, Moody's and Fitch have us at investment-grade. S&P has yet to figure it out, but they will get there, I'm sure. And so, the balance sheet is in good shape.

We've paid down significant pension liabilities. At the beginning of our company, we had a massive, underfunded pension liability, both from a net and a gross basis. And I bring up the fact that the net has been largely closed as far as the unfunded status and the gross we've made significant

progress on annuitizing. I think we've annuitized around \$3.5 billion of the gross liability. That's important for investors because that just means that liability won't swing with interest rates. In addition to that, we've implemented a fairly significant LDI strategy which is not derivative based. So, anybody who is following the UK gilt issue, that's not us, but we've initiated an LDI strategy that should inoculate us largely from interest rate exposure. Can the balance sheet be better? In a commodity company, maybe the balance sheet can always be a little bit stronger. But at this point, it would be just around the edges.

So, that brings me back to the capital allocation framework. And I know many of you have heard us talk about our capital allocation framework. It starts with maintaining a strong balance sheet. We then go to sustaining the assets. We're looking at an increase in sustaining capital next year, on both sustaining and return seeking, that we provided. We'll give you an update at the beginning of next year on the latest thinking there. And then there's three uses of cash flow. One is to continue to reposition the portfolio. For instance, when we curtailed Spain that cost us some money. The second is returns to shareholders, and these are not necessarily in rank order. At any given time, we're balancing these three priorities and the third is position for growth. We've not talked in this forum about some of the breakthrough technologies that we have coming down the pipeline for the middle part of this decade. But at some point, given these breakthrough technologies will work, we will have the opportunity to grow and retrofit the facilities in a much lower carbon fashion. So, those are the three priorities, we balance them at any given time. You saw that we returned cash to shareholders really through the first three quarters of this year. When cash flows are good, when the balance sheet is strong, we're able to return cash to shareholders.

Emily Chieng: Bill is there any thinking around potentially putting a formula around some of those priorities that makes it easier for us to think about?

William Oplinger: There has been a lot of thinking over time, and for the first five years of this company, I've been telling shareholders that paying down debt, fixing the balance sheet was the best use of cash flow. And I think it's proven to be right. You look at where we are in the cycle and the strength of the share price, given the earnings level, the balance sheet improvement was important to happen. We'll continue to consider different capital allocation metrics, have a lot of discussion internally and with our Board around capital allocation. But at this point, nothing to announce.

Emily Chieng: And then maybe just finally around the Sustana™ suite of products we talked about ELYSIS before. Sounds like there's some good progress there ahead. But on the Sustana maybe reintroduce the suite of products you

have there, the low carbon alumina and aluminum products?

William Oplinger: So, we have the broadest set of green products in the industry and we're able to say that because of EcoSource, which is the alumina product. So, EcoSource is a certified product that's a point six tonne [of carbon] per tonne of alumina that is certified, that if someone who is on the curve of the carbon generation, if they're looking in the smelting industry to lower their carbon footprint, they can buy a certified low carbon alumina from us.

In addition to that we have got EcoLum™ and EcoDura™. EcoLum is our low carbon aluminum product and we have seen good pickup from our customers on that product. We're largely seeing customers in the automotive space, to some extent consumer electronics, who are looking to get a very low carbon product that are willing to pay to be able to get certified a low carbon product. When ELYSIS works, between us and Rio, we will have the lowest carbon aluminum in the world, and it will be a massive step change because it will eliminate the direct emissions from the smelting process.

And then on top of that we've got two other breakthrough technologies that we really haven't talked much about here. One is called ASTRAEA™, which is a process that allows us to enter the secondary aluminum market. Secondary is broken down between post industrial and post consumer. ASTRAEA allows us to use post consumer scrap and make very high purity aluminum. And then we've got a suite of decarbonizing projects in the refinery industry that will decarbonize refining. So, we've got a process called mechanical vapor recompression, [and] a process called electric calcination that should take the carbon out of the refining process even further.

Emily Chieng: Great. So, we'll open it up for questions from the audience.

William Oplinger: Alright.

Audience Member: Sorry, Bill. Hi. Just in terms of San Ciprián, just looking at costs, obviously, we did see power prices sort of revert back slightly over the last quarter. When you look forward to making a decision around that, are you thinking more about how the curve is or are you thinking about prices at these levels? Because I know most analysts forecast that the prices will actually, or input prices, particularly for energy, will be higher as we come through 2023. So, just wondering where it needs to stay in order for the operations to maintain that current capacity?

William Oplinger: Yeah. And when I talked about the volatility and the dynamism around that particular plant, spot energy prices are down considerably, spot natural gas

prices, but you can't lock that in going forward. We don't have the ability to translate today's spot price into a long term contract. We'll balance a lot of different things for San Ciprián over the next year. One, we make a product called non-metallurgical alumina there for many customers in the water treatment space and we'll be looking at what we can do there. And comparing alumina prices to energy prices and try to make the best decisions. So, not a lot more I can say around San Ciprián.

Audience Member: So, just maybe on that point around aluminum pricing. The LME kind of told us last Friday they sound like they're waiting for the White House. What's the White House waiting for in terms of Russian sanctions?

William Oplinger: Yeah, I am certainly not in the position to speak for the White House. We can let the White House speak for themselves. I can give you some insight into our thinking about what we were pushing the LME to do and what we continue to lobby the U.S. government to do. Around the LME, it was really interesting to me, their response. It was really an economic discussion around the LME. Russian metal, for many western world customers, is not a desired source of metal. And if Russian metal continues to go into the LME, the underlying LME contract will be based on a product that is less desired by customers and hence, you've got a reference price that is theoretically lower than what it should be. And that was our argument with the LME is that you're essentially damaging your own brand, you're damaging the underlying contract by continuing to allow Russian metal into the warehouses.

The discussion or the lobbying with the U.S. government is slightly different, slightly more nuanced. Essentially, the energy crisis that has been caused around the world has been caused by the invasion of Ukraine, by Russia, and the Western world suppliers have had to deal with that energy crisis in aluminum. And yet the aluminum industry in Russia hasn't had to deal with that. So, our lobbying with the U.S. government has been, if you're looking for opportunities to sanction Russia further, there's an opportunity to do so on aluminum.

Emily Chieng: Any other questions from the audience?

William Oplinger: Appreciate the time. Appreciate the interest that you've shown in Alcoa and look forward to talking to many of you over the next day. Thank you.

Emily Chieng: Thanks, Bill.