

Alcoa Corporation

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CORPORATE PARTICIPANTS

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Carlos De Alba: Thank you very much for joining us in the fireside chat with Alcoa. Bill Oplinger is the CFO of Alcoa. Thank you very much for joining us.

Well, thank you very much again. Yes, I was in Latin America London Conference the last two days, coming now hot for the Laguna Conference. So, again, thank you very much, everyone, for joining. Thank you, Bill. So, let me just read some disclosures that are important. For important disclosures, please see Morgan Stanley Research Disclosure Website at morganstanley.com/researchdisclosures. If you have any questions, please reach out to your Morgan Stanley representative.

So, with that, a lot to talk about for sure. Why don't we maybe start with what are you seeing in the current conditions for Alcoa? Any comments that you want to share with the audience? Clearly, big news this morning by Nucor and the whole sector came down maybe there is something that could potentially relate to Alcoa? I don't know. I'll just leave it open for you to comment.

William Oplinger: Yes. So, let me just make some opening comments, Carlos. First of all, thank you for having us here. I always like to come to Laguna for this conference. For those of you who don't know, Carlos and I have a long-term relationship, I hired Carlos into Alcoa 20-plus years ago but he's made something out of himself at Morgan Stanley in the last few years. So, it's good to see you again.

Wow, crazy, crazy times in the aluminum industry and it's been a wild ride for Alcoa for the last five and a half years. As you all know, we split out of Alcoa Inc. back in November of 2016. We've made a lot of progress over the last five years, we've really been focused on fixing the balance sheet and we've done tremendous work on fixing the balance sheet. Total proportional net debt has gone down from a high of nearly \$4 billion to close to \$1 billion now. Spent a lot of time working on adjusting the portfolio and have closed, curtailed, restarted a number of sites around the world, one down in Brazil that we're in the process of restarting. So, really focused on the portfolio. And in the meantime, have announced a series of breakthrough technologies that we're focusing on for the middle part of the decade, we think that we can fundamentally change the industry by some of our breakthrough technologies.

Fast forward to this year, first half has been spectacular, right? So, metal

prices were very good in the first half. And we had near-record earnings in the second quarter, close to \$1 billion of EBITDA in the second quarter. We initiated a dividend in the fourth quarter of last year. So, we started to return capital to shareholders, bought back shares in the first half of this year, fairly significantly. Fast forward to the third quarter. Third quarter is shaping up to be a tougher quarter for us. Metal prices and alumina prices versus the second quarter have come down fairly sharply. At the same time, raw material prices have stayed stubbornly high. We, along with many other players in the industry are seeing significantly higher energy costs, specifically in Europe. You know for instance, then I think most people know that we are exposed to higher energy costs in southern Norway in Lista. So, we're anticipating that we have about \$30 million higher energy costs in Lista this quarter than what we had anticipated at the beginning of the quarter.

So, we've had lower metal prices, some higher raw material costs, higher energy costs in Lista. And we've had some operational issues in Western Australia and that, I think, is going to cost us around \$50 million in the third quarter. So, like I said, the third quarter is shaping up to be a tough one. However, if we then transition to the mid-term outlook and this is the same mid-term outlook that we gave back in November. We think that the fundamentals for the aluminum industry are as good or better than they've been in decades. Why do we say that, with some of the supply limitations that we see around the world with the Chinese 45 million metric tonne cap, with the drive towards better ESG performance in the industry, our new technology of ELYSIS™ coming out in the future. We think that the fundamentals of the industry are as strong as they have been.

Continued strong growth in the future with some of the demand trends that we've seen with higher electric vehicle production. So, overall, a great start to the year, difficult times in the third quarter and mid-term, I think the outlook continues to be strong.

Carlos De Alba: Thank you for that introduction. A lot of material for us to go through in the next few minutes. Just on the third quarter, just to clarify for the benefit of everyone. Those comments that you made on Western Australia and Lista, are those above and beyond the business consideration?

William Oplinger: Yes, they are above and beyond. So, and I probably should have commented that results in lower earnings, we would anticipate that the tax expense in the quarter is like \$50 million to \$60 million. We typically give people guidance around tax. Obviously, tax expenses are down. But yes, those are on top of the guidance that we gave in the beginning of July.

Carlos De Alba: And any comments that you might be able to share with us in terms of

capital or cash generation in the quarter, given the balance sheet, as you mentioned, has been strengthened significantly? You started to give dividend and a lot of investors are following how companies doing working capital and other things that sometimes provide a benefit for cash operations though EBITDA might be coming down.

William Oplinger: Yes. So, let me address that holistically and then get to what's going on in the quarter. When we consider capital allocation and I'm sure many of you have heard this in the past, we want to maintain a strong balance sheet. We just reached investment grade this quarter. So, the company has gone from being a BB minus to an investment-grade company over the last five years. So, the balance sheet is strong. We want to maintain a strong balance sheet. We had a large cash balance at the end of the second quarter due to the cash generation that we've had in the first and the second quarter. Beyond that, we're spending around \$450 million of sustaining capital this year, \$75 million of small return-seeking capital. And then, we consider three uses for cash. And just before I get there, one thing that needs to be clear is that we've cleaned up our pensions a lot, right? We have had massive infusion of cash into the pension over the last four or five years. We're largely done with that. So, pension cash contribution should be small. OPEB cash contributions in the neighborhood of \$50 million to \$60 million. So, very manageable long-term liabilities over the near term. And then you get to the potential three uses of cash flow, repositioning the portfolio costs money, you saw that in Spain. Positioning for growth in the future. We will have the opportunity to grow in the middle part of the decade when ELYSIS works, when ASTRAEA™ and refinery in the future come to fruition. And then thirdly, it has been returning cash to shareholders and we've done that in the first half of the year.

If you fast forward to the second half of this year, with metal prices down, alumina prices down, raw material costs still high, you get a margin compression. However, in the second half of the year, we generally see working capital free up, right? So, we built working capital in the first part of the year, working capital should be a cash generator in the second half of the year.

Carlos De Alba: Alright. So, some good news definitely there. So, let's step back from the quarter and think a bit medium-term and portfolio restructuring that you have been pursuing. Where do we stand there? Can you share us a little bit more comments? Clearly, a lot of things have been happening in Brazil. The restart is going in Spain, the renegotiation of the contract for San Ciprián smelter. With everything that is happening, how does that affect the outlook for the energy contract and the alumina refinery there, obviously, facing some challenges? So, where do we stand? What would be, broadly speaking, the next steps for the portfolio?

William Oplinger: So, the portfolio work that we've done over the last number of years, we started back, and I believe it was in 2018, where we put 1.5 million metric tonnes under review of smelting capacity, 4 million metric tons of refining capacity. We've taken action on roughly 1 million metric tonnes on the smelter. What does that mean?

We've curtailed Intalco, we've permanently closed Wenatchee, we repowered down in Australia and got a good power deal in Portland that allows that facility to run for a number of years and we'll get an opportunity over the next four or five years to repower it again. We've announced the restart of Sao Luis. Sao Luis is a great smelter in a part of the world where we were able to get a midterm energy contract that's affordable. The dollar is strong versus the real. It's right next to the refinery, great workforce. So, we're restarting that.

So, on the portfolio side, we've done a lot. We still have a lot of opportunities on the portfolio side. So, for instance, in Lista this quarter, I alluded to the fact that we're seeing \$30 million higher energy cost. We didn't just sit back. We've curtailed one line in Lista at this point. We've negotiated some medium-term power in Lista to mitigate some of those losses that we saw in the third quarter.

In Spain, specifically, we got a two year curtailment in the smelter there. That smelter was in a really bad position, given exposure to spot energy prices. We got a deal with the union and the governments to be able to curtail it for two years, maintain the employment level, commit to restarting it in 2024. The refinery, with high natural gas prices, is struggling. We said the refinery was going to lose \$75 million in the third quarter.

We took action. We've been able to curtail it down to about half the production level that mitigates the losses to more like \$50 million in the third quarter and we're looking at further opportunities to take action there to mitigate the losses.

So, while we've done a lot of great work on the portfolio with the energy situation in Europe, we'll continue to take action where we need to.

Carlos De Alba: And just in Lista, the fourth quarter, there might be some opportunities to lower energy costs, I think...

William Oplinger: Yes. So, we will not be exposed to spot energy in Lista in the fourth quarter. We've negotiated energy prices that are high in relation to where we would typically be but not anywhere near the spot power prices that we were seeing in the third quarter.

Carlos De Alba: Alright. So, things moving a little bit in the right direction. And talking about the technology that you also addressed a bit earlier on, ELYSIS is clearly very exciting. It could transform the way aluminum is made. Where are we in the process? What are the next milestones?

We recently addressed this topic in a recent report and it created a lot of interest and trying to understand a little bit more what is next? What are you looking for? It has already had some commercial success already with Apple using it in iPhone but larger scale is quite relevant. So, can you give us an update there on where the technology is right now? And also how you potentially could monetize that?

William Oplinger: So, for those of you who are not familiar with ELYSIS. ELYSIS is a breakthrough technology that fundamentally changes how aluminum is made. Aluminum is made today the same way it's been made since our founder, Charles Martin Hall designed the process originally 130-some years ago. But ELYSIS actually takes out the anode that's consumed in the current process, doesn't generate any CO₂, generates oxygen, target is to have lower operating costs by 15 percent because you're not making the anodes, you're not putting the anodes in, you're not taking the anodes out.

Higher productivity out of the same footprint for the pot by about 15 percent, again, because you're not disturbing the pot all day, every day by taking anodes out you can get better productivity out of the cell and at a lower current capital cost. So, we're targeting a 10 percent lower capital cost than a similar Hall-Hérault installation. We're making good progress.

We've had a couple of cells running at smaller operating amperages than what a commercial cell would be at. We have a cell operating at Arvida that was at 100 kA cell. We are now subsequently investing -- us and our partner are investing in putting new cells in at Alma. And in 2023, we will build those cells and we'll have good line of sight to how the cells work.

Again, it's an R&D program and it's exciting and we've made tremendous progress but it is an R&D program. So, the target is to have a good idea of how these cells work at a commercial level in 2023. Then in 2024, have a commercial package so that one of the partners, us or Rio can deploy that in Quebec.

It will be in Quebec because Quebec negotiated that as part of their ownership. So, the first installation will be in Quebec targeting that for the end of 2024 and first hot metal in 2026. And so, it's coming true and it's an extremely exciting new technology. And it happens to be just one of the new technologies that we have. It's the one that's closest to becoming

reality for us at this point.

Carlos De Alba: Yes. But before we touch maybe on some of those latest technologies, it's very exciting what is happening. I remember when I joined Alcoa, the inert anode was going already and so it's got more than 20 -- almost 25 years ago.

William Oplinger: Yes. We've been working on inert anode technology since the early [19]80s. We partnered with Rio and I should have made that clear. This is a partnership with Rio Tinto. They are the world's experts on commercializing technology in the aluminum space and we thought it would be a great partnership. We bought the technology, they're bringing a lot of expertise to the process on how to commercialize it. And it's been a great partnership between the two of us.

Carlos De Alba: And, obviously, understanding that it might be very early on for you to comment on this but any idea as to like would the partnership you and Rio Tinto retain the IP to take advantage from a competitive position? Or maybe you just lease out and it becomes a revenue generator?

William Oplinger: Still thinking through the options. When we originally announced the partnership, the intention was to license the technology out widely. As the world has evolved and we see that there could be a significant value in having the lowest carbon aluminum in the world, starting to rethink that and working with our partners on how to consider that. So, that decision-making process will be made in 2023, 2024 before the first installation in 2025.

Carlos De Alba: I mean from a deployment perspective for us to try to get our heads around this, would you be building a new smelter? Would you be retrofitting a current one? Any magnitude on the potential CapEx that will require?

William Oplinger: So, it's early to answer those questions. We have a lot of optionality. The technology is designed to be a retrofit for AP3X technology. What that means is that the pot fits into an AP3X pot, you retain the building, you retain the electrical, the transformers, the distribution but the pot itself is new. The superstructure is new. And so, we have the optionality to retrofit or do a brownfield. We and our partners will make that decision as we get closer.

Carlos De Alba: All right. We'll keep following that as it unfolds. Let me go and touch on another thing, I know you have another development that you're pursuing which is ASTRAEA.

William Oplinger: ASTRAEA. We should give out a pronunciation guide, ASTRAEA.

Carlos De Alba: Right, ASTRAEA. Yes, for sure. What can you tell us on that? Particularly because what we have seen in terms of the new initiatives like some competitors in the aluminum industry here in North America, where they're going to be fully integrated based on recycled scrap.

William Oplinger: So, ASTRAEA is first of all, it's early stage R&D. It's really desktop type applications at this point, looking at potentially considering a pilot plant in the middle part of the decade. So, more work to be done. But as it stands today, ASTRAEA is has the ability to take post-consumer scrap and convert it into very high purity aluminum.

Higher purity than 0101 standard. And you know 0101 is the aerospace standard in the U.S. So, the thinking there is that it allows us to enter the secondary market in a place that others really aren't playing today. The secondary market today is really focused on post-industrial scrap. And those scrap cycles, those scrap loops are pretty well defined at this point. Where we're looking to enter is in the post-consumer scrap, where we think we can make a huge difference by taking fairly dirty scrap, zorba or twitch out of the scrapyards and converting that into high purity aluminum. Again, early stages R&D but it's very exciting.

Carlos De Alba: Alright. And then maybe coming to the announcement of Steel Dynamics, Novelis in this integrated recycled mills that are going to be coming into 2025, if everything goes well. How does that change the competitive dynamics in the North American aluminum market? And how much of a threat that might be for primary aluminum producers like yourselves?

William Oplinger: Well, we don't see it as a massive threat at this point. Those companies will, for instance, the Novelis, Constelliums, Arconics are doing very well at this point. They've got good strong demand. They need both secondary and primary. We have become a very good supplier to those customers on the primary side.

So, we don't see it as a massive threat at this point. As we look forward, we continue to see demand globally in primary products grow. But secondary is more important in the world. And I'm stating the obvious, as secondary becomes more available, growth rate of secondary actually will eclipse growth rate of primary. So, that's why one of the reasons why we're very focused on ASTRAEA is to be able to enter into the secondary market.

Carlos De Alba: Alright. I want to leave you some time to discuss the global aluminum market. So, what are you seeing? Clearly is, the world is upside down in many ways. What are you seeing in terms of demand growth? Europe obviously plays both ways impacting supply, the energy crisis they are experiencing but also definitely would impact demand as well.

In China, at the beginning of the year, we saw a lot of restarts new capacity. More recently, power conditions they have been challenging. They have been shutting down capacity, a repeat of what we saw last year. So, this might be becoming more recurrent. So, like what can you share in terms of how you see the global supply-demand conditions right now in aluminum?

William Oplinger: Yes. So, if I just kind of go around the globe but before I do so, I'm really commenting on really near-term demand issues. Again, as we look out, the dynamics for the aluminum industry are pretty strong. However, in the near-term, some of the things that we're seeing around the globe. In China, we're seeing a little bit of weakening demand.

Our year-over-year China growth demand was projected at about a one percent growth year-over-year. You know from history, that's a pretty small growth level. That was back before we saw some of the slowdowns associated with the COVID shutdowns again. So, weakening or weakened demand growth in China. At the same time, in the beginning part of the year, as you said, we saw a ramp-up of some of the supply. So, whether China is running at between 40 million metric tonnes, 41 million metric tonnes of production, we saw some of that increase in the first half of the year. That results in atoms of aluminum coming out of China.

And in this particular case, it's semi-fabricated products. So, we saw higher semi-fabricated product shipments out of China in July and August. But as you noted, they are starting to see some of the issues around water in the southern part of China. Some of the reservoir levels and some cuts in production there. So, that's the China view currently. We then transition to Europe. We've seen supply cuts in Europe. So, a million metric tonnes coming offline in Europe, some of that that was ours, right? So, we curtailed Spain, we've partially curtailed Lista. But just recently, a state of announcements of curtailments related to the higher energy costs in Europe.

On the demand side and I think Roy noted this in his Fastmarkets comments today, the visibility around the order book is a little bit shorter in Europe today than it was six months ago. Our customers who normally buy on a quarterly basis are saying, "Hey, can we buy on a month-to-month basis?" Because they just don't have the visibility to their demand.

Where we're seeing some of that demand reduction is specifically in our billet business which sells into building and construction, commercial transportation. And so, that's where we're seeing a little bit of a lack of visibility. But the supply side, supply cuts have been coming off, we anticipate there could be an additional 1 million metric tonnes of supply cuts

coming offline over the next few months as this energy situation plays out.

Now come over to North America. Surprisingly, North America continues to be strong. Our customers on the slab side are continuing to order well. Our order books are largely full in North America. We're going into a contracting season for 2023, where we have to see how willing customers are to buy Russian metal in 2023. So, things feel pretty solid in North America.

Carlos De Alba: And any differences across end markets here in North America? You alluded to some in Europe.

William Oplinger: In North America, packaging continues to be strong for us, right? The aluminum packaging is just so compelling compared to some of the alternatives. Packaging continues to be strong. Across the other markets, things are okay.

Carlos De Alba: Alright. And then maybe coming back to China. They have continued to keep the 45 million tonne cap has been in place for several years. How do you see that? What are your sources telling you there?

William Oplinger: Our internal house view is that they are sticking to the 45 million tonne cap. And when I ask our internal experts, why do you think they will? And the answer has been because they have. Over the last couple of years, they have enforced the cap so that capacity limit is at around 45 million metric tonnes. If you want to add capacity in the southern part of China, you have to buy an operating permit from somewhere else to be able to build it.

Now, from a production level, depending on what month or what quarter they bounce between 40 million metric tonnes and 41 million metric tonnes of production. So, they haven't approached that 45 million tonne cap yet, we believe toward the end of the decade, they will start to hit like a 95 percent run rate on that 45 million metric tonne cap. So, our view today is that they will hold to it, largely, because as you said, over the last couple of years, they have held to it.

Carlos De Alba: And then more short-term in China, you mentioned that demand has weakened recently but also, the government has put a lot of stimulus mostly in infrastructure. To what extent, aluminum do you expect will benefit from this in the coming quarters?

William Oplinger: It's hard to pinpoint a number around it. Obviously, the stimulus spending will help the property markets, will help demand growth. So, it's just hard to say how big, how much, how fast.

Carlos De Alba: Alright. Good. My final question will be regarding, you alluded to the capital

allocation program that you have in place. But in many numbers, obviously, depending on commodity prices, the company would generate very good cash flows, even with the cost challenges that you are facing. The balance sheet is quite strong and you potentially could see going close to zero net debt, right? What then? I mean, if that scenario falls.

William Oplinger: So, we revert back to our capital allocation policy. The three potential uses for excess cash flow. Positioning for growth in the future, portfolio repositioning if we have to take further action in places like Europe and returning cash to shareholders. We've returned cash to shareholders in the first half of the year. Our preferred method, at least through the first half of the year, was through stock buybacks. We instituted the dividend. And as you said, the balance sheet could it get potentially a little bit stronger? It could, it's in great shape today. And to think that I'm sitting here five and a half years later with an investment grade, with a dividend in place, it's just a great place to be.

And then, looking out to the breakthrough technologies that we have opportunities to deploy in the middle part of the decade, the company is extremely well-positioned.

Carlos De Alba: Alright. Excellent. Well, we'll end in this very constructive note. Thank you very much, Bill.

William Oplinger: Thank you. It's nice to see you.

Carlos De Alba: Likewise, we'll see you here next year I hope.

William Oplinger: Glad you were able to make it in.

Carlos De Alba: Yes. Thank you very much. Thank you, everyone.

William Oplinger: Thank you.