Alcoa Corporation

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CORPORATE PARTICIPANTS

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

Andrew Quail: Guys, welcome back. Our first company presenting is a new old company, I suppose.

Bill Oplinger: New old, yeah. A 128-year-old startup.

Andrew Quail: Yeah. Well, startups are in. and we've very fortunate enough to have Executive Vice President and CFO, most of you guys know Bill Oplinger. He's going to give us an update of what's actually happened, maybe, and where to from here in 2017 for Alcoa Corp, the new Alcoa.

Bill Oplinger: Thanks, Andrew. Good morning. This is a dead crowd. Good morning. All right. Everybody wake up. It's the first presentation of the day. Do you have this? All right. You'll probably see a few of these during the course of the day.

Andrew already introduced me. I'm Bill Oplinger. I've been with Alcoa, Inc. for around 16 years. I was most recently CFO of Alcoa Inc. Before that, I was chief operating officer of the upstream business, which is now Alcoa Corp., and am CFO of Alcoa Corp today. And as Andrew said, we've been a new company for a couple of weeks. So we have a 128-year-old company, but we just launched two weeks ago.

As Andrew said, I'll walk you through a couple of things, and then we'll field questions. When you look at Alcoa Corp, I think we're a very compelling investment. We launched two weeks ago today and have done pretty well so far. We have, as we say here, a global network of assets, tremendous leadership that has deep experience in the industry, very, very focused on cutting costs, and you'll hear me talk about that. That's one of the things that's different about Alcoa Corp. As we go forward, we'll be very, very focused on not only cutting costs at the plant level, but also in the overhead structure. Focused on return on capital, and so one of our key metrics will be return on capital. And I believe we're getting launched at the right point in the cycle with a strong balance sheet. So I'll walk you through all of those points.

When you look at our presence around the world, we've got six different business lines. Currently, we've got mining, refining, smelting, casting, energy, and our rolling business. We have 16,000 employees globally, 25 manufacturing sites, 10 different countries, so a very, very global presence, and I will walk you through each one of those businesses here shortly.

What are we doing differently? You can see on this slide a number of things that we're planning on doing differently from Alcoa Inc. First of all, if you look at our values, these are values that management have chosen. These are values that management believe in firmly, and they're very, very simplified values. I ask our people in the company, all 16,000 employees, to know these values, and they should be able to know them very easily. Act with integrity, operate with excellence, and care for people. What does that mean to you guys? Well, what it should mean to you is that we've simplified things, and these are the three values that we ask our employees to know every single day.

We're going to decentralize decision-making. If my boss were here, Roy Harvey, he would talk to you about having an operator-centric culture, where we would push down decision-making into the organization further, try to unlock some of the entrepreneurial spirit of the people that we have, and yet, continue to be very, very cost focused. Alcoa Inc. had a good track record of delivering significant productivity savings. We'll continue that with a little bit more focus around taking out some of the overhead structure that a mini conglomerate had in Alcoa Inc., versus a very focused commodity business in Alcoa Corp.

So, if you're buying Alcoa Corp, what are you buying? You're buying the world's largest bauxite producer with a first quartile cash cost position. You're buying the world's largest alumina refiner, with a 17th percentile cost position. So not only first quartile, but very good first quartile cost position. And you're buying a restructured smelting business. If you were to look back on our smelting business five years ago, seven years ago, we would have been at the 51st percentile to cost curve. We were double the size. And at low metal prices, we would have many assets that were losing cash. We've closed those assets over the last few years. We're down to less than 2.5 million metric tons of operating capacity, and we sit squarely in the second quartile of the cash cost curve. So a much better—much better positioned on the smelting cost curve, and a very good position in both bauxite and alumina.

In addition to these three businesses, we have three additional businesses. We've got a casting business that provides steady returns, on top of our smelting business. We've got an energy business that has a portfolio of assets down in Brazil, four hydro plants that at times have made very, very good money. With the environment today, as I'll show you with some of the financials, they still make very good money. And then, on top of that, we have a rolling business, and rolling is new to us. It's one of the assets that we picked up during the divestiture process. We have two rolling mills, one in Indiana and the other in Saudi Arabia. And we're going to treat those like the commodity businesses that they are. They play in the North American can sheet market. So what we will be doing differently there is filling the mill, driving costs down, and making those rolling businesses successful.

I'll transition to what does our marketplace look like. I told you you're buying into a very, very well positioned bauxite refining and smelting business. As we look out into 2017—2016, if I take a second to talk about 2016, 2016 we were probably the only company or the only industry analyst that was projecting a significant deficit of aluminum and alumina. I think some people scoffed at us at the beginning of the year, that we were projecting such large deficits. Both of those deficits came true during the course of the year. You can see that with the inventory flows out of the inventory and got consumed in 2016.

As we look forward to 2017, and just back on 2016, what happened? Prices went up a lot. We started the year at very low prices, and it's nice to see that the market did respond to the fact that there were deficits in the marketplace. So both alumina and smelting prices, as you can see from this chart, went up sizably during the course of 2016. As we look out into 2017, we continue to see some fairly good trends in the marketplace. Third party bauxite demand is growing sharply. Alumina demand is still very strong. We would see both of those markets to be balanced in 2017, so we don't see large surpluses globally, like some others may see. We don't see that going into 2017.

Aluminum, on the other hand, we've not taken a position. We'll take a position in January. You're probably wondering why haven't we taken a position. We wanted to gain a couple of extra months to see what actually restarts in China. We've seen, and many of you that follow this space, we are starting to see some restarts in China. We've also seen tremendous cost push in China, with higher coal prices, a weaker yuan, higher alumina prices. So we've decided to take a couple of extra months before putting out what we anticipate 2017 will look like in the aluminum space.

Now, let me get to some of the financials that I personally feel much more comfortable with. Six segments—six segments that drive earnings for the company. You can see this is the first half of 2016. We will have the first three quarters of 2016 here shortly. And you can see that both the bauxite business and the energy businesses provide great returns. If you were to look back at 2015, this picture would look slightly different, in that the alumina business is stronger in 2015. Recall that the first half of 2016 were historically very low prices, both in alumina and aluminum. So during the course of the second half of 2016, these numbers will improve.

With six distinct generators of EBITDA, we've broken out some of the corporate costs. We've got a group called Transformation at some of the plants that we've shut down, and then in addition to that, that's a power contract that we have down at our Rockdale facility, so you can see that. And then total overhead costs for the company through the first half were $94 million. If you think about that, through the second half, we'll be at around a little bit less than $200 million, so that's around 2 percent of total sales. So corporate cost at 2 percent of total sales. That's one of the areas that we'll be looking to reduce over time.

This is probably my favorite chart. The reason why it's my favorite chart is that if you look at the last three years, we had significant erosion in metal prices and alumina prices, and you can see that on the line there. So we've taken $300—the aluminum price, between 2013 and the first half of 2016 has come down $300. That means that our topline revenue fell by $3 billion, the combination of those two things. But look at our profitability. Profitability was only off by $50 million on a pretax basis. That speaks volumes to the repositioning that we've done in this business to take out higher cost facilities. So we're at a run rate in the first half of $1 billion of EBITDA. You can also see there the capital expenditures. We've taken out significant capital expenditures. We're running at around $400 million, and I'll give you guidance as we go into 2017.

So with that EBITDA level, and I haven't yet talked about the balance sheet, but I will, we will get—we were launched with $1.5 billion of debt. We were launched with around $600 million of cash, so net debt of $900 million, EBITDA of around $1 billion. It rounds out to 0.8 times, so fairly lightly levered. Debt to equity ratio of 0.2. We're going to—we currently have a DD- credit rating from S&P. We have a BA3 from Moody's. And you may be wondering why is that? And the reason for that is, if I just jump ahead one, is because we have a fairly large underfunded pension and OPEB obligation. So we have, as of the first half of this year, we have a $2.9 billion underfunded pension and OPEB liability, and we'll be going after that over the next few years on trying to reduce that. So we'll map out every opportunity that we can to potentially take that liability and reduce it over time.

We've provided a lot of transparency to you on the right-hand part of this chart around where that pension and OPEB expense is. The reason why we do that is we fundamentally believe that many people mis-value our pension and OPEB obligations. If you're simply doing an EBITDA multiple calculation for our valuation, many people will use an EBITDA multiple on our valuation and then subtract out the value and pension—the underfunded pension and OPEB obligation. If you're doing that, then you're fundamentally undervaluing the company. The reason being is that

$200 million of our expense, of that pension and OPEB expense, already sits in our EBITDA. So if you're doing that calculation, you just need to make sure that you're looking at the pension expense correctly.

But jump back to one slide and just take a moment to talk about our financial policy. I already said we're lightly levered. We have about $800 to $900 million of net debt. We have very strong liquidity. We've got $1.5 billion of a revolver, so it's undrawn as ofwhen we launched the company. Very, very focused on using return on capital as a metric for measuring our success. If we generate excess cash flow, we're going to do two things with that excess cash flow. The first would be to invest in growth projects, and I'll walk you through those growth projects—small, very, very small growth projects that provide returns of one to two years. And secondly, and I probably shouldn't list them as first and second because we'll balance between the two, we will do further deleveraging with that excess cash flow.

So how will we do the deleveraging? We'll put money into the pension plan or hold cash on the balance sheet. We haven't determined which way we would go at this point. But those are the uses of cash flow. If we have significant cash flow beyond executing on those two items, we will do either share repurchases or a special dividend. Very, very committed to returning capital to shareholders with excess free cash flow.

And then the last point is we've aggressively managed the portfolio. We'll continue to aggressively manage the portfolio if we see that the market environment requires it. At this point, much of the portfolio work that we've done is behind us. We still have one or two plants that we're looking at repowering and have to come up with solutions on those.

I talked about growth. We're not talking about huge numbers here. We have around $370 million of projects lined up. We will execute on $100 million of those growth projects in 2017. If we see that the market is very strong and that cash flows are good, we would consider increasing that return, seeking spend in 2017. You can see that they also have a return of $300 million of EBITDA, so on average, these projects have a one- to two-year payback. So across all six parts of our business, what you can also see here on the slide that much of the growth is projected to be in the bauxite and the alumina business, because that's where we see the best returns.

So guidance. We've provided much better transparency with Alcoa Corp than what we had provided in the past. We're now giving operational guidance around production volumes, and so we're seeing growth in the bauxite business, growth in the rolled products business. The other businesses, from a production standpoint, are flat because we're still losing some of the volume that we took out in 2016. So for instance, we curtailed one of our large refineries, which we were getting production in 2016. We curtailed a smelter in 2016 in Indiana, and that volume is being replaced by low-cost pre-projects (ph) that are much lower-cost than the volume we took out.

Some additional guidance: Corporate spending, less than $200 million. We left behind a significant amount of corporate overhead with Alcoa, Inc. So we talked about this. We did not take any of the corporate jets with us. We skinnied down the corporate office to only 15 people here in New York, so we're now on one floor in the New York office. We've eliminated our Geneva office. We've gone—and I use these just as examples—location by location and cut overhead costs, but there's still more work to be done. We'll spend around $100 million of return-seeking capital, $300 million of sustaining capital. You can see over the last few years, those are very low levels, and we'll maintain those low levels. And then pension and OPEB expense, as I said on the prior chart, $250 million of cash contributions to the pension in 2017; $200 million of expense. The cash contributions are the minimum cash contributions at this point.

To be clear on our pension, we'll be 95 percent funded from an ERISA basis, and 75 percent funded from a GAAP basis. So in a—not anticipating having to make significant contributions above that $250 million, but can if we desire to.

One of the things that I have been asked repeatedly is what's different about Alcoa, and one of the things about Alcoa Corp that is fundamentally different than Alcoa, Inc. is that we were given the opportunity to come out with a much better governance structure. So as a new company, we've separated the chairman and the CEO role. I personally believe that's the right way to have the business set up. We have a great CEO, a gentleman who has been in just about every job in the business over the last 15 years, as you can imagine. He ran a cast house. He ran a smelter. He ran a cast house in São Luís in Brazil, ran a smelter in Spain. Worked for me in finance in a number of different jobs, and actually ran HR for the last year for Alcoa Inc. So he's touched about every part of the business.

The other piece that I would bring to your attention in Mike Morris will be our chairman. Mike has a long history in the power business, which is very much like a commodity business, and so we're really, really happy to have Mike as a separate chairman.

In addition to that, we've decided to incorporate in Delaware. You say why is that a big deal? Well, Alcoa, Inc. was incorporated in Pennsylvania. We had the opportunity to incorporate in Pennsylvania. Delaware is much more shareholder-friendly. We've gotten rid of our staggered board. Alcoa Corp won't have a staggered board. I think that's much more shareholder-friendly. And then, in addition to that, we've put in place immediately proxy access. So again, I think we were—originated with really first-tier governance structure that we didn't have before.

So I will, before I take questions, I'll leave where I started. But in addition to that, I thought I'd take just a moment to summarize, fundamentally, how are we different than where we were when we were Alcoa Inc. Hopefully, you've gotten this message, but let me take a moment just to reiterate it. First of all, extremely cost focused, going after all the overhead costs, getting rid of all the processes that don't add value that were put in place really for a mini conglomerate that we don't need for a very, very focused commodity business. So going after costs at all levels. Secondly, capital allocations fundamentally different than what we had in Alcoa Inc. Free cash flow that is generated, as I said, will be used to grow the upstream business. It will be used to delever the balance sheet, and it will be returned to our shareholders. And then thirdly, the big fundamental difference is a world-class governance structure.

So those are the three things that I leave you with that are fundamentally different for Alcoa Corp. And I guess at this point, I guess Andrew and I will take questions.

Andrew Quail: Questions from the audience?

Unidentified Audience Member: You have a balance sheet for alumina for—I believe it's next year, and so wanted to know is that because of capacity additions, or is it due to restarts?

Bill Oplinger: It's a combination of things, Jim. It's looking at the demand that we're seeing in China with some of the smelting restarts and some of the projects that are coming online in China. We're not seeing significant growth in capacity outside of China. But yeah, we have a view of alumina that's balanced at this point.

Andrew Quail: I have a couple of questions, before people accelerate their question asking. (Inaudible) is obviously going to (inaudible) keeps going up through this underfunded pension is going to be helped. You guys are going to be speeding up a lot of cash flow, especially on our numbers, next year. And you're talked about a special—you've talked about deleveraging. What about dividends, and how do you guys balance that with return on capital for these 18 projects? And can you just go into a bit more about what are the top three projects? Are they all in bauxite? Are they just bolt-ons? Are they any sort of greenfield sort of stuff? Like, obviously, seeing sort of one- to two- to three-year paybacks, which suggests they're not greenfield. But are these just bolt-ons?

Bill Oplinger: Boy, how many questions can you—

Andrew Quail: Sorry. Yeah, that was a lot.

Bill Oplinger: Let me start where you started. You talk about the 10-year being up. We have a sensitivity to interest rates on the liability side, and just purely on the liability side, that's a 100-basis point move, which up until two weeks ago, if you talked about a 100-basis point move, people would say hey, you're nuts. But a 100-basis point move in any given year would help reduce our underfunded status by around $820 million, and that's both on the pension and the OPEB side. So a move up in interest rates would help us from the liability, and that quickly closes some of that liability.

In addition to that, as our EBITDA grows, and you saw that we're on a run rate of about $1 billion at much lower and alumina prices, as our EBITDA grows, I'm hoping we can get to a better position with the rating agencies. We're launched as a BB-. I think our optimal capital structure would be something more along the lines of a BB+. So you can see, with a little bit of help of interest rates, and as metal prices improve, we should be able to get there fairly quickly.

When we think about growth projects, the projects that we've listed out there are all brownfield projects. We are not, at this point, looking at making any large greenfield type of an investment. And the reason why we're doing that is we really feel, as a new management team, we've got to be able to show that we can deliver the smaller projects and deliver the returns on the smaller projects. We listed the 18 projects. We've got very good growth opportunities on the bauxite side, so that would be de-bottlenecking at Juruti. Juruti is our mine in the Amazon. We currently run that at around 6 million metric tons. When we launched that mine, it was less than 3 million metric tons. But ultimately, the infrastructure is scaled for around 12 million metric tons, so we think we can grow Juruti.

We are also working toward exporting out of Western Australia. And so this year, we've grown our third party bauxite market from 1 million metric tons to 6 million metric tons. We'd be looking to grow that further into the future. So it was a long-winded answer to a multi-faceted question.

Andrew Quail: And the last one was on dividends.

Bill Oplinger: Oh, I dodged that one.

Andrew Quail: Yeah, you did. Yeah, sorry. I know it's up to the board, obviously, but—

Bill Oplinger: It is up to the board, and our board gets seated in November. Let me just tell you how I'm thinking about things. You know, we would be weighing a special dividend versus share buybacks. And I know a lot of people sometimes get uncomfortable about share buybacks, because sometimes mining and metals companies buy back at the peak of the cycle. I personally favor share buybacks for a number of different reasons, but we would also be considering a special dividend, if we had excess free cash flow.

Andrew Quail: And how's the relationship with Alumina, now that you guys have split?

Bill Oplinger: The relationship with Alumina is good. You know, it's a long-term relationship that we've had since the mid-'90s. You didn't ask this, but I personally value the leadership of Alumina Limited. I think Alumina Limited has—a number of their top leaders are really, really bright guys, and they bring a lot to the venture.

When we first sat down and had the dispute over the consent rights, we were a little bit concerned that there would be a value transfer between Alcoa Corp and Alumina Limited. I think we came up with a solution that really helps both Alcoa Corp and Alumina Limited. So we came up with a solution that relaxed exclusivity, so it gives them the opportunity that if an industrial buyer wanted to purchase them, they can come into the partnership and not necessarily have to contribute their assets. It streamlined some of the governance, and so ultimately, I think it really helped. The solution that we came up with is one that adds value for both companies, and the relationship is good.

Andrew Quail: Any more questions from the audience?

Unidentified Audience Member: A couple of questions. First, what's been your historic maintenance CapEx? You're projecting about 3-odd percent for next year on the guidance you gave, number one. Number two, on your sensitivities, do those incorporate the AWAC (ph) split on the sensitivity tables? And then, the third thing was, post-split, do you have any visibility on what Arconic is going to be looking at to divest their last retained ownership in you, or is that pretty much with them and you don't share thoughts on how they would look at that?

Bill Oplinger: Okay, I will tell you, I'm not great with multi-part questions. To answer your first question—I generally remember the first one and the last one—maintenance CapEx, we've brought it down from $470 in 2013 down to a run rate of around $300 million. We would be projecting to keep it at $300 million in 2017. And then, from there, we've not given a projection forward. Our maintenance CapEx, as you know, in this industry can be a little bit lumpy, because in the refining business, you've got large red mud-like projects. But at this point, for 2017, we would be projecting $300 million.

The second question—what was the second question?

Unidentified Audience Member: Was sensitivity (inaudible) AWAC.

Bill Oplinger: Yeah, the sensitivities that we provide in the back are EBITDA sensitivities. Our EBITDA is 100 percent accounted for. If you look at the bauxite and the alumina business, you would have to back out their share of that. So the sensitivities are given on an EBITDA basis.

The third piece is around whether Arconic will continue to own the 20 percent. I should have mentioned that. For those of you who aren't that familiar with us, in the separation process, our parent company, which was Alcoa Inc. now Arconic, retained a 20 percent stake in Alcoa Corp. I would imagine at this point they're very happy that they did that. But they have a 60-day lockup period, so they would not be selling before that. They have stated—. ultimately, I stated before the separation it would be—they would anticipate liquidating that within the first 18 months of post-separation. So a lockup period of 60 days, a target of having sold those shares by 18 months, and beyond that, you can ask them if they have other plans.

Unidentified Audience Member: Is the merchant market for alumina shrinking, and is it your customers that are adding to alumina capacity?

Bill Oplinger: Is the merchant market for alumina shrinking? Let's ask Andrew. What do you think on that one?

Andrew Quail: I think so.

Bill Oplinger: You think it is?

Andrew Quail: No, I—I—

Bill Oplinger: Okay. Jim, there is a view that, in the longer term, the industry will get more vertically integrated again. We're working our way through that view and trying to determine that. But I don't think in the near term that we see that the merchant market is shrinking. We, if you think about Alcoa Corp, we've got 13 million metric tons of production internally—and that's AWAC, I should say. Alcoa Corp uses around 5 million metric tons, so that means that AWAC, the entity, is long about 8 million metric tons. The global market for alumina is approximately 110 million metric tons. So I'm confident that we can place our 8 million metric tons into the market effectively. I don't know if that's what you were getting at, but we shouldn't have a problem there.

Andrew Quail: Any last questions? I've got one more, and it's over to the share process being very strong. I think Arconic would be very pleased with keeping their 20 percent. What is the most common two questions that—you've obviously seen a lot of investors over the last couple of weeks, or probably months. What are the two most common questions, since the split, that you've fielded on the new Alcoa Corp?

Bill Oplinger: Well, you know, the Alcoa Corp story, and I hate to use that term, but the Alcoa Corp story is pretty easy nowadays. We're a much more streamlined company. Our commodities business, we're going to run it like a commodities business, very, very focused on cost. I think the areas of interest that we get the most are really around the upstream part of the upstream. So are there opportunities to grow the bauxite business? We believe there opportunities to grow the bauxite business. But then we also make sure that people understand that we have five other businesses than bauxite, and those five other businesses are good business. And that's one of the reasons why I spent so much time talking about the low cost position in smelting and refining. So I think at this point, it's an easier business to understand and to explain, and so I think we're in pretty good shape.

Andrew Quail: What about the energy business segment? Is that a harder one for a sell side analyst to model?

Bill Oplinger: It can be. Ultimately, our energy business is going to be very much centered around Brazilian hydro prices. And there are publicly available sources of Brazilian hydro prices. We sell forward a little bit. Going into 2017, we've probably locked in about a third of our revenues for that business, so we're exposed to increasing energy prices in Brazil. We're bullish on energy in Brazil. And so you say why is that? The economy—right now, if you look at the first half, we generated around—or say 2015, I think we generated around $175 million in EBITDA. It was not a good year for energy prices in Brazil, and with the economy hopefully coming back stronger, with the real being where it's at, I think there's opportunity for upside in our energy business, and at this point, we like it.

Andrew Quail: All right, well, please join me in thanking Bill for his time this morning. It's a great update on Alcoa.

Bill Oplinger: Thank you.