Alcoa Corporation

First Quarter 2017 Earnings Presentation and Conference Call

Monday, April 24, 2017, 05:00 PM Eastern

CORPORATE PARTICIPANTS

Roy Harvey - *Chief Executive Officer*

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

James Dwyer - *Vice-President of Investor Relations*

PRESENTATION

Operator
Good afternoon and welcome to the Alcoa Corporation First Quarter 2017 Earnings Presentation and Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your touchtone phone, to withdraw your question, please press "*" then "2." Please note this event is being recorded.

I would now like to turn the conference over to James Dwyer, Vice-President of Investor Relations. Please go ahead.

James Dwyer
Thank you, Amy, and good day, everyone. I am joined today by Roy Harvey, Alcoa Corporation's Chief Executive Officer and William Oplinger, Executive Vice-President and Chief Financial Officer. After comments by Roy and Bill, we will take your questions.

As a reminder, today's discussion will contain forward-looking statements relating to future events and expectations that are subject to various assumptions and caveats. Factors that may cause the company's actual results to differ materially from these statements are included in today's presentation and in our SEC filings.

In addition, we have included some non-GAAP financial measures in this presentation. Reconciliations to the most directly comparable GAAP financial measures can be found in the Appendix to today's presentation. Any reference in our discussion today to the historical EBITDA means adjusted EBITDA for which we have provided reconciliations and calculations in the Appendix.

Finally, a note on financial statements methodology. Because Alcoa Corporation commenced operations as a standalone public company on November 1st, 2016, the financial statements are a combination of financials carved out from Alcoa Inc, prior to November 1st, 2016 and actual results of Alcoa Corporation thereafter.

For example, the fourth quarter 2016 results include October on a carve-out basis and November and December actual results. Similarly, the first quarter of 2016 results included in the presentation are entirely on a carve-out basis while the first quarter 2017 results are entirely actuals. With that, here is Roy.

Roy Harvey
Thank you, Jim. Welcome to our call to review Alcoa's first quarter results, our first full quarter as a standalone publicly traded company. Looking back at the last three months, we are pleased with what we've achieved in the first quarter. We had a strong financial performance, and we also made strides towards our strategic priorities. We still have much to accomplish, but we are on the right path to meet our goals this year.

Turning to some of the highlights of this last quarter, we generated adjusted net income of $117 million or $0.63 per share. From an adjusted EBITDA point of view, excluding special items, company profits rose 59% sequentially as our employees drove higher pricing to the bottom line. All three segments increased profits and margins, plus we closed the quarter with a healthy cash balance. As for our markets, we are maintaining our stable outlook for 2017 but raising expectations for global aluminum demand growth.

Using refreshed assumptions, our full year outlook of $2.1 [billion] to $2.3 billion in adjusted EBITDA excluding special items remains unchanged and we continue to target $50 million in net performance improvement this year.

Lastly, and importantly, we continue to execute on our three strategic priorities to reduce complexity, drive returns and strengthen the balance sheet. It's been a very busy quarter but one that demonstrates our commitment to simplify our overhead structure, we've streamlined our segments and we will be doing the same with our administrative locations. In addition, the recent rating by Fitch underscores our strengthening balance sheet.

With that, I'll turn it over to Bill for a closer look at the first quarter financials.

William Oplinger
Thanks, Roy. I'll quickly run through some of the details of the results. As Jim said, it's important to remember that prior to November '16, our financials were prepared on a carve-out basis. First up is our GAAP quarterly income statement which includes all special items. Revenues increased to $2.7 billion improving $118 million sequentially and $526 million year-on-year on higher alumina and aluminum prices.

Net income attributable to Alcoa Corporation was $225 million or a $1.21 per share improving $350 million sequentially and $435 million year-on-year. The gain on sale of our Yadkin hydropower assets in North Carolina drove other income of $100 million and in accordance with the terms of our separation agreement, Arconic received the sale's net cash proceeds.

Let's take a look at the special items in the quarter. Special items this quarter totaled a favorable $108 million after tax, and as I mentioned the main special item is the Yadkin gain on sale of $120 million. There are some smaller unfavorable special items, restructuring and other charges are $9 million driven by cost related to our curtailed Wenatchee smelter. Remaining special items include energy contracts, mark-to-market and a small favorable discrete tax item.

Now let's look at adjusted EBITDA and the full income statement after special items. Adjusted EBITDA including special items is $533 million in the first quarter, up $198 million sequentially and $354 million year-over-year. Net income attributable to Alcoa excluding special items was a $117 million or $0.63 per share.

Some key points: margin expanded as cost of goods sold grew slower than revenue, revenue was up both sequentially and year-on-year on higher alumina and aluminum prices, SG&A and R&D decreased sequentially in year-on-year.

For items below the EBITDA line, other income and expenses unfavorable at $25 million, primarily due to foreign currency translation effect. Interest expense declined to $26 million reflecting our low debt level; remember that due to carve-out accounting interest expense in the fourth quarter included $19 million of allocated interest in October. Our operational tax rate depends heavily on market prices and in which jurisdictions we have gains and losses. And in the first quarter, the operational tax rate settled at 35.3%. Net earnings attributable to non-controlling interest increased $29 million, to $80 million due to higher earnings in our AWAC joint venture.

Take a closer look at the factors driving adjusted EBITDA in the quarter. Sequentially EBITDA is up a $198 million, higher metal and alumina prices drove $249 million of EBITDA improvement with partial offsets from unfavorable currency, higher cost and lower volumes. The currency impact at $23 million was unfavorable primarily due to balance sheet revaluation in our alumina business, volume at a negative $18 million was unfavorable due to weather conditions in Brazil impacting bauxite shipments and changes in alumina shipping schedules partially offset by the improvement in our flat rolled aluminum shipments.

Energy, an unfavorable $18 million, reflects the planned shifting of Brazilian energy sales into the second half of the year as well as higher fuel oil and natural gas prices in our alumina segments. The remaining items netted to an $8 million sequential improvement.

Now let’s take a look at our business segments. We are providing EBITDAs and margins of our three segments for the first quarter ’17 as well as fourth quarter ’16 restated to our new structure. To see details of how the new segment structure differs from the old one, refer to the Appendix. First quarter ’17 adjusted EBITDA in the segment totaled $613 million, up $188 million sequentially, a result of substantial gains in the Alumina and Aluminum segments and solid Bauxite segment performance.

Compared to fourth quarter, EBITDA margins expanded in all segments, led by Alumina’s 990 basis points jump. Bauxite adjusted EBITDA rose $8 million on higher inter-segment pricing which helped increase margins at 38.1%, and Alumina improved $126 million on favorable alumina price index pricing and stronger price mix partially offset by higher bauxite costs and unfavorable foreign currency. In Aluminum, adjusted EBITDA was up $54 million or 36% to $206 million, the $96 million favorable impact from higher metal prices with a partial offset by higher alumina cost.

Segment earning bridges as well as other more detailed financial information are available in the Appendix to this presentation. While it’s moved to a simplified segment structure we intend to provide some details for the Aluminum segment. For example, the Brazilian hydro energy assets produced EBITDA of $11 million and North American flat rolled aluminum had a very strong rebound with an adjusted EBITDA of $11 million in the first quarter.

Now let’s look at adjusted EBITDA’s items outside of the segment. Combined, our three non-segment line items improved $10 million sequentially and impacted EBITDA by $80 million in the first quarter. We’ve combined our legacy pension and OPEB cost with transformation to show all of our legacy cost on one line.

This quarter, we moved the closed Warrick Smelter and Suriname Refinery, as well as the Anglesea and Afobaka power facilities into transformation. Our transformation entities plus our legacy pension and OPEB costs totaled $32 million in the quarter decreasing $4 million sequentially. In the first quarter 2017, Rockdale was $13 million or approximately 40% of the total.

Other corporate costs increased $9 million to $39 million primarily as a result of higher intercompany profit eliminations, mainly in Alumina. The eliminations are caused by changes in intercompany profit held in inventory. As our segment margins improve, there is more intercompany margin to eliminate at the corporate level. If margins and inventories remain stable, future eliminations should be minimal.

Finally let's take a look at the quarter with a review of the balance sheet metrics. Cash remains a focal point and cash balance as of March 31st was $804 million, only $49 million lower than December 31st. This is despite first quarter typically being our lowest of the year for free cash flow due to seasonal build in working capital, the January Department of Justice and SEC payments and bi-annual interest payments and other seasonal outflows. Our strong EBITDA of $533 million for the quarter drove free cash flow of $3 million. For perspective, free cash flow in the first quarter last year was a negative $445 million on a carve-out basis.

Total capital expenditures in the quarter was $71 million. We anticipate the spend to pick up speed as we move through the year and continue to invest in more return-seeking projects. Our first quarter return on capital at 6.2% is up 4.7 percentage points compared to our full year 2016 level.

Leverage remains low with net debt at $650 million and net debt to adjusted EBITDA of 0.5 times, and the underfunded pension and OPEB net liability is $3.0 billion. Now before I move on to the outlook for the quarter for 2017, I would note that Fitch launched coverage on the Company today and launched at BB+ if you have not seen that news.

Moving on to the 2017 full year projections, our shipments outlook for the Bauxite and Alumina segments is unchanged. For Aluminum our new total shipments outlook combines third-party shipments of the former cast products and rolled products businesses. We've expanded the financial metrics section slightly to improve visibility between segments EBITDA, corporate EBITDA and net income.

As noted earlier, we have moved four facilities into transformation. For 2017, we now estimate combined transformation and legacy pension OPEB impact to be $165 million. Looking at the first quarter '17 run rates, we are on track on all income statement items expect other corporate spending where we expect improvement throughout the year and are holding to our full year outlook.

Two items will be a bit uneven over the next few quarters. We expect Rockdale to cause a $15 million to $20 million unfavorable sequential impact in the second quarter due to a planned annual maintenance outage, and we expect depreciation to be approximately $10 [million] to $15 million higher in the second quarter than in the first quarter, but then decline to hit the full year target. Our outlook for the 2017 cash flow impacts remains unchanged.

Now, let me turn it back to Roy

Roy Harvey
Thank you, Bill. To start, I would like to touch on our fundamental outlook for bauxite, alumina and aluminum. We continue to expect our markets to remain stable in 2017. For bauxite, we still see the market in relative balance, anticipating that Chinese will continue to stockpile bauxite strategically throughout this year while in search of new sources of high quality consistently delivered material. The announced winter alumina and aluminum curtailments, as well as the extension in the Malaysian bauxite export ban to June 2017, lead us to a tighter range for Chinese stockpile growth throughout this year.

At the BMO conference, we spoke about the potential for government-driven winter curtailments in China. Since that time, the winter curtailment plan has been altered by the Chinese Ministry for Environmental Protection, resulting in changes embedded in our latest outlook. As such, for alumina, we are still forecasting the market to be in relative balance, albeit slightly longer than previously anticipated. In addition, to the expectation of MEP curtailment, we continue to see strong global demand and relatively little competitive capacity available to restart.

For metal, we are maintaining our outlook of a modest surplus for 2017. We are raising our demand forecast, both in and outside of China. In China, we have upwardly revised our demand growth rate figure from 6% to a range of 6.5% to 7%, driven by encouraging news in the transportation and construction market which are the two largest aluminum consuming factors.

In the world ex-China, we are upwardly revising our demand growth estimate from 2% to a range of 2.5% to 3%, driven impart by improved semi-fabricated products production in Europe and continued strong demand growth in North America. As a result of these regional trends, we are revising global demand growth from 4% last quarter to a range of 4.5% to 5%. However, this higher demand is mostly offset by higher expected supply, resulting in a similar outlook to last quarter of a modest surplus this year.

With our supply forecast rising slightly, I would like to spend a few minutes describing global competitive pressures in aluminum. Our outlook for aluminum this year is based in part on divergent cost trends we are seeing in China versus the world ex-China. When we look at the past few quarters in alumina, energy, carbon and metal prices, we see a consistent trend that favors the competiveness of operating capacity outside of China.

Rest of world revenues have increased more than cost, while the opposite is true in China. The price changes reflect balance conditions in each of the two regions, as China remains in a stubborn surplus, while the rest of the world continues in a structural deficit. The cost movements steepen the global aluminum cost curve, and in general a steeper cost curve supports improved industry margins.

As China has moved up the cost curve, smelting margins have been under pressure and have even turned negative for an increasing proportion of their production facilities. This pressure supports our market outlook that includes further curtailments in China this year.

Also, we continue to see minimal primary exports from China as the current economics make them unprofitable. Additionally, fake semi-fabricated products are trickling out of the China at a rate lower than each of the past two years, driven again by economics and increased global awareness.

These factors combine to drive our outlook of a stable global aluminum market, but also illustrate the risk of sustained overcapacity should no action be taken. As I stated during my remarks at the BMO Conference, supply side reductions in China are still uncertain. Still, a heightened focus on environmental issues and shifting competitiveness can have outsize impact on our market. Alcoa Corporation remains ready to act thoughtfully and quickly as our markets develop.

To further strengthen our company, and as I mentioned earlier, we've remained focused on our strategic priorities. We made two announcements over the last few months, both in support of reduced complexity.

First, we streamlined our business segment from six to three. We took this action to align our segments with our three main product families, bauxite, alumina and aluminum. The new Aluminum business unit encompasses four former segments, aluminum smelting, cast and rolled products along with the majority of the energy assets. There are three major benefits to a combined aluminum business.

First, it offers the ability to better align on strategic, operational and commercial activities.

Second, it allows us to take advantage of synergies across the segment and to optimize resources. Finally, it permits us to simplify our chain of command and supports quicker decision-making.

Importantly, we have thoughtfully crafted this new BU strategy to avoid losing the benefits of having separated these businesses originally. Our organizational structure will continue to permit transparency in reporting, detailed understanding of each individual product line and strategic insight of the markets we serve. We have also committed to transparent external reporting, so our investors can continue to measure our progress.

Second, we are consolidating our administrative locations to reduce corporate overhead; eight locations around the globe will be closed, including our New York office. As a result, we will move our global headquarters to our existing Pittsburgh location starting on September 1st. Once the office changes are implemented, we expect annual savings in corporate overhead of about $5 million which is, of course, a help to our bottom line.

More importantly, however, it's another example of how we are driving to be a more operator centric company with a smaller footprint of corporate overhead and focused at all levels on profitable and successful operations. These changes will bring the executive team closer to employees and strengthen collaboration at all of our remaining administrative locations. It was a simple announcement, but emblematic of a drive to simplify our structure.

We've also taken action this quarter to further embed the concept of the capital stewardship across the organization. While this spans all levels of management, one important and publicly visible aspect involves our compensation philosophy. We believe that Alcoa's executive compensation program should be aligned with our stockholders' interests, and the metrics that measured performance should reflect this philosophy.

To that end, this year we adopted a new long term compensation plan focused on two equally weighted metrics.

One, one half of performance will be based on improvement in our return on capital. We have targeted a 200 basis point increase from a 2016 baseline to the end of 2019, normalized for market conditions. We chose this target following extensive dialog, but the rationale is simple. The entry point to the top-quartile of performers on S&P 500 Index was at 200 basis points; it seemed a logical place for our first set of targets and would demonstrate our resolve to quickly and decisively improve our returns independent of market pricing.

Two, the other half of executive compensation will be based on total shareholder return relative to the performance of the S&P 500 index over the plan's performance period, which spans January 2017 to the end of 2019. Again, this aligns executive management's compensation with the interests of our stockholders.

As you can see our philosophy is quite simple, align our interests with our stockholders, use simple easily explained metrics and create aggressive targets that lead to a clearly strengthened company.

As I've stated during prior presentations, we are pursuing a simple and easily explained set of strategic priorities. In each of our decisions, we strive to examine three key levers, reduce complexity, drive returns and strengthen the balance sheet.

As stockholders of this company, I invite you to hold us accountable to delivering on these three pillars, and it is our responsibility to explain our business performance, as well as our strategic actions in light of these guiding principles. We have made real progress this quarter. I am very proud of what the team has accomplished financially and operationally, although we are never satisfied and see many opportunities for further improvement.

I am pleased with the steps we have taken to simplify our overhead structures, eliminating three segments while maintaining operational transparency, consolidating our global administrative offices to foster a more inclusive corporate culture and re-tooling our executive compensation metrics to clearly align our interests with our stockholders.

Furthermore, we continue to see strength in our underlying markets. In aluminum, demand growth has ratcheted up since last quarter, while we continue to see positive developments on supply side reform, although we await tangible actions. There are no doubt challenges ahead, still, we will continue to reap the benefit of an operator centric culture an aligned and enthusiastic management team and an unrivalled set of global assets.

With that, I would like to invite any questions that you might have for either of us.

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. Please limit yourself to one question. To ask a question, you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys, to withdraw your question, please press "*" then "2." At this time, we will pause momentarily to assemble our roster.

The first question comes from Andrew Quail at Goldman Sachs.

Andrew Quail
Good afternoon, Roy and Bill. Thanks very much for the update, and well done on a very strong quarter. Hey, if I only get one question, it's on cash and just on free cash flow. If I look at the working capital which you guys did touch on, what's more normalized going forward? Obviously, it's almost $370 million hit this quarter, which obviously understand the cash flow. Can you guys just give us some guidance on where you'd be happy with going forward, and if that's going to reverse in say Q2 or in the second half of 2017? And then following on from that, on cash is that you guys obviously spinning off a lot of cash. Can you talk about capital allocation going forward, maybe Roy and just to say what's the preference for you guys with any excess cash that you guys generate?

William Oplinger
Yes, so Andrew, let me comment on both of those. We did consume cash in working capital in the first quarter. I can't get to your $300 million, but I am sure Jim can step you through the numbers later, but we did consume cash. That is not unusual for us, and we typically recover cash during the course of the year as we bring working capital back down. We would be targeting to keep our days working capital similar to where we ended the end of Q4, and I think

from a days basis, we ended Q4 at around 13 days of working capital. We would be targeting to do that same level in the fourth quarter of this year. Now, the reason why I expressed it in a days basis is because I don't know where prices will be in the fourth quarter and that impacts revenue and AR and payable. So generally, we would anticipate bringing working capital down, recovering the burn that we had in the first quarter and getting back to around 13 days basis.

I'll address your second question around capital allocation. We have been pretty clear, so I will just reiterate it again. Primary use of cash for us is to first of all sustain the assets; second of all we make mandatory contributions to the pension and OPEB plan. Beyond that, we would be looking to de-lever more, and so we have got a couple hundred million dollars of pre-payable debt down in Brazil and potentially increase the spend on return-seeking projects. So that would be the rank order of capital allocation going forward.

Roy Harvey
And Andrew, just to connect that with our three key strategic priorities too; you think about number two and number three, driving returns, making sure that we have the right projects in place and projects that are strong enough in all markets to have an end point that generates value for our shareholders and then strengthening our balance sheet, right. I think Bill said it very well, but we are focused as we generate extra cash to make this Company future safe, but also to find how do we generate more earnings into the future.

Andrew Quail
Thank you very much.

Roy Harvey
Thanks.

Operator
The next question is from Dave Gagliano at BMO Capital Market.

Dave Gagliano
Great, thanks for taking my questions and for the clear presentation. I just actually have a couple of questions related to a couple of slides in the appendices. First one, slide 25, it shows how the volumes flow through the aluminum value chain. This is that of one, you also showed some positives as well, shows 12% of bauxite goes to third parties, 30% of alumina goes to third parties. My question is, where should we expect those third-party percentages in both bauxite and alumina to be, say in the next one and two years? That's my first question.

William Oplinger
Dave, that's a great question. And let me start from the back of the chain and work backward. We will, on the alumina side, we will continue to creep our alumina refineries. We would typically try to get to 1% to 2% creep per annum. We have been very successful at creeping those facilities over the years. And as we would creep, most of that would go to external customers, if you assume that our smelting base stays the same. And the reason why I say if you assume the smelting base stays the same that would drive your next logical question to what will we be doing with smelting over the next year or two.

And at this point, we are evaluating as we always do our smelting portfolio on the conditions that we have today, and seeing if there is anything we want to do from a strategic perspective on smelting. If we then work backward into the bauxite side, we have said that we will grow our external bauxite business by around 10 million metric tons over the next four to five years, that would be on top of the roughly 6 million metric tons that we sell to customers in 2017, so that would change those numbers to a higher percentage for third party over the next four to five years.

Roy Harvey
And Dave, just to add one point too, remember that we are always transferring at market price and the more external sales we have for bauxite, the better we can make sure that price really reflects the market. So as we think about how we creep forward those sales, and we see the mix between internal and external sale. I think you are going to see a lot of consistency behind the markets that we are in, in each of those segments. And to bring it back to this quarter, we actually saw an increase in prices between our bauxite and our refining alumina business in the first quarter versus the fourth quarter because we have seen bauxite pricing go up over time, and so we adjusted that to try to put it on as arms length on the basis as possible.

Dave Gagliano
Okay. That's helpful, thank you. Then I have a follow-up with a couple of pieces to it. First, on the comment you made about the smelting capacity and evaluating strategic or you mentioned the word strategic in there. I am wondering, we have seen price increases obviously lately, what do you think in regards of the strategic, more closures, more curtailments, restarts, divestitures, how should we be thinking about that comment?

William Oplinger
Yes, and that comment wasn't meant to lead you anywhere in specific. You know, having followed us for years we do a regular review of our entire smelting portfolio and our refining portfolio. When prices were way down, we were consistently curtailing and closing facilities when it did not make sense to run those. At today's pricing level, we are running the analysis and trying to determine whether it makes sense to restart facilities.

And in the case of potential restarts, as you well know, we would be looking at what do we think of metal prices, what's going on with currencies, can we get a mid to long-term power supply solution, those were the big inputs. So that wasn't meant to give you anything that would surprise you. It's an analysis that we run on a monthly basis to see whether we would make more money running facilities than having them curtailed.

Dave Gagliano
Alright, that's perfect, thank you. And then just a last related part of that question, are you thinking about restarts along the alumina side as well 2.3 million tons, I think, of curtailed alumina capacity at Point Comfort. Is that also being considered?

Roy Harvey
We look at all the capacity that we have idled and we take a good hard look at it. I think Bill hit just the right set of criteria that we use. So we absolutely look at it, and when and if we make the announcement we would let you know.

Dave Gagliano
Okay, thanks very much.

Roy Harvey
Thanks Dave.

Operator
The next question is from Evan Kurtz of Morgan Stanley.

Evan Kurtz
Hey Roy, Bill, Jim…how are you doing?

Roy Harvey
Hi, Evan, good.

William Oplinger
Hi, Evan.

Evan Kurtz
So just a real quick one first on aluminum pricing, is there any way you could provide us with realized aluminum price in the quarter, some of what we used to get from the combined company? Is that something that's going to be disclosed going forward?

William Oplinger
Should be; it will be in the [10-]Q, and I say, yes, we can provide that for you and it will be in the [10-]Q.

Evan Kurtz
Okay great. And then next question is just on pension and OPEB. I noticed that there is a pretty big step up in mandatory cash, if you go out past 2017. And just thinking some of those through, it seems like we are in an environment where interest rates are rising. I assume that most of those mandatory cash contributions are based on MAP-21, so that's falling since you are going to the 20 year average and taking out high interest years and replacing them with low interest years. Is there an opportunity there to petition for getting back on a spot interest rate system where you're able to actually raise your discount rate, and maybe reduce some of those mandatory cash contributions and/or reduce your pension OPEB liability as interest rates rise, assuming they do over the next few years?

William Oplinger
Yes, so the biggest driver of the increase in the pension contributions, and I would note that OPEB contributions are not being projected to go up at this point, but it's really being driven by pension. We had a difficult 2016 when it came to asset returns. Our asset returns were down, and the US pension were down about 5%. And so, that is the biggest driver in the 2018 and 2019 increase in pension contributions that is projected to occur.

As far as going off the interest rate today, we are looking at all the different alternatives, Evan, and if we can find out a way to potentially lower those projected future cash contributions, we will take advantage of it.

Evan Kurtz
Great, thanks. I will hand it over.

Operator
The next question comes from Timna Tanners at Bank of America.

Timna Tanners
Yes, hi. Good afternoon, guys.

Roy Harvey
Hi, Timma.

William Oplinger
Hi, Timna.

Timna Tanners
So I wanted to just be a little more oblique about the guidance for the year and if we think about the puts and takes, it seems like since last quarter, aluminum is stronger and alumina is weaker, so I want to delve into alumina a little bit more and in particular there has been a lot of concern about caustic prices going up and new capacity coming on more quickly in China being frontend loaded relative to the aluminum capacity in China. Can you address a little bit more your views on the alumina market and why it's more bullish than aluminum given that it's been weaker and also address the caustic issue and any measures you might be able to enact there to control this cost? Thanks.

Roy Harvey
Sure, Timma. Let me hit a few pieces of that and Bill can chime in as well. So when we think about the dynamics in China, I think you've seen three significant changes over the course of 2016 and then coming into 2017 as well. On the aluminum and alumina fronts, but particularly on the alumina front from prices below 200 up to a sustained high that just started to come off. And so, at this point what we see is that pretty much every refinery in China is operating. So the good news there is that you don't have additional capacity to come online outside of some of the expansions that have been talked about, but the bad news is that you got every refinery operating and you are starting to generate a good amount of production.

At this point, as we look at what's happening in the market, we continue to see relative strengths in marketing. We are sitting around $305 per ton on outside of China, but we've seen weakness, just lately, inside of China. We also have the impact of a couple of smelters having operational problems. And so, that generated a little bit of a pause in the alumina market to try and find where it's going.

Now when we think about the announcements particularly concerning the environmental reduction during the winter months, those are targeted both for aluminum and alumina. However, what we see is that we still have consumers for each of the shipments that we have from an alumina perspective. So I think the market right now is waiting to see what happens with some of the reductions from an aluminum standpoint and then the knock-on impact from what happens in alumina. I think the aluminum side gets a lot of press and a lot of coverage. I also think there is a lot of work going on the environmental side on alumina as well.

So similar to my comments during the presentation, I think we are at a moment of cautious optimism because of so many programs that seem to be constructed at this point but still haven't seen the tonnage reductions on the ground in China yet.

William Oplinger
If you allow me, I can address the caustic question. Great question, Timma. Caustic is up substantially year-on-year. Caustic is up 40% from a year ago probably another 15% just from the prior quarter, from the fourth quarter. As you know, our caustic flows through on a lag basis, so we don't see that impact immediately. But in China, specifically many of the dynamics that are impacting our industry are also impacting the chlor-alkali industry. Specifically, we believe China is getting serious around the environmental impacts of many of their heavy industries and

we are seeing Chinese caustic prices rise quicker than US Gulf Coast caustic price. We take advantage of our ability to arbitrage between the two but locally in China the environmental and transportation restrictions we believe could potentially have some impacts on caustic availability in the second quarter and the third quarter of this year.

Roy Harvey
So just bringing that back to an Alcoa Corp. perspective, we've seen what have been more cost pressures from a caustic standpoint in China. We do see knock-on impact outside of China but our ability to arbitrage does give us an advantage there. The other important advantage and I'll start in alumina is that the bauxite that we use tend to drive a lower caustic consumption, hence rising caustic prices effect everybody, but it helps drive us down the cost curve because of lower caustic consumption.

Now I am also going to make an advertisement for our bauxite business, which is we actually sell bauxite that allows a customer to lower their caustic consumption and it increases the value of our bauxite to a potential customer. So for us, it's obviously a headwind as we see caustic prices starting to come up, that also helps to play to our strategic advantage both in our alumina and our bauxite businesses.

Timna Tanners
Got you. So just pulling that all back together to the guidance that you gave, is it a fair assessment of the reason that the guidance is flat, is that while aluminum is up, alumina is down and caustic is up, are there other big moving parts if I'm looking top level at the guidance, lack of guidance change?

Roy Harvey
Yes, I would say remember that when we look at the $2.1 or $2.3 billion in EBITDA, all were really changing for is the market impacts of the currencies and then alumina and aluminum prices. So we continue to hold to the $50 million net performance target, within that there is a higher increase in caustic prices and we expected, but we're planning on offsetting that with some of the overheard moves that we made as an example. So we hold to the $50 million and we are flexing what's happening in the external environment. So since the end of the fourth quarter when we reported fourth quarter earnings, what we've seen is exactly what you've said, aluminum prices have increased, alumina prices have come off to a certain extent and the Aussie dollar has also strengthened. So the mix of those things mean that our guidance essentially is unchanged even though the mix is coming from different segments.

William Oplinger
And so like Roy said just versus prior guidance, aluminum is up $105, so went from $1795 to $1900. Alumina I believe we were at $335 and we are taking it down to $305. There are loads of things that change within other factors, for instance higher raw material costs, which will make that $50 million challenge that we've laid out for ourselves harder to achieve, but at this point we're committed to achieve that and maintain the [$] 2.1 to 2.3 [billion] EBITDA level.

Timna Tanners
Okay, good. Thank you very much.

Roy Harvey
Thanks Timna.

Operator
The next question is from Justin Bergner at Gabelli & Company.

Justin Bergner
Hi, good afternoon, Roy, good afternoon Bill. Thank you for taking my questions.

Roy Harvey
Thank you.

William Oplinger
Thank you, Justin.

Justin Bergner
I just wanted to start off by clarifying a few things. On the EBITDA bridge, I think it came out a little bit fast, but could you just talk about the energy headwind of $18 million, what drove that and how that's going to vary in future quarters, was that in line with your expectations or a little bit larger than what you were expecting?

Roy Harvey
Yes, so really two big impacts on the energy piece in the first quarter. We made a decision, to the most of our ability down in Brazil, to shift megawatts from the first half to the second half of the year. We looked out; we saw that pricing was pretty low in the first half and we are able to shift an amount of our energy to be sold into the second half.

That decision impacted us by about $15 million on a sequential quarter basis in Brazilian energy sale, and we hope to pick that up in the second half of this year and at this point that decision is looking pretty smart because second half prices are higher than first half in Brazil. In addition to that, there is some slightly higher natural gas prices and oil prices in the Alumina segment, that's an additional $5 million, but the biggest impact on a sequential quarter basis was that decision to shift megawatts into the second half of the year.

Justin Bergner
Okay. And then, in terms of the higher natural gas and oil prices that's $5 million in the quarter, assuming it persists, that's something you also need to offset as part of your annual framework?

Roy Harvey
Yes, remember our annual framework is a $50 million improvement on a net basis, not a gross basis, on a net basis, outside of everything other than metal prices, alumina prices and currencies. So on this bridge, everything to the right of currency for the full year we are targeting a $50 million improvement. As you've heard us talk already today, some higher caustic cost, some headwinds, some higher energy cost or a little bit of headwinds, but we are still going after that $50 million net improvement.

Justin Bergner
Okay. Thank you. Another question is in terms of your production guidance for the year, when I combine the old segment reporting into the new segment reporting, the aluminum production number, shipment number is unchanged at the 3.2 to 3.4 shipment guidance for annual aluminum, it's consistent with the prior guide under a different framework?

Roy Harvey
Actually it should be a little bit lower, so if you go back and add our guidance on cast products and rolled products, if you add those two, I think you would get a slightly higher amount than 3.2 to 3.4, I think by about 200,000 tons approximately. And the reason is that our casting business sells into our rolling business and therefore when we look at this purely from an external basis, we would be bringing that down a little bit. So you can't simply add the old cast products, the old rolled products because cast products sells to rolled products hence while we took that down. Nothing structural, it's not like we are envisioning the market getting worse, it's just a matter of how the segments get put together.

Justin Bergner
Okay. And then, in terms of the segments that have been collapsed into the Aluminum segment, you gave detail on the profitability of the North American rolled products and the EBITDA for the Brazilian hydro assets. I just want to make sure that those are the two pieces of disclosure that you provided or those are the ones that you are going to consistently provide and then are you going to speak to the rest of the power business or keep that wrapped into the aluminum segment?

Roy Harvey
Well, we are going to get that wrapped into aluminum segment. And part of the reason for putting these together is to get synergies, and not having to do all the math between the different segments. But, what I can tell you is that in the first quarter, if you look at it on a like for like basis from the fourth quarter, energy contributed around $27 million of EBITDA of which in my comments I said that Brazilian energy was $11 [million].

Justin Bergner
I am sorry, in the first quarter the 2017 energy…?

Roy Harvey
Yes, in the first quarter and maybe I am confusing you, but in the first quarter, we were to look at the energy business similar to how we looked at it in the fourth quarter, the energy business in the aluminum piece of the Aluminum segment is around $27 million. Out of that energy business the Brazilian energy is around $11 million.

Justin Bergner
Okay. Thank you.

Roy Harvey
Good.

Operator
The next question…

William Oplinger
But, I will also point out the rolled products business did really well in the first quarter and they generated $11 million, which is comparable to the return, the earnings that they generated in the first quarter of last year when they still had a hot metal business, then very, very good rebounds in our earnings in our rolled products business.

Operator
The next question comes from Novid Rassouli at Cowen & Co.

Novid Rassouli
Hey, guys, Novid Rassouli with Cowen. Thanks for taking my questions. So you touched on this earlier as far as your price forecast were implied in your guidance, aluminum prices moving up, alumina down. I just wanted to see the widening of the spread, how sustainable you guys think it is going forward? That's my first question.

Roy Harvey
Yes, hard to predict because the two move with similar characteristics, but they don't always move in concert. If you think about at the beginning of this quarter, I think you would have said that alumina prices had run up more quickly than had aluminum because essentially you had a bunch of demand and insufficient supply to meet that.

Now, as we've seen then particularly in China, the refiners come back up and more alumina becomes available in the market. I think you've started to see some of that reverse out. So, when you look at it in the broader scope and you think about how those two markets have moved, we see a lot of strength in aluminum and I am not taking position or whether it's the right price or not the right price, but we are seeing strength in aluminum pricing over these last particularly a couple of weeks. And we've started to see a little bit of weakness in alumina. However, we continue to see consumers of every shipment that we have and we also continue to see the demand growth inside of aluminum as well. So, I would say that the prices could go in either direction but they seemed to be pretty fairly representative at this point.

Novid Rassouli
Got it. And then, shifting over to third party, shipments and sales, it looks like alumina and aluminum were relatively stable quarter-over-quarter and it looks like bauxite third party sales were down about a little over 20% quarter-over-quarter. I was just curious if you could just touch on what's driving that? Thank you.

Roy Harvey
Yes. From a qualitative standpoint, bauxite was slower than it was in the fourth quarter for the most part because of the lot of our production system is in pretty rainy areas this time of the year. So you think about our MRN joint venture in Northern Brazil and our Juruti bauxite mine both of which do give us material for the third party sales, both experienced what is normally very heavy rain season, but even more rain than it was typical. So neither of which we expect to have impacts on the full year, but they did drive down third party sales in bauxite for this first quarter, that will recover later.

Novid Rassouli
Great. Thanks guys.

Roy Harvey
Thank you.

Operator
The next question is from John Tumazos at John Tumazos Very Independent Research.

John Tumazos
Thank you. Could you describe the eight locations in addition to the headquarters where you streamlined? It seemed like a very sweeping organizational change.

Roy Harvey
So, John. I think you asked if we see that as a sweeping organizational…

John Tumazos
Yes, whether you could describe…

William Oplinger
We were busy hearing the sirens, which will change now that we are not going to have our headquarters here on Park Avenue, but he asked about the eight, which the eight are and then he characterized as the sweeping change.

Roy Harvey
Yes. So I don't have the list of eight sitting right in front of me. But, essentially what we are trying to do is simplify as much as possible and bring Alcoans together, that they can work collaboratively. Now, we are not doing it in a way that's in a draconian way, but we were trying to do it through the time and we are trying to do it in a way that generates as much of a positive return on the ability to work together while also not being incredibly costly for us and saving us money for the long-term. So, it does cover pretty much every region around the world. And obviously one of the key ones sits in New York here and we would no longer enjoy the benefit of the sirens in the background for our next earnings call. But it is very important when you think about it, from what it tells the organization. It says that from an overhead perspective, we are going to continue to make tough changes and find ways to ratchet down those total overhead costs, which is what we have asked of each and every one of our plants consistently through everyone, every quarter over the past 5 or 10 years. And so, it touches on a large number of people. However, we are being very careful to make sure that each one of those changes makes financial sense and helps us to simply our overhead structure.

John Tumazos
Thank you.

Roy Harvey
Thanks, John.

William Oplinger
Thanks, John.

Operator
The next question comes from Justin Bergner at Gabelli & Co.

Justin Bergner
Thanks for taking my follow up. Just on uses of free cash flow. Is there a point at which your leverage gets low enough that capital return becomes a more active conversation, I realize that pension funding and return seeking capital are important. But, assuming those two are satisfied, is there a target leverage level at which capital return discussion becomes more pronounced?

William Oplinger
Yes, there is. We essentially, as we said, have a number of potential uses of cash, you added one that's potentially to contribute to the pension plan to help de-lever. Beyond that, we have a fairly restrictive set of covenants on our revolver currently. It restricts our ability to pay dividends, a significant dividend; it also restricts our ability to do significant share buybacks. Both of those and off the top of my head I might still get it wrong, but, I think we are restricted around dividends to around $37 million and on share buybacks to around $25 million.

Once we were to get a significantly improved credit rating and I think we took the first step today with the coverage of Fitch that rated us at a BB plus, we should be able to renegotiate that revolver and be able to get into a position where we can have more substantive conversations about returning cash to shareholders. But in the meantime, it will be a course of de-levering, de-levering through either the Brazilian debt or contributing to the pension plan and investing in growth projects.

Justin Bergner
Great. Thank you.

Operator
And our final question comes from the Dave Gagliano at BMO Capital.

Dave Gagliano
Great. Thanks for taking my follow up question as well. Just a quick one, Slide 14, as we get into some of the details of the presentation here and we are just doing some side by side versus last quarter. So I just have a question on slide 14, which is all the financial metrics and the fiscal or the full 2017 outlook on those metrics. Last quarter, we had, let's see, pension and OPEB, interest, transformation and other corporate spending. This quarter when I look we have other corporate spending, interest, transformation and legacy pension in OPEB, but no pension in OPEB broken out, but I am just wondering if you can reconcile between last quarter and this quarter because the numbers are significantly different?

Roy Harvey
Yes. We can; let me give you one broad comment, if you go to page 28, I hope it's page 28 on your deck, it's a slide that says pension and OPEB summary. We are holding the expense projection at $175 million. I believe that's the same level that we projected last January. We are holding the cash impact at less than $250 million, it's just how we have sliced and diced a little bit, Dave. We put some of that pension backup in the transformation only because we are trying to make that transformation line very clear to people that that is the legacy liabilities that we have, that we are going to be working to drive down over the next few years. And beyond that, if you want to get any more detail on how some of these lines changed, you can talk to Jim. I think the only change that we had from a quantitative perspective was that transformation and legacy pension OPEB and then on that same page was the aluminum shipments that I addressed in somebody's prior question that if you added up casting and rolling you would get a number higher and its simply because of intercompany sales between the two.

Dave Gagliano
Okay, perfect. That's what I needed. Thank you.

Roy Harvey
And we are really, Dave, not trying to surprise you at all with any of these changing numbers; they are largely completely in line with what we have shown before, so no surprises whatsoever.

Dave Gagliano
Alright, got it. Thanks.

CONCLUSION

Roy Harvey
Great. I would like to thank everybody for the questions. I think it was a good set of clarifying opportunities. We are pleased with our results for this first full quarter of Alcoa Corporation. And we are on a good path for the reminder of the year. That said, we still have three quarters to go. Over the coming months, you can be certain that we will continue to find ways to reduce complexity, to drive returns and to strengthen the balance sheet. And we look forward to sharing our progress with each of you in the future. Thank you very much. And I will turn it back over to you, Amy.

Operator
Thank you. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.