

Alcoa Corporation

Second Quarter 2017 Earnings Presentation  
and Conference Call

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**CORPORATE PARTICIPANTS**

**Roy Harvey** - *President and Chief Executive Officer*

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

**James Dwyer** - *Vice President, Investor Relations*

## PRESENTATION

### Operator

Good afternoon and welcome to the Alcoa Corporation Second 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 sir.

### James Dwyer

Thank you Denise and good day everyone. I am joined today by Roy Harvey, Alcoa Corporation President and Chief Executive Officer and William Oplinger, Executive Vice President and Chief Financial Officer. We will take your questions after comments by Roy and Bill.

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 historical EBITDA means adjusted EBITDA.

A note on financial statements methodology, because Alcoa Corporation commenced operation as a stand-alone public company on November 1, 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 second quarter 2016 results are entirely on a carve-out basis, while the first and second quarter 2017 results are entirely actuals. Finally, as previously announced, the earnings release and slide presentation are available on our website. With that, here's Roy.

### Roy Harvey

Thank you, Jim. Welcome to our call to review Alcoa's second quarter results. Overall our businesses reported solid financial performance in the second quarter even as we experienced lower alumina prices versus the first quarter of this year. We also continued to make progress against our strategic priorities. We grew cash to strengthen the balance sheet and continued to progress on our actions to reduce complexity. We have accomplished much in this first half of the year as a new company, including producing 1 billion dollars in profits and we remain committed to further improving the business for the benefit of our stockholders.

Let's start with a few highlights of the second quarter. We generated adjusted net income of \$116 million, or \$0.62 per share. We reported \$483 million in adjusted EBITDA excluding special items, which is down 9% sequentially as lower alumina prices more than offset higher aluminum prices.

Cash generation was strong; our cash position increased \$150 million from the end of the first quarter to \$954 million at the end of the second quarter. In our drive to reduce complexity and lower costs, last week we announced plans to restart three of the five potlines at our Warrick aluminum smelter in Indiana. It will supply metal to our co-located rolling mill and improve the overall efficiency of the integrated site. We continue to work to improve results for our can sheet business and respond to the increased volume that we expect for this rolling mill. Our fundamental outlook for bauxite, alumina and aluminum is relatively unchanged from last quarter.

Our alumina balance outlook has improved slightly due to higher alumina demand in China. In the aluminum market, similar to last quarter, recent data indicate that global aluminum demand has strengthened and we have increased our 2017 global aluminum demand growth forecast to a range between 4.75% and 5.25%. This additional projected demand is offset by increased production in China.

China has significant work to do to bring its market back into balance, although it has already announced and taken some action to eliminate its over-capacity. With this continued strength in both demand and supply and with six months already behind us, we are now anticipating further increases in our input costs. While cost inflation is never welcome, it is paired with improved commodity pricing that drives better profitability. As a result of these changes, we have adjusted our 2017 outlook on net performance to negative \$50 million for the year.

We have also tightened our outlook on adjusted EBITDA to be between \$2.1 billion and \$2.2 billion excluding special items. This is updated from our forecast of \$2.1 billion to \$2.3 billion in the previous quarter. With that I will turn it over to Bill for a closer look at our second quarter financials.

### **William Oplinger**

Thanks Roy. I'll quickly run through the details of the results, and as Jim said, all financials prior to November 2016 are on a carve-out basis. First up is our quarterly income statement. Sequentially, revenues are up 8%, increasing \$204 million up to \$2.9 billion with higher third party shipments across all segments; compared to last year revenues are up 23%, increasing \$536 million on higher alumina and aluminum prices. Net income attributable to Alcoa Corporation was \$75 million or \$0.40 a share, declining \$150 million sequentially primarily due to the first quarter \$120 million gain from the sale of the Yadkin hydroelectric assets.

Let's take a look at the special items in the quarter. The combination of special items this quarter totaled an unfavorable \$41 million after tax; the contributors include discrete tax items of \$18 million, comprised of \$28 million unfavorable related to the interim period treatment of operational jurisdictions for which no tax benefit was recognized and \$10 million favorable from the difference between the Alcoa consolidated rate and statutory rate on special items.

Other items include restructuring of \$11 million, mark-to-market energy contracts of \$6 million and Portland restart power exposure of \$6 million. In particular: restructuring items are largely related to labor cost optimization at the Warrick rolling mill and our smelting system. Portland restart power exposure is the near-term market exposure resulting from renegotiating the smelter's long term power contract and that exposure ends this July.

Now let's look at adjusted EBITDA and the full income statement after special items. Second quarter adjusted earnings were slightly below the first quarter with net income attributable to Alcoa excluding special items of \$116 million, but improved \$160 million year-over-year.

Likewise, adjusted diluted earnings per share was slightly lower sequentially at \$0.62 per share but up substantially year-over-year.

Adjusted EBITDA excluding special items is \$483 million in the second quarter, down \$50 million sequentially but up \$173 million year-over-year. Some key points on a sequential basis: EBITDA margins tightened to 17% due to lower alumina prices; year-over-year margins improved 350 basis points on higher alumina and aluminum prices.

SG&A and R&D increased \$1 million from last quarter due to a slight ramp up in R&D spending. On a constant currency basis however SG&A decreased versus both comparison periods.

For items below the EBITDA line, depreciation increased \$11 million sequentially due to non-recurring asset disposals in Canada and a residue disposal area replacement coming on line at the same time previous projects were completing their appreciated lives.

Other income expense at \$12 million improved \$37 million primarily due to foreign currency translation effects; interest expense is \$25 million, consistent sequentially. Remember that the interest expense of \$66 million in the second quarter of '16 was interest allocated from our former parent company, Alcoa Inc. Our operational tax rate depends heavily on the jurisdictions where we have profits and losses; in the second quarter the rate settled at 32.8%.

Net earnings attributable to non-controlling interest decreased \$8 million sequentially to \$72 million due to lower earnings in our AWAC joint venture.

Let's take a deeper look at the factors driving adjusted EBITDA. Sequentially, adjusted EBITDA is down \$50 million primarily due to unfavorable alumina prices with partial offsets from higher aluminum prices and other factors. Stronger metal prices were more than offset by the impact of the alumina price index declining from \$342 to \$306 per ton, lowering margins \$100 million in the alumina segment.

Increased shipments of both alumina and aluminum drove a \$15 million gain sequentially, and favorable energy performance from improved pricing in Brazil and lower costs in Spain more than offset unfavorable net productivity in the quarter. The negative net productivity is a combination of smaller items including temporarily higher operational costs in the bauxite business and slightly higher conversion costs in rolling. Foreign exchange changes in the quarter were a net favorable \$17 million. The largest driver of the other category was the planned outage at the Rockdale Power facility.

Now let's take a look at the business segments. Second quarter adjusted EBITDA in the segments totaled \$546 million, down \$67 million sequentially with declines in our bauxite and alumina segments partially offset by higher aluminum segment earnings.

Let's take a closer look at each of the segment's sequential comparison. Bauxite adjusted EBITDA temporarily declined \$12 million on lower earnings from our equity partnership mines as well as higher operational costs at Huntly and Juruti; Alumina declined \$70 million due to a \$98 million impact from lower API prices with favorable partial offsets from currency, LME and positive net performance. In Aluminum, adjusted EBITDA was up \$15 million to \$221 million; higher metal prices drove \$31 million improvement along with favorable Brazilian and Spanish power prices; partial offsets came predominantly from higher alumina costs as well as unfavorable price mix and other factors. As many of you are aware, alumina costs for our Aluminum segment are approximately on a 90-day lag.

For those tracking particular assets, the Brazilian hydroelectric assets produced adjusted EBITDA of \$22 million, up 100% sequentially as energy prices increased in the region. North American flat rolled aluminum declined sequentially to break even adjusted EBITDA in the quarter due to slightly lower production.

Now let's look at adjusted EBITDA items outside of the segments. Combined our three non-segment EBITDA line items improved \$17 million sequentially and totaled \$63 million. Our transformation entities plus our legacy pension and OPEB costs totaled \$40 million in the quarter, increasing \$8 million sequentially primarily due to the planned maintenance outage at Rockdale. In the second quarter '17, Rockdale was \$20 million of the total transformation expense.

LIFO and metal price lag, which over time we expect to net near zero, turned unfavorable this quarter and improved \$12 million. Other corporate costs also improved \$13 million to \$26 million, primarily as a result of lower intercompany profit eliminations, mainly in Alumina. As we noted last quarter, the eliminations are caused by changes in intercompany profit held in inventory. This quarter lower Alumina segment margins meant there was less intercompany margin to eliminate at the corporate level. If margins and inventories remain stable, future eliminations should be minimal.

Next let's take a closer look at cash generation; at the end of the second quarter, we had close to \$1 billion in cash on our balance sheet, primarily the result of \$223 million in free cash flow in the quarter. We also have included a summary table to point out a few key features of our cash flow statement; typically and as you can see in the second quarter the key cash driver used for...the key driver of cash used for financing is dividends to our AWAC joint venture minority partner and the key driver of cash used for investing is capital expenditures. In the first quarter of 2017, the sale of our Yadkin hydroelectric project and remittance of those proceeds to Arconic as part of the separation agreement impacted both the cash for financing and cash for investing.

Now let's move to the other financial metrics; our balance sheet and related financial metrics continue to strengthen; in addition to our increased cash position, days working capital improved to 18 days in the second quarter compared to 19 days in the first quarter. Capital expenditures now total \$159 million for the first half, second quarter spend was \$88 million up \$17 million from the first quarter. Return-seeking capital was \$27 million and sustaining capital was \$61 million. We anticipate the spend to accelerate as we move through the year. Our first half annualized return on capital at 6.1% is up 4.6 percentage points compared to our full year 2016 level.

Leverage improvement continues with net debt of \$487 million and net debt to adjusted EBITDA of 0.3 times; the pension and OPEB net liability is \$2.9 billion.

Let's review our full 2017 outlook. As Roy mentioned, we are narrowing our full year EBITDA outlook to a range of \$2.1 billion to \$2.2 billion. This tighter range is based on the same forward price assumptions as last quarter's outlook, LME of 1900, API of 305 and an Aussie dollar of \$0.76, and actual results for the first half of the year. With stronger markets pulling up input costs, we believe net performance will be negative \$50 million, with the largest impact being higher raw materials and energy prices.

Turning to shipments, our outlook for all three segments is unchanged versus last quarter; for both Bauxite and Alumina we expect the run rate in the second half of the year to increase to meet the full year outlook.

On the financial metrics, we are tracking well and have made three updates, all favorable. First, we reduced the transformation and legacy pension OPEB spend from approximately \$165 million to \$150 million; the Rockdale outage and power prices have been better than expected, as has been Suriname's energy volume. Second, the cash contributions for pension and OPEB will be approximately \$230 million, down from \$250 million. Finally, the cash flow impact of environmental and ARO payments has improved \$30 million from a range of \$150 million to \$170 million to a range of \$120 million to \$140 million. A large reason for the improvement is cancelling scheduled demolition work at Warrick as well as schedule changes at a variety of closed locations.

Now, let me turn it back to Roy.

### **Roy Harvey**

Thanks Bill. To start, I would like to provide additional details on the rationale behind our decision to restart aluminum production at our Warrick smelter in Indiana and explain why this was the right decision for our business.

To recap the details, the restart is expected to be complete in the second quarter of 2018 and includes three of five potlines. Restart expenses are estimated between \$30 million and \$35 million in the second half of this year. And lastly, we plan to record an after-tax benefit in the third quarter to reverse accruals from the previous decision to halt production at the smelter.

To be clear, the decision to restart production at our Warrick smelter was not about adding more capacity to the aluminum market, rather, we based our decision on three things. First, our ability to more fully utilize the assets at the integrated site, which includes the smelter, a rolling mill and power supply. Initially, as you may recall, the assets at Warrick Operations would have been divided as part of the company's separation. The rolling mill would have gone to our former parent company, meanwhile, the power plant and idle smelter would be with Alcoa Corporation. Now, as one integrated location, we can increase the efficiencies at the site. The demolition of the smelter had not yet started and our environmental operating permits remained effective.

Second, we evaluated the ability to restart the site with minimal capital expense while directly supplying the mill with molten metal. Essentially, the chosen solution was the optimal use of capital to ensure our Warrick mill was fully supplied with high quality metal at the lowest possible cost.

Third, we also considered that this restart would make our rolling mill more competitive in the can sheet market through operational efficiencies as the rolling mill prepares to meet expected growth in production volume. Importantly, the decision is also aligned with our strategic priorities; we can reduce complexity by more fully utilizing the assets at an integrated site and will drive returns due to cost synergies and the expected volume growth for our rolling business at Warrick.

Turning now to our fundamental outlook for bauxite, alumina and aluminum, we continue to expect our markets to remain stable in 2017. For bauxite, we continue to see the market in relative balance. Our view anticipates that the Chinese will continue to stockpile bauxite

strategically throughout this year while in search of new sources of high quality, consistently delivered material. We maintain our view that China is likely to grow its strategic bauxite stockpile due to refining expansions in China offset by production growth in Guinea and the potential export of remaining port stocks in Malaysia.

For alumina, our forecast is somewhat improved with a slight deficit compared to what we anticipated last quarter. We continue to expect that China will curtail refining capacity during the winter heating season for environmental reasons and we are forecasting slightly stronger global alumina demand driven by additional Chinese smelting production.

In aluminum, we continue to see strong demand and we are increasing our global aluminum demand growth outlook from a range of 4.5% to 5% last quarter to a range of 4.75% to 5.25% this quarter. This revision includes a slightly higher 2.75% to 3.25% demand growth forecast outside of China driven by strong European demand where we see improved forecasts for rolled products and extrusion production. In China, we are maintaining our demand growth figure at 6.5% to 7% on expected strong growth in electrical and machinery applications and in the transportation and construction markets, which are the two largest aluminum consuming sectors. However, this increased demand is offset by higher expected supply in China, so we maintain our general view of a modest aluminum surplus this year.

With our aluminum supply forecast still projecting a modest surplus, I would like to spend a few minutes describing policy activities in China. The Chinese government has made two significant announcements about potential supply reforms in aluminum through two different government agencies. First, the Chinese Ministry of Environmental Protection announced the reduction of metal production in select cities to improve air quality during the winter heating season.

Second, the Chinese National Development and Reform Commission announced that aluminum smelters operating without proper licenses will be curtailed. These actions could potentially impact about 6 million metric tons of capacity per annum; if all of that occurs, we could see a reduction in China's 2017 aluminum surplus. However, only about 800,000 tons per year have been curtailed so far and our 2017 outlook assumes that these initiatives will have only a moderate impact this year.

It is clear though that the effects of these policies could be significant, creating risk to both the upside and the downside relative to our forecast. The potential for meaningful positive change remains, but at present, we maintain our 2017 outlook for a continued surplus of aluminum in China.

As we continue to see strength in both aluminum demand and more importantly aluminum supply, we have also been experiencing raw material cost inflation over these last critical months. In our aluminum and alumina markets particularly, we have seen steep increases from last year in the prices for caustic, calcined coke and pitch.

As you can see on the right side of this chart, caustic prices have increased by more than 50% compared to the year ago quarter, pitch prices by more than 25% and coke prices by more than 10%. We expect these increases to continue and they are the principle basis for our net performance guidance change. However, this inflationary environment also represents an opportunity for operators like Alcoa who are more efficient and with access to high quality raw materials. Let me illustrate how this helps with a deeper dive into caustic soda's impact.

In the last year we have seen average caustic prices, a key input in alumina production, climb 54% from the second quarter 2016's average of \$295 per metric ton to this quarter's average of \$455. Alcoa is an efficient consumer of caustic per ton of alumina produced, using less than other ex-China refineries and essentially half as much as Chinese refineries. This difference is created by two things: the characteristics of the bauxite supplied by our mines and our process control systems that optimize our refineries.

As a result, our refineries see less of a cost increase than most of the market. Higher caustic consumers on the right of the cost curve experience cost inflation faster than those on the left, steepening the cost curve and supporting Alcoa's cost position.

On this slide, we quantify the approximate impact from the \$160 per metric ton increase in caustic prices experienced over the last year, showing Alcoa refineries cost improving \$12 per ton relative to those of Chinese producers and \$3 per ton versus the rest of the world average. Increases in input costs are an unfortunate characteristic of a stronger market; however, we believe Alcoa Corporation can create three advantages in these situations.

Number one, strong procurement processes and the advantage of the scale of our purchases blunts the impact versus the general market. Number two, the efficiency of our operations strengthens our competitive position. And number three, the attractiveness of our low caustic consumption bauxite is enhanced in our own refineries but also as part of our third-party sales portfolio.

As we enter the second half of the year, we remain focused on our three strategic priorities which we factor into each of our decisions. We seek to reduce complexity, drive returns and strengthen the balance sheet. To reduce complexity and improve the operational efficiency of the Warrick integrated site, we are restarting some aluminum capacity at the Warrick smelter. It will provide a direct supply of molten metal to the site's rolling mill as it prepares for production growth, which optimizes our use of capital in this business and will also serve to drive returns. We will continue to pursue opportunities to further streamline our business as the year progresses.

We delivered solid profitability in the second quarter and generated \$1 billion in profits for the first half of the year. As we get a better view of the second half, we have tightened our outlook for 2017. We expect our business to remain strong and to generate \$2.1 to \$2.2 billion in adjusted EBITDA this year excluding special items. The strength in our markets is creating an increase in input costs and we have adjusted our net performance outlook for 2017 to negative \$50 million. And lastly, we increased our cash position to \$954 million last quarter and improved our working capital, both serving to strengthen our balance sheet.

Our three strategic priorities have guided our actions so far in 2017, and we are making a concerted effort to drive these priorities deep into the organization at every plant and every resource unit by encouraging our employees to pursue all opportunities that can further strengthen Alcoa. With that, I'd like to invite any question that you might have either for Bill or for me.

## **QUESTION AND ANSWER**

### **Operator**

Thank you, Mr. Harvey. Ladies and gentlemen, we will now begin the question and answer session. In order to use the time for Q&A most efficiently, we do ask that you limit your



questions to one and one follow up. However, you may reenter the queue at anytime. 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. If your question has been addressed, you may withdraw from the queue by pressing "\*" then "2."

Your first question will be from Evan Kurtz of Morgan Stanley. Please go ahead.

**Evan Kurtz**

Good afternoon Roy and Bill.

**Roy Harvey**

Hey Evan.

**Evan Kurtz**

So just wanted to dig in a little bit on some of the improvements that you made on the outlook slide on financial metrics to get a sense of kind of how sustainable they are and how we should be thinking about some of these items in future years, so specifically, maybe just start with the transformation legacy Pension, OPEB line. You took that down to 150. It sounds like a piece of that was Rockdale which would be sustainable, that's what lowered that, and so how should we think about 150 as we get into 2018-2019. Is that a number that we could see going forward? And then similarly, same question really for Environmental and ARO payments that came down as well because you are foregoing the Warrick smelter, it seems like that smelter is going to be around, so should we use these lower number in future years?

**William Oplinger**

Yes, and I think...I think you should use those two particular numbers for future years and on the Pension and OPEB piece, I believe in the 10-K we gave an outlook for future years, so that one will go up in 2018 and 2019, but the two you referenced are your best estimate for moving forward. I would comment on the fact that in the transformation expense item Rockdale does fluctuate up and down. Second quarter was a quarter where we had a planned maintenance outage that drove some of the expense in the second quarter, and as many of you know, we are working toward a resolution on the Rockdale power contract. So for now, I think those are your two best estimates for those numbers going forward.

**Evan Kurtz**

Great, thanks and for my follow up, just maybe one on the other corporate expense line. You are tracking way below your full-year outlook. Is there some chance here that that can move lower or is there going to be some significant second half spending?

**William Oplinger**

That's still the estimate. Yes, we are tracking below but are anticipating a little bit of a run up in the second half so we chose not to take that one down to 150, I mean below 150, based on our outlook for the second half.

**Evan Kurtz**

Okay, great. Thanks. I'll step back in the queue.

**Operator**

The next question will come from Novid Rassouli of Cowen & Company. Please go ahead.

**Novid Rassouli**

Hey guys, thanks for taking my question. So when you had some EBITDA margin compression on Bauxite and Alumina and clearly Alumina was on the pricing side, I think Roy you had mentioned about Bauxite costs and I just want to see if you guys could give us some more details on kind of what was driving the cost higher for Bauxite.

**William Oplinger**

Yeah, this is Bill. I will give you a couple of items that occurred in the second quarter around bauxite. We had some additional maintenance spending around our fleet in Western Australia – that's temporary maintenance spending that will decline in future quarters. We had a particularly low production at a couple of our joint venture mine sites, specifically MRN and CBG, and in CBG for instance there was some labor unrest that caused an outage at CBG, so that has now been resolved and should be okay going into the third quarter. And then lastly, on the Bauxite side a lot of rain in the rainy season that curtailed some production specifically in Brazil. So those were the three big factors around the Bauxite margin compression in the second quarter. I would point you toward the fact that we haven't moved our full-year production estimates so we have a fairly aggressive outlook on the third and fourth quarter around bauxite mining production so....and we still believe in that.

**Novid Rassouli**

Great. And then just one follow-up on the Chinese I think surplus that you increased, I just wanted to see the 800,000 that you mentioned that had been curtailed, that is being included in the estimate that you guys provided?

**Roy Harvey**

Yes, so let me give you a little bit of background on how we put our numbers together, and if you look at Slide #5, you can see what the total impact could be if everything the Chinese have talked about has been incorporated. What we have done is going back in and looked at the credibility of each of the potential or already announced curtailments and when they could actually happen and we have prepared what is our best estimate about what will actually occur. So just to give you a range of...a range that should be helpful to you, if everything were to happen exactly according to what the official announcements are it would drive a significant reduction in that surplus if not drive it into a deficit. However, it's our best estimate of what we think will actually happen in China given past practices et cetera. So the 800,000 tons because it has already taken offline is absolutely in the number but I will also tell you that part of the 1.7 which has been announced but not yet enacted, we've taken our best expert opinion on what will actually come down and we actually have a very talented group in China. We have been working to improve our reconnaissance on what's happening both from the political side but also from the actual operational side. I would say that over these last few weeks we have seen a lot of...not just a lot of rhetoric, but actual some movement to bring down production, so that certainly bodes well and there is certainly a lot of talk about these actions being real and not just hopes.

**Novid Rassouli**

Great, thanks for taking my questions guys.

**Roy Harvey**

Thank you.

**Operator**

The next question will come from Timna Tanners of Bank of America Merrill Lynch. Please go ahead.

**Timna Tanners**

Good afternoon guys. So about the Warrick restarts, I want first and foremost ask if there are other smelters that you are considering restarting or assets that you are considering restarting. This is the first such move obviously after a lot of closures though. Just wanted a little bit more insight on how you are thinking about your portfolio overall.

**Roy Harvey**

Yes Timna, so let me hit that one. It's the similar response to what we have said in prior quarters. The fact is we look at every single one of our assets and judge and determine whether it's the right time to either restart or curtail, so at the moment Warrick was one that made the most sense and it's not, as I said in my comment, it's not a need for extra aluminum in the world. It's very specifically because it will strengthen our rolling mill and will be very positive for our shareholders in a number of market configurations. So as we look at places like Sao Luis, like Wenatchee in the Pacific Northwest, we also have some curtailed production in Intalco and in Spain even. Each one of those are opportunities for us to define ways to drive returns for our shareholders. It requires the right energy pricing. It requires a local demand for value-added products or local demand for even prime P-1020, but we look at each one of those and evaluate it based upon the cost structure and the ability to drive better returns. So we have made the decision that we have made to date and will continue to look at those and see where this takes us. There is obviously a lot of uncertainty right now about what the second half of this year looks like from a Chinese curtailment point of view and so that's going to also effect how we make those decisions over these next couple of critical quarters.

**Timna Tanners**

Fair enough.

**William Oplinger**

If I could just add on to that Timna, I mean that Warrick is a pretty unique situation. As many of you know, we have captive self-generation on one side of the smelter and on the other side we have got a rolling mill that we are growing and one of our key desires is to grow the production out of the rolling mill and it made a lot of sense under a lot of different, as Roy said, under a lot of different market configurations to restart work.

**Roy Harvey**

And we talked about in the prior conference calls about Warrick being work and our can sheet business being a bit of fixer upper, you should look at the restart of that smelter as an important step towards making that business stronger and better. The fact is we can grow volumes and we need extra metal units in order to do it, and by restarting the smelter it is the lowest capital cost alternative that gives us the best return, it was a pretty smart decision from my standpoint.

**Timna Tanners**

That's it. So just to follow up, you mentioned uncertainty and we got certainly a lot of it with China and possible tariff action here in the US, I just wanted to ask you, if you are talking about can sheet from Warrick, does that preclude you from the strategy you've been enumerating before about using Ma'aden. Are you thinking differently about that project and if you could give us any fresh thoughts about what Section 232 may or may not mean for you guys? Thanks.

**Roy Harvey**

What we are trying to drive from can sheet perspective and Warrick specifically is separate from what we can do in conjunction with Ma'aden. The fact is it replaces some of the material that we are getting from the Tennessee that is now part of Arconic. So a shift into Warrick and driving opportunities there is going to be additive and in fact would help to complement the work that we are doing with our Saudi Arabian partners. So we continue to be very positive on our joint venture in the desert. The smelter has been operating very stably now. The refinery has hit better and improved days and we are seeing, we are coming out of the startup phase and getting into just normal stable production, which is a very good thing to have from a refining perspective and the rolling mill we continue to be in the midst of trials and have incredible opportunities to make that a stronger place. So we spend a lot of time with our partners there and as you saw we were over there as part of the US-Saudi dialogue. We are an important partner inside of the Kingdom and we have really, I would say a lot of opportunities to make our current joint venture even stronger.

**William Oplinger**

What about 232.

**Roy Harvey**

I thought I'd...

**William Oplinger**

Did you? You want to comment?

**Roy Harvey**

Yes, so from a Section 232 standpoint, I think everybody knows the investigation is still ongoing. Alcoa believes that the United States and the US government and Europe and a number of other areas have really been doing a very good job at highlighting the aluminum issue and that issue very specifically being over-capacity and over-production inside of China. So just the debate from the 232 case and from the World Trade Organization before that has created what I think is a very positive set of potential outcomes for aluminum.

Now again, we are not going to say that everything China says that they are going to do will be done. However, I would say that the work done by the US government and other actors has really helped to create an atmosphere that has a lot of potential upside for our industry and then of course quite specifically for Alcoa Corporation. That said, I don't think right now there is determination about which way that 232 cases is going to go. I know they're in the midst of discussing steel as we speak and so we will react to what the final determination will be.

**William Oplinger**

And ultimately and I think you said it, but ultimately what we want is a level playing field and so that's what our efforts have been, and I think as Roy said some of the dialogue that has occurred over 232 and WTO has helped that situation.

**Roy Harvey**

And it's given us an opportunity to talk about what could drive competitiveness inside the United States in not talking about trade barriers, but more talking about how can we get long-term energy contracts that are favorable. How can we look at ways to enhance our ability to smelt efficiently or to create technology or to find ways to run our smelters in a completely different fashion? So, lots of discussions going on, I think it can have a very positive outcome but still more to come.

**Timna Tanners**

Okay. Great. Thanks again.

**Roy Harvey**

Thanks Timna.

**William Oplinger**

Thank you Timna.

**Operator**

The next question will be from Justin Bergner of Gabelli & Company. Please go ahead.

**Justin Bergner**

Hi, good afternoon Roy. Good afternoon Bill.

**Roy Harvey**

Hi.

**William Oplinger**

Hey, Justin.

**Justin Bergner**

Just first question would be to just clarify two numbers that sort of came at me a little bit quickly. The Brazilian Hydro profit generation and the sustaining CAPEX?

**Roy Harvey**

Brazilian Hydro was \$22 million in the second quarter; sustaining CAPEX in the second quarter was \$61 million, return-seeking capital was \$27 million.

**Justin Bergner**

Okay. Thanks for that. A refresh on the bauxite business, can you just talk about sort of what the dynamics in Southeast Asia mean for your ability to grow your bauxite business to the extent that those dynamics are changing, I think you refer to some of them earlier?

**Roy Harvey**

So let me try and hit that and see if it answers your question. Southeast Asia covers a good amount of ground. So let me see if I hit the right countries. First of all, Indonesia, obviously Indonesia has just started to allow some exports again. They are relatively modest to date and all indications point to them continuing to be relatively modest, essentially there is a requirement that you are operating a refinery or very close to operating a refinery in order to get those export permits. So we think there will be some selective bauxite coming out but we don't think it's going to reach anywhere near the levels that I had for a period of time. Malaysia is...it was a similar story before, but they continue to ban any kind of production.

Now there appears to be some illegal production going on, those stock piles are not draining as quickly as one would think, given the number of shipments coming out, but the shipments are relatively slim, there really isn't a lot of material coming from Malaysia into China. So stepping back, I think one of the big highlights over the course of this quarter is that Guinea picked up a pretty significant amount of speed over the course of the last number of months and you now see Guinea as the largest exporter of bauxite into China.

Australia continues to be very important, you are also seeing from a demand perspective inside of China that you have a number of new announcements about refineries that are going to be bauxite import refineries, which means that they are built on the coast and relatively isolated from the bauxite reserves in the country. I think that's a very good testament to the fact that the reserves inside of China are starting to suffer from a quality perspective and are starting to increase in costs because of the additional need for stripping, for infrastructure or for even going underground in some cases.

And so it continues to remain that there is very healthy demand of bauxite and I also believe and if you step back to the caustic story that I spent a little time talking about it, I happen to believe that the bauxite that we can offer, whether it's coming from our joint ventures in Guinea or in Brazil or coming from a Western Australian mine is an excellent opportunity for us to grow our value but also to have a great product that can be imported into China. Now we connect that over with the broader questions about what is China's production portfolio going to look like.

One of the great opportunities we have as Alcoa is that we can choose to allocate our capital into the part of the business that's most attractive. I think for us Bauxite has real opportunities for us and we have customers that are essentially lining up in order to take additional production as soon as we can get it out of the ground and get the right infrastructure in place. But we also have opportunities in Alumina and Aluminum and so we will continue to pretty thoughtfully look at each and every one of those places to look for growth. Did I hit the right points of your question or did I miss something?

**Justin Bergner**

Yes. No, that was extraordinarily thorough. Thank you. Just one quick question then I will get back in queue. On the Warrick restart, how does this affect your ability? Are you actually going to be selling, have the opportunity to sell power onto the open market under this restart or you are just going to be consuming more power in...have the opportunity consume more power in the use of your own assets?

**William Oplinger**

The vast majority as the power that we will generate is going to be used in the restart. So just to give you a little bit of perspective, we've got joint ownership of a fairly large unit there, joint ownership with Vectren, we got three smaller units, and those three smaller units were completely being sub-optimized in a curtailed state. So the economics for this restart are going to be seen really within three areas. One is better utilization of the power plant. Two, is running the smelter and making earnings in the smelter and then thirdly, is the growth and opportunities that we have in the rolling mill. So, again, it's largely a no regrets move at this point.

**Justin Bergner**

Great. And each of those three areas will be earnings accretive individually?

**William Oplinger**

Each of those three areas will be earnings accretive into the Aluminum sector. So you won't get a lot of transparency into it other than to see earnings grow when the facility is up and running and as we said first hot metal in the first part of next year full operation in the second quarter.

**Operator**

And the next question will come from Dave Gagliano of BMO Capital Markets. Please go ahead.

**Dave Gagliano**

Hi, thanks for taking my questions. Just a quick one, what was the average alumina cost that flow through the primary aluminum segment in the second quarter?

**Roy Harvey**

You know, what Dave, on top of my head I don't know and you can follow up with Jim after the call.

**Dave Gagliano**

Easy enough. Thanks.

**Roy Harvey**

Thanks.

**Operator**

The next question will be from Jorge Beristain of Deutsche Bank. Please go ahead.

**Jorge Beristain**

Hi, good afternoon guys. On your growing free cash flow, just wondering if you could again reprioritize for us what your uses of that cash are over the next 12 to 18 months and what your view is toward reestablishing a dividend policy?

**William Oplinger**

Yes, sure. So, good question, there was very good cash flow generation in the second quarter \$223 million of free cash flow, you know, I like to see that the cash balance grew, had \$954 million of cash in the bank at the end of the second quarter.

Some of the priorities that we would have for that cash first and foremost we are looking to continue to de-lever, we think that the rating agencies probably have our credit rating incorrect now, because when you look at our EBITDA generation and the fact that we are targeting \$2.1 billion of EBITDA this year, we think that there is...that they fundamentally have the rating wrong now. But, in order to show them that they have the rating wrong we are most likely to continue to pay down a little bit of debt. We have pre-payable debt down in Brazil of around \$200 million. Secondly, you know, we have increased the amount of return-seeking capital that we are looking to spend. We did that at the very beginning of the year. So, that's not new news, we are looking to spend 150 million of return-seeking capital this year. And then, beyond that, you know, first of all, we will hold cash on the balance sheet, we would like to hold a billion dollars of cash on the balance sheet. But, once we get north of a billion dollars we will be looking at opportunities to either invest in the business or potentially paying to the pension plan to do further de-levering.

As far as returns to shareholders, as many of you know, our revolver today is fairly restrictive on our ability to return cash to shareholders. We would like to get a better credit rating over the next few quarters, in order for us to go back and renegotiate those terms on the revolver so that we can begin to talk about returning cash to shareholders either through stock buybacks or dividends. But, that's where we stand today for it.

**Jorge Beristain**

Got it. And just if I could have a follow up as well, I think back in 2Q'16 you had mentioned that the closure of Warrick was going to be about \$50 per ton impact would we expect to see a similar \$50 per ton benefit once it's fully operational?

**William Oplinger**

We haven't provided what the dollar per ton impact is, I think if you were to go back and look at the announcements that we made around the first couple of quarters last year to see the impact on cold metal, we will reverse that impact once it's up and running. So, I don't have a number that I can give you, but we would have provided in prior quarters what the negative impact of cold metal was and quite honestly I just don't have it off the top of my head, but it's there.

**Jorge Beristain**

Got it. Thank you.

**Operator**

The next question will be a follow up from Evan Kurtz of Morgan Stanley. Please go ahead.

**Evan Kurtz**

Thanks for taking the follow up. Just a quick one on Midwest premiums, just want to get your thoughts on the recent weakness I heard an interesting story about maybe some sub-optimally shaped P-1020 in the market that was imported and people are willing to pay less for it, just hoping you could either confirm or dismiss that and kind of what your thoughts are on that move in the market? Thanks.

**Roy Harvey**

Yes, Evan I appreciate the question. I have not heard the story of oddly shaped P-1020; when I took out a look at it and we spent a little bit of time discussing particularly because of the most recent decline, you know, to me it sort of steps back to what's happening from a contango standpoint. We have seen the contango shrink pretty significantly over the last couple for the last few months and when that contango shrinks it typically means that you are starting to see...you are starting to see metal delivered and actually coming out of warehouses and the lowest cost warrant that's out there right now sits over in Japan or in Korea really in East Asia. And so that material started flowing to what was a very short market which tends to be North America and you started to see more material show up in North America and maybe that's some of these sort of oddly shaped P-1020 that's coming over. And so, I think what you are seeing is that with contangos start to reassert themselves and it's actually come back to a much healthier position last I looked at it, I think you are going to see some of that material continue to be financed or start building up some more of these finance stocks and we would like to see that premium of course go back up to prior levels. So, it really just seems to be more of a movement of metal from one part of the globe to another part of the globe and really, really isn't an indicator of the underlying demand. I have said that North America continues to be very strong demand you are seeing even stronger demand in Europe than we had seen the last time we talked about this. And so, it doesn't signal to me that there is a problem, underlying problems, in the markets themselves.

**Evan Kurtz**

Okay, very helpful. Thank you.

**Roy Harvey**

Thank you, Evan.

**Operator**

And as a reminder, if you would like to ask a question, please press start than one and we will pause briefly for any additional questions.



And we have a question from John Tumazos of John Tumazos Very Independent Research. Please go ahead.

**John Tumazos**

Thank you for taking my questions. If I could follow up on your balanced or almost balanced alumina outlook to the world market, in February to May months for international aluminum institute data, the alumina output averaged 6% more than the ingot output required or about 2.3 million tons too much. And this is just naively using the IAI output. In your balanced outlook do you expect the alumina output to go down because of the Chinese environmental restrictions next winter, do you think the ingot output is more, obviously the alumina is hard to store, at least the first half of the year it doesn't seemed to be balanced?

**Roy Harvey**

Yes, John. So, I think, I think I know where you are going with the question and let me just walk you through a couple of points. I think coming in, coming into this year, we had already cleared out a lot of the inventory that was sitting out there, you look at the end of 2015, beginning of 2016 when prices were so depressed there, we had built up about as much inventory as is possible inside of the alumina market and we worked that off over the course of 2016. For coming into this year, I think that was a pretty balanced market between buyers and sellers. And so, as we progressed through it, the way that we look at both production and production and demand, we found it to be pretty equally balanced and we look at it on a quarter-by-quarter basis and in fact when we look at the first quarter that it really looked to be a slight deficit. Now, the fact is like you said, you cannot, it's not particularly easy to store alumina and when we have seen is that we have got pretty quick reactions in the market, so that we actually, because of the spot pricing mechanism in the load by load or vessel by vessel characteristics of the way this is sold, you can really see what's happening on almost a day-by-day basis in this market.

And up until now, we have not seen an excess of tons either sitting in China or sitting outside of China which is what has driven a lot of strength in pricing. I think you started to see here over the course of second quarter prices had come down some, you had more sellers than you had buyers. But, we have essentially rectified that situation, we are back to a point where, well it's relatively quiet from a sales perspective, we continue to see that there is just not a lot of alumina out there that can be purchased and therefore not a lot of opportunity for downside. So, you know, I am not as familiar with the IAI data. We have a very clear look at how we do this ourselves and we watch what's actually being produced in China. From our perspective our balances are the ones that makes more sense to us and it's the ones that best describe what's happened from the pricing in a sales perspective on each of those vessels.

**John Tumazos**

Thank you.

**Roy Harvey**

Thanks John. I appreciate the question.

**Operator**

Ladies and gentlemen, this will conclude our question and answer session. I would like to hand the conference back over to Roy Harvey for his closing remarks.

## **CONCLUSION**

### **Roy Harvey**

Yes, in closing I just wanted to say that we have had solid results in this first half of the year. We have a clear path in front us for the remainder of 2017, there is a lot going on whether you talk about China and you talk about the aluminum industry globally. I think there are great opportunities but we also are prepared no matter what comes at us and prepared to respond as might be necessary. We are going to continue to find ways to reduce complexity. We are going to search for ideas like Warrick that can drive better returns for our stockholders. We are going to strengthen our balance sheet, we continue to put cash in the bank and we look forward to continuing to describe that story to all of our investors in the coming quarters. So, thank you very much for your attention, I truly do appreciate it. And I'm going to turn it back over to our operator Denise now. Thank you.

### **Operator**

Thank you, sir. Ladies and gentlemen, the conference has not concluded. Thank you for attending today's presentation. At this time, you may disconnect your lines.