Alcoa Corporation

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CORPORATE PARTICIPANTS

Roy Harvey - *Chief Executive Officer*

David Gagliano, BMO: We're going to kick this off about seven minutes late, but I think Alcoa, who is up next gets the "Toughest Act to Follow of the Year Award," no doubt about it. But I think it's a pretty good opportunity for Roy Harvey to defend the Alcoa story and tell some good aluminum stories.

Roy Harvey: Thank you very much, Dave. Can everybody hear me okay? Perfect. So I had the privilege of walking through those doors just at the moment where we were talking about geologists and how much they like to deposit. So for those of you that were here, I'm not sure I can rival some of the comments from the prior presentation, but what I can promise you is that I will give you a good, strong understanding of who Alcoa is, what we've been able to accomplish over the course of this last year and a quarter since we've been a standalone company and, really, where we're going. So let's go ahead and jump right into it.

I've now been a part of Alcoa for the last 17 years. I've had the opportunity to work around the world, had the opportunity to interact with Alcoans around the world. I want to leave each and every one of you with a very clear understanding of why I think that is a real privilege for me and why I think that has a direct and important impact on our shareholders.

So I'm going to cover three things that you can see here on the right side of the slide. I'm going to help you understand who Alcoa is and what we do. Number two, I'm going to talk a little bit about 2017 because that is the springboard for where we're going in the future. And then I'm going to spend a little bit of time talking about what we're planning on doing in 2018 and beyond.

The last time I was here in Florida last year for the BMO conference, I think I made the comment that CEOs in my particular type of way to try and succeed is I always think in terms of three. So you're going to see a lot of threes in this presentation. And that is emblematic of our focus to try and simplify everything down so we can make this Company as strong as possible.

So on the left of this slide, I'd like you to understand very briefly who is Alcoa and what is it that we do. And I believe what makes us different from many of our competitors is our solid reputation. Our reputation for being a good operator; a reputation for working with our communities and being a very solid partner; a reputation for having a great set of assets. So it very much is about who we are and what we do.

We start with a set of bedrock values, and those are very simple, and there's three of them. We care for people, we operate with excellence, and we always act with integrity. So those three very basic things are how we get started, it's how we start talking with our employees, how we talk with our managers, and it's how we ensure that we are aligned about the way that we do things.

From there, we step into what we call our "three strategic objectives." So when we first launched and separated from Alcoa, Inc., we stepped back, and we said how can we make sure that we have everybody in the Company focused on doing very basic, very simple things on driving value for our shareholders is what we're really trying to achieve.

And so we collapsed it backwards to three very basic things, and we told our employees to hold us accountable to what those three things were telling us to do. Number one, we always reduce complexity. We were a very complex organization when we were part of Alcoa, Inc. We had headquarters in New York, and we complicated things incredibly. So we're reducing complexity, we're simplifying the way that we do everything.

Number two, we drive returns. We make sure that every time we are using our shareholders' capital, whether it be to sustain the operations that we have, or whether it's to invest money to either reduce cost or to drive creep volumes, we make sure that we're always focused on driving a return; that we understand that this is our shareholders' money and, therefore, we need to follow our projects from conception all the way down to accomplishment.

And the third thing we do, and this is where we've made an incredible amount of progress over the course of this past year -- we strengthened the balance sheet. One of the things that makes Alcoa different is because of our rich 130-year history, it also means that we have a pretty significant number of liabilities that we need to resolve. And one of those is our unfunded pension liability. So a lot of what we've been doing in 2017 is taking the cash that we've earned and using that to strengthen our balance sheet to make our Company stronger, for when that next downturn comes.

So when I step back and think about what makes Alcoa different, is the fact that we have all of our employees focused on doing the same set of simple things, and that helps us better use and better utilize our assets.

So let's talk a little bit about our assets. And I think many in the room probably have a decent understanding, but let me start all the way from bauxite and move our way down to aluminum products. So from a bauxite perspective, we mine about 48 million tons of bauxite. Up until very recently, about three years ago, we did that for the benefit of our own internal refineries. We saw that as an integrated part of refining.

The big difference is that we have started to grow our merchant third-party bauxite business and see that as an incredible opportunity for us to connect with customers but also for us to grow and to create value for our shareholders. We're in the first quartile from a cost-positioning standpoint. We are very focused on what are some very basic principles. We are consistent deliverers of bauxite. You get it when you need it, and we deliver high-quality tons.

One of the differentiators, particularly of our Australian bauxite is that it is very low in reactive silica, which makes it a very positive use of caustic. You are able to make more efficient the use of your caustic in your process. That means our bauxite is worth more than other bauxites in the world. So we're focused on growing this portfolio.

The last time we were in BMO we talked about 10 million tons over the next four to five years. We only grow when we find customers on the other side. Bauxite is a differentiated product and, therefore, you need to match your bauxite with your customer. So we're out there looking for the right customers. We have lots of growth opportunities across our bauxite portfolio, and that is a business that we are determined to grow.

Our second business is Alumina. It's the refining segment. In Alumina, we are the largest seller of third-party alumina in the world. It is a system of just short of 14 million tons. It is a system where, because we have a technological advantage, it allows us to very quickly transfer best practices from one set of our facilities to the rest of our facilities.

We have, over the course of the last five years, we have been working to change the pricing format in our market so that it really reflects the underlying fundamentals of the alumina business itself, and therefore we've developed what we call the Alumina Price Index, which measures spot transactions and allows us to truly gauge what's happening in the market.

And, finally, this is a first-quartile cost curve position, which means that this is a set of assets that is not only large but that is also very competitive. And so we continue to see this as a really great place for us to continue to creep capacity, to drive down our costs, and to continue to make that business very vibrant.

Our third business is our aluminum business, and that spans all the way from smelting to cast products, rolled products, and down into some energy that we have, as well, particularly in Brazil. That is the business where we have been focused over these last years on restructuring the portfolio. So we are now in a second quartile cost curve position. That is significantly improved from where we started, which was about the middle of the pack. And what it means for us is that we are now much more capable of weathering the downturns.

So when prices are good, times like today, you generate a significant amount of cash from these assets. And when that cycle starts to turn the other direction and say it's 10 years from now, these assets have been restructured such that we are not consuming cash in the downturn. This has been a lot of work on changing the portfolio. New power contracts as well as finding ways to either close or curtail some of our facilities, and it's a place where we continue to look for opportunities that will create value for our shareholders.

So when you look from Bauxite to Alumina to Aluminum, we have no shortage of opportunities and no shortage of ways to continue to make this Company great.

So let's talk a little bit about what we did in 2017 and why I think our first full year as a standalone Company, was one that we can be truly proud of. And let me start a little bit talking about operations. And I mentioned the number three at the beginning; you're going to very quickly see in this first bullet that we achieved production records in three of our bauxite mines, three of our Alumina refineries, and three of our smelters.

So that's a very good thing. It means that we're creeping capacity. It also means that we have some facilities that need to be setting those production records every year as well. So I look at as 2017 as a great step forward, but we still have lots more to do.

The other important thing, and I talked about our customers for our bauxite is that we now are selling third party bauxite from each and every one of our mines. So some of those are single shipments, they're not significant volumes. But it's attuning our bauxite mining group to understand that they always need to be focused on the customer and not just the refinery they know but also third-party customers that can be out there, and it allows us to expand those bauxite mines very quickly.

We've also done a lot of work to improve our portfolio and have restarts in a number of facilities. And so there are three facilities that we restarted in 2017 or in the process of restarting. The first of those is the Portland smelter in eastern Australia. Right after separation we had a power disruption that caused that smelter to be mostly curtailed. Since then, we now have that fully back up and operational. Very good work from the team in Australia.

The second facility is our Lake Charles calciner, coke calciner. That is a facility that we've got back up and running and also has the ability to produce anodes should we decide that is a better financial outcome than buying them from China. So a great backwards integration opportunity in a place where we create a lot of value by calcining coke.

And a third is a restart that is ongoing right now. Our Warrick facility in Indiana is a large rolling mill that has a smelter that has a coal-fired power plant that has coal reserves in the ground. So it goes all the way from coal down to rolled products. We're in the midst of restarting three of the five lines at that smelter. That will be done by the end of the second quarter. That was a decision based upon optimizing the metal inputs into our Warrick rolling mill.

So we've also been blessed by improved aluminum pricing, which means not only was it a very good decision for Warrick, it was a very good decision for Alcoa Corporation in our Aluminum business. But that is very quickly moving forward.

We then step back and think about what have we done in order to restructure this Company and to make it stronger and better. The first thing I'll point to is the fact that we chose to move our headquarters from New York to Pittsburgh. Now, there is a cost savings associated with that. It is not billions of dollars, but it is a mindset where we no longer feel we need to isolate top management from our employees but rather are embedding our management where they can hear what's happening.

It is a process of driving a more operations-centric culture where we truly believe we can run our plants better and that those of us who are supporting the plants, those of us who are management in our support structures, are focused on making sure that our customers are delighted, and we're doing that at the lowest possible cost.

Other financial items that we accomplished over 2017 -- we generated about $2.35 billion of EBITDA. That's twice what we did in 2016. That was a great first full year, because that generated a lot of cash for us. We ended the year at $1.4 billion of cash on the balance sheet, and you're going to see why that's important when we talk a little bit about 2018.

We also were able to start making those first steps towards a better credit rating and also a more flexible revolving credit facility. Now, why is that important? Very simple. One of the first things we did when we entered into 2018, and this was work in process over the course of the end of 2017 as well -- is to be very clear for our shareholders, our priorities for our capital. When we have cash generation, what do we choose to do with that capital? And you can see this, what I call a virtuous circle here, about how we plan on deploying that capital.

So depending on conditions on the ground that's generating cash, and we then allocate it in this very basic fashion. First of all, we start with $1 billion of cash on our balance sheet. We do that because we believe our investors want us to be exposed to commodity prices, aluminum, alumina, and bauxite and, therefore, having cash on the balance sheet allows us to react when times turn tough very quickly. It also helps us to weather some seasonality where we have cash draws at the beginning of the year.

The second thing we do is we sustain our operations. We understand that our plants need to be operating well through all parts of the cycle, and so we invest about $300 million in sustaining capital. We're growing and improving our business. We have allocated $150 million for relatively small projects. There are expansions of bauxite mines, they are de-bottlenecking of refineries, they are small creep projects where we become more efficient in our smelting assets. So that spans across all three of our product families.

The next thing we do, and this gets back to strengthening the balance sheet. Because we have this unfunded pension overhang, one of the things that we need to do is to work our way out from under that. And we have made a very clear demonstration that we will be finding a way to make that balance sheet stronger and to work our way out from under that pension overhang.

So what we've done is committed not just the $450 million of mandatory pension contributions in 2018, we will also invest $300 million in strengthening the balance sheet in that way. So what happens when we generate cash over and above that, when we end up with a cash balance greater than $1 billion? We've decided that we're going to go 50-50, half-and-half. Half of it will continue to strengthen the balance sheet, and that can be through funding of debt, or it can be through further actions on the pension. The other half will be returned to shareholders.

So your question, the immediate question should be is that a dividend? Is it a special dividend? Is it a share buyback? Still to be determined? That is a great analysis for us to run through. When we were preparing for launch we spent nothing but time preparing for disaster scenarios. The fact that we're standing here as a year-old Company, a year and a quarter, and talking about returning capital to shareholders in the second half of the year, I think is a testament to all the work that has been done as well as to a strengthening aluminum industry.

So a few other things that we're very determined to do over the course of 2018, and let me start with one that will be our singular focus this year. 2017 did not have a stellar safety performance. So we need, as Alcoa Corporation, to turn that trend around, and to turn it around immediately. Every single one of the 15,000 Alcoans are focused on making that shift. So we are very focused on safety, because it is the way that we do business.

We are also planning on doing a lot of activities that drive this operations-centric philosophy, making sure that we have a lot of transparency so that Bill, our CFO, and I understand what's happening across our operations but ensure that we're driving our plants to not just continue to operate well but to understand their pathway and to be in continuous improvement mode.

Each of our plant managers need to be focused on how they make that facility successful for the next 5, 10, 15, or 20 years. So we're driving a mentality, again, of simplicity, but also a mentality where we try and make sure that our plants are the center of our universe and that those plants are selling products to customers that are clamoring for more opportunities from Alcoa.

We also plan to finish the restart of our Warrick smelter. We're watching very carefully what's happening with the trade issues in the United States and elsewhere in the world. We have a number of other facilities that we could think about restarting, although we always look at those from a holistic standpoint, not just immediate prices but long-term prices -- the power contracts and how we can choose to operate those. So a lot to come there.

From the balance sheet perspective, we've already talked about putting some discretionary cash into our pension. We have also made some decisions and made some changes to our actual pension status from an operational perspective. We have just rolled out a pension freeze for all of our salaried employees, those that continue to have the benefits of a pension. That will occur over the next three years, and it is simply another step towards making this Company stronger and more prepared and more ready to face the future.

So when you bring all this together, and we'll go back where we started the presentation, and you think about what we're trying to do with Alcoa, it's pretty simple. We're trying to have very clear priorities and very clear messaging about what we do with our shareholders' money. We're trying to focus, in 2018, on not just strengthening the balance sheet but also trying to return cash to our shareholders. We're also focused on making this Company stronger. As Alcoa emerges from this cycle, we want to be the ones who, at that bottom part of the cycle, are doing really smart things, continuing to invest in cost reduction activities and not having -- not running into troubles when times are tough.

But we also want to be very careful when times are good, when we're generating cash. We want to be very thoughtful about the deployment of each and every one of our dollars. And it comes back to our three very clear strategic priorities. And I would invite you to measure each one of us and each of our decisions on how we are achieving these objectives.

We're going to continue to simplify, reduce complexities. We will continue to be good stewards of shareholder capital, and we will drive returns, and when you see us invest in growth projects, we'll talk about the benefits coming out the other end. And we will strengthen the balance sheet and prepare ourselves for rough times ahead.

So, with that, it's, to me, really what can make Alcoa different – reliable, predictor, does what it says, and when we start looking at 2019 and beyond, I'll call your attention to our capital allocation framework, which is focused on 2018 and which provides us the opportunity to look what is the status at the end and where shall we go?

So, with that, Dave, I'll turn it over to you if we have time for questions.

David Gagliano: We have about 10 minutes' worth of questions on the app. And there's been, like, two minutes to get them in. So I'm going to try and wrap it all into one. A lot of the questions are around this 232 investigation and what it could mean for the market in the US, what it could mean specifically for Alcoa, how much metal does Alcoa actually send into the US? And then, thirdly, what it could mean from a restart potential in terms of quantifying how much capacity you could restart?

Roy Harvey: Good. And I think that is probably going to wrap a lot of questions into one, so I think you're right.

So let me start with a very basic overview of what Alcoa thinks about some of the trade actions that are being discussed, still to be revealed. Alcoa wants a level playing field, and we want to get aluminum out of the self-destructive cycle of over-capacity. So the really good news from our standpoint is that over this last decade, we have seen everything outside of China readjust itself and get back to a point where we are now in a structural deficit, and we're drawing down on inventories.

So, on the other side, specifically in China, we've also seen significant progress in China starting to actually act upon its supply side reforms. So when you think about what happened in 2017 in the middle of the year, they had had a policy on the books for three years about how to operationally permit new plants. It was just in the middle of 2017 where they actually started to enforce that.

So the big difference in the world is that China has started to take on supply side reforms in aluminum. They've taken it very seriously, and they've taken real steps. So we see it as a constructive environment right now.

So now to get back specifically to your question, Dave, what's happening on the trade side? So Alcoa started off as the Aluminum Company of America. We continue to have operations here in the United States. We have at least -- we have one complete facility that is not operating -- Wenatchee, out in the Pacific Northwest. We have a partial facility that's not operating, Intalco in the Pacific Northwest, and we still have two lines at Warrick that we have chosen not to restart at this point.

So we continue to have an important footprint in the United States, but we also continue to have a much larger global portfolio. So what happens on tariffs has an important impact to us.

When we look at what's happening in the industry today, we see it as constructive. So when we talk about putting trade barriers around the US to incentivize production to come back online, we don't see that as an answer that can address the fundamental problem. What we don't need is older capacity coming online and starting to create a less balanced situation in the rest of the world. The same way that we don't need China to let up on its supply side reforms.

So from our perspective, the best outcome from all of these discussions really has been happening since the end of 2016 with that first WTO case that was filed. All of this attention, all of this discussion, has driven a much more laser focus on what's happening in aluminum. And while China has its own reasons for going through supply side reform, I think all of that pressure has certainly been supportive.

So continuing down that multilateral approach, ensuring that places like Canada and Europe and Australia and other parts of the world are aligned and connected with what the United States is doing for us is the best outcome. Now, if they choose to erect trade barriers, to us that tariff is the easiest to understand. The quota system is really very difficult for us to understand how the rules would even work. The danger inside of a quota system is how do you make sure that the customers inside the United States get the products that they actually need.

If they need rolling ingot, if they need billets, depending on where that metal is coming from. If it's imported, what happens if you hit the quota in the first six months of the year, and then customers cannot get their product. The danger that we see is that customers cannot be competitive inside the United States. If prices are higher in the US than elsewhere, that is a strategic problem for our customers, and we care deeply what happens with our customers. And if they can't get the products that they need, they might not even be able to operate.

So, for us, we run our Company for our shareholders. So we will make decisions based upon what is placed, what decision that the US administration takes. But we're also advocating this concept of a fair and level playing field. And while China is actually taking action to reform their industry, their aluminum industry, then we will support that and look for ways to continue to motivate that kind of behavior.

David Gagliano: All right, great. Well, thank you very much. Now we've run out of time, but thanks, Roy.

Roy Harvey: Thank you, everybody.