Alcoa Corporation
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CORPORATE PARTICIPANTS
William F. Oplinger – *Executive Vice President and Chief Financial Officer*

OTHER PARTICIPANTS
Carlos F. De Alba – *Analyst, Morgan Stanley & Co. LLC*

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Carlos F. De Alba: Let’s start the meeting with Bill Oplinger, the CFO of Alcoa. Bill and I go a long time back, way back – before joining Morgan Stanley I was in Alcoa, for those that don’t know.

William F. Oplinger: How long ago was that?

Carlos F. De Alba: 14 years ago

William F. Oplinger: When you left or when you started?

Carlos F. De Alba: When I left

William F. Oplinger: Okay.

Carlos F. De Alba: So that was 17 years ago that I spent three years with you guys. So ...

William F. Oplinger: Best three years of your life.

Carlos F. De Alba: That was very good, yeah, exactly. So a lot of changes obviously since those years, and more recently you guys announced on Monday another restructuring where you collapsed the group or the company structure to just corporate and operations, right? Basically the business units are no longer there. So, can you talk a little bit about what drove that change and sort of, not quantifying because you haven't done it, but at least broadly speaking, what are the benefits that you expect to get out of this?

William F. Oplinger: Sure. We've had a number of strategic priorities since we became an independent company and one of the strategic priorities out of the three, so we've had three strategic priorities –the first is to simplify and cut costs; the second was to provide good returns on the investments that we're making; and the third was to strengthen the balance sheet. So I think this latest organizational design is just the most recent effort to implement that first strategic priority. And I'll get to what we've done, but just to give you a little bit of background, in 2016, when we separated the company from Alcoa Inc., and we started with six business units, we immediately took that down to three business units and eliminated some overhead offices.

This most recent announcement is the next step toward becoming much more operator and customer-centric. And what it does is it eliminates the business unit level, connects the commercial organization through the entirety of the company and really connects the executive level with the plants. So now that business unit level is gone, should provide for faster decision-making, more agility, and reduced overhead. We've not quantified how much the overhead reduction will be yet. I would tell you that we were already pretty lean to start. We spend about $75 million of SG&A cost each quarter, so we're fairly lean to start, but we'll get better clarity in October on how much run rate savings we’ll be able to capture and what the costs will be to implement.

Carlos F. De Alba: So clearly the company has done tremendous amount of restructuring on the smelting business, in particular. The balance sheet has been strengthened. So going forward, is there a target or a vision to maybe set a more clear capital allocation policy in terms either of percentage of free cash flow or an amount per share?

William F. Oplinger: Sure. We are, again, just a little bit of the evolution that's occurred over the time. When we launched we came out with debt of a –funded debt of around $1.3 billion. We had a large pension and OPEB unfunded obligation. We made significant progress in 2017 and 2018 on addressing a number of those legacy liabilities. Early in 2019, we announced our latest capital allocation model. And very simply, it starts with maintain liquidity. We're a commodity company, so we like to maintain strong liquidity in the company and that means trying to maintain $1 billion of cash on the balance sheet. Secondly, we sustain the operations. We spend roughly $300 million of sustaining capital every year. We invest in small return-seeking projects. This year we announced that we would do about $150 million of those.

Subsequently during 2019, as the markets have been a little bit more difficult than what we had planned at the beginning of the year, we've scaled some of that back. So the sustaining capital has come down to $290 million. Return-seeking capital's come down to $130 million.[1] Once we've done those two things – maintain liquidity, sustain the operations –there are three areas that we can spend capital on. And those three areas are:

We have a target net debt. Target net debt is to get to $2 billion to $2.5 billion of net debt and that's a proportional net debt. So it's net debt, pension, OPEB on a proportional basis.

The second item is that we have some mid-sized growth opportunities, specifically in our refining business. Our refining business is one of the largest, lowest-cost refining businesses in the world. We've got brownfield opportunities that we can grow there.

And then the third is returning cash to shareholders.

Those are not in any rank order as I've listed them. We will look at when the cash is available and make the best choice at that time.

Carlos F. De Alba: And you probably have –obviously the choice of either do buybacks or do dividends. Is there any preference? How do you ensure the company...

William F. Oplinger: Sure. Yeah, and I should have addressed that. We announced – I was really pleased that in 2018 we had significant excess free cash flow, that we announced a $200 million share buyback. We executed $50 million of that $200 million share buyback in 2018. So we still have $150 million that we can spend on share buybacks. We typically prefer share buybacks over dividends because it gives us the flexibility, that again, since we're a commodity company, as we see cash comes in, we can distribute it to shareholders at the right time.

[1] *Editor's Note: As noted on slide 20 of the September 2019 Investor Presentation released on September 10, 2019, Alcoa Corporation has estimated approximately $120 million in return-seeking capital expenditures for FY19.*

Carlos F. De Alba: All right. And you briefly mentioned the opportunities that maybe the company has on the refining business, can you give us any update? Or when can we expect to have a news on those projects?

William F. Oplinger: Yes. So let me put it in perspective. We've got eight refineries around the world. We produce – so we've got the capacity to produce about 15 million metric tonnes. Our refining business is large, it's low cost, it's squarely first quartile. Within that first quartile cost position, we have some facilities that are first decile. That's specifically Wagerup and Pinjarra are both first decile refineries. We have opportunities to expand Wagerup and Pinjarra, roughly about 1,000 tonnes a day. So that would add, what, roughly 350,000 tonnes each. And we've got that capability to expand those at a good capital expenditure costs. We are going through the engineering process. We will make a determination toward the end of this year, maybe at the beginning of next year, on whether that makes sense to do.

Carlos F. De Alba: And how much of that potential expansion could go to your own smelting business and how much to the third-party market?

William F. Oplinger: We really don't look at it that way to tell you the truth. The product is fungible. And so, the way we look at it is, essentially, that product can go into either internal use or external use. Given the fact that we are curtailing and have curtailed the Spanish facilities and sold the Spanish facilities so that demand will be gone. However, we're ramping up one of our Québec facilities this year and next year, so that will be additional capacity.

Carlos F. De Alba: And any updates there on Bécancour? How is it going? And also you have the potential expansion of Deschambault, right?

William F. Oplinger: Sure. Again, a little bit of perspective. We've got three great facilities in Québec. And so we've got the Deschambault facility, Bécancour, and Baie Comeau which is in the northern part of Québec. We recently, in the second quarter achieved a six-year labor deal with Baie Comeau, and so that sets Baie Comeau up with labor stability for the next six years. We got an agreement with Bécancour facility on also a six-year labor deal. So that positions Bécancour for labor stability for the next six years. That is in the process of restarting. We are on target to restart fully by the end of the second quarter of next year. We've talked a little bit about the fact that we're spending around $30 million to $35 million in the second half of this year, another $30 million to $35 million in the first half of next year to restart that facility, but we expect it to be free cash flow positive by the second quarter, even at these market prices, next year. So both of those facilities are really set for success for the long term.

Specifically in Deschambault: Deschambault is a 260,000-metric-tonne smelter. We are looking to creep that production and so we've got a creep project that we've recently announced that should grow that production by around 10%. So that creep project is ongoing today, approximately $65 million project. We've gotten some support from the Canadian Strategic Investment Fund. So we believe that the project will be very successful.

Carlos F. De Alba: Excellent. And keeping on the important topic of projects, with all the focus right now on ESG, the ELYSIS project is very interesting to say the least. Any updates on how that is going?

William F. Oplinger: I'm sorry...

Carlos F. De Alba: ELYSIS.

William F. Oplinger: ELYSIS. Okay.

Carlos F. De Alba: ELYSIS.

William F. Oplinger: ELYSIS. Yeah. ELYSIS is a really interesting technology. And you know, you were with us, we've been working on an inert anode for a long time, and this is the next step on making progress on the inert anode. If we, ELYSIS, and we're a partner in ELYSIS with Rio Tinto, if we're successful, that will create the lowest carbon aluminum in the world. And so that project we just recently announced that the R&D center has opened up and we're spending money in Saguenay to open that R&D facility, and we really are targeting commercialization of that product in 2024. So there's still time that we're working through the R&D nature of the product and expect commercialization in 2024.

Carlos F. De Alba: And, Bill, when you talk about commercialization, is the company planning, or the joint venture planning, on selling this technology to third parties or it's just going to be only for the benefit of...

William F. Oplinger: At this point I think it's too early to say. We'll work through the technology and then have a package that we'll be able to use internally between the partners and potentially sell.

Carlos F. De Alba: All right. So moving a little bit now to the market. Can you give us an update on your latest views on demand and supply? Production in China declined last month but clearly that is something that we need to constantly monitor given the influence that it has in the global market. What are you seeing in that regard?

William F. Oplinger: Yeah. So let's start from the dirt and work to aluminum. On the global bauxite picture, we are projecting a surplus of global bauxite of 13 million to 17 million metric tonnes in 2019. That's not a significant change than what we've seen in the past. And so that's our view of 2019. The Chinese continue to import significant amounts of bauxite into China. The Chinese are ramping up towards importing 100 million metric tonnes over time into China.

We would then go to the refining business. There is a little bit of a surplus in refining and I believe the numbers that we put out in July were approximately 1 million metric ton surplus of refining. You've seen alumina prices come down over the last few months directly in relation to that surplus. And then in aluminum, we are projecting approximately one million metric tonne deficit. It's 1.0 million to 1.4 million metric tonne deficit in aluminum. That's on top of the deficits that we've seen over the last few years. The industry has had inventories on a days of consumption basis continue to trend down. Inventories on a days of consumption basis have trended down really since the global financial crisis when they peaked, and we're projecting inventories to be at approximately 56 to 59 days of inventory in the aluminum supply chain by the end of the year, which is the lowest it's been since the global financial crisis.

So to get to your question, specifically on aluminum demand, we ramped back a little bit in the second quarter. We took demand growth on a year-over-year basis to 1.25% to 2.25%. Some of the drivers of slower demand were a slowdown in

China, specifically around China and the electrical grid –I'm sorry, specifically around transportation and the electrical grid. And then in the rest of the world it's a lot about automotive slowdown and transportation slowdown. So we did decrease in July our projection for global growth. However, some of the supply side reductions have matched that. And therefore, we continue to see a deficit in aluminum in the world.

Carlos F. De Alba: All right. And so you alluded to the very low levels of inventories globally. That's also something that we see in zinc, copper, and yet the prices for all three commodities are down, just keep going down.

William F. Oplinger: Sure.

Carlos F. De Alba: So how should we understand the current dynamics? Is there any hope that we're going to see a restock at some point? What could be the triggers or the drivers for that? Or are we now in a structurally different world where we're going to see lower inventories going forward?

William F. Oplinger: Yeah. So to put it in perspective, our projection of 56 to 59 days is substantially lower than the amount of days of consumption of inventory in the world since the global financial crisis. Every year, and we actually have a chart in our own presentation on our website that shows the decline of overall inventories in the world. The question will, which the one you're asking the other folks are asking, is when does restocking occur? There are a couple of fundamental changes that have happened in our industry over the last decade that makes it very, very difficult to determine when restocking will occur. One, since the global financial crisis, 10 years ago, supply chains in the North America have gotten longer. North America used to have more smelters in it that supplied the local market. There are less smelters in the U.S., significantly less smelters in the U.S., than there were 10 years ago. Therefore, supply chains have gotten longer. That would suggest that we need more inventory in the system.

However, on the other side, largely in China, the Chinese have really gone to a molten model where they ship molten to their customers. That would suggest to you that those supply lines have gotten shorter and therefore restocking may occur at a lower level. We don't have a perfect answer. What we can tell you is that as deficits continue, inventories continue to come down, and at some point we will have to get into a restocking phase.

Carlos F. De Alba: Right. Complicated thing here. And what about the Chinese industry? In the past you have discussed the level of profitability that they, that they have, that is quite challenging. What are you seeing right now in terms of those metrics or those margins that the Chinese are doing and the prospects that that's going to lead in more capacity rationalization?

William F. Oplinger: Sure. Just to be clear, since we put out our supply-demand view in July, on the aluminum side, a number of production issues have occurred in China. First of all, one of our major competitors had a transformer outage. That took off, on an annual basis, probably 500,000 metric tonnes. Another major competitor was hit by the typhoon. That took off probably close to one million metric tonnes.

So in aggregate we think just that and some of the economic curtailments have probably reduced production on an annual basis by 1.7 million metric tonnes.

With that said, at current pricing for both –and I'd say at August level pricing because the last time we ran the analysis, for both alumina and smelting – on the smelting side, we think both the Chinese and the rest of the world are at less than 10% of the global capacity is cash negative, all right.

So today, there's not a lot of smelting capacity globally that's cash negative. Slightly different on the refining side with alumina prices having come down as quickly as they have, the rest of the world refineries, there's not a significant amount of capacity that's cash negative, but in China the cost curve is so flat for the refineries that a reduction in price in China makes that capacity go cash negative fairly quickly. We would project that there's probably 27% of the Chinese refineries that are currently cash negative at current prices. So on the smelting side, single digits; on the refining side, a fairly large amount of capacity in the refineries in China are cash negative.

Carlos F. De Alba: All right. Let me see if there is any questions on the audience at this point.

Unidentified: Great. Thanks. If you could maybe comment on your thoughts or implications from prospective export bans from Indonesia on bauxite, we've seen some headlines there as it relates to nickel and some talk that it could start impacting other commodities as well.

William F. Oplinger: Sure. We've seen the news along with everyone else. There's a potential export ban of bauxite coming out of Indonesia. To put it into perspective, we believe that Indonesia exports about 12 million to 13 million metric tonnes on an annual basis to China. And as you heard me say earlier, we think that the surplus in the world is 13 million to 17 million metric tonnes. So a ban of Indonesian bauxite would go a long way towards tightening up the bauxite market. I would tell you though that the Chinese have been very resourceful over time on trying to get bauxite out of places like Guinea. So, if they're not able to get bauxite out of Indonesia, they would probably most likely ramp up getting bauxite out of Guinea. There is a cost differential. When you look at the freight differentials between Indonesian and Guinea, it's about $10 a tonne. So on an alumina basis, $10 a tonne for bauxite is $20 to $30 for alumina. So it's not inconsequential.

Unidentified: Maybe just to follow up now just on end market demand, you kind of spoke from a high level on aluminum demand. But I guess more to subsector level, what are you seeing? There's been a lot of concern globally around auto production levels, both domestically and in China. And then more so on the bev. can side as well there's a growing focus there and that substrate shift from plastic in water bottles to aluminum cans and stuff like that. Are you seeing any appreciable change in demand parameters from those end markets?

William F. Oplinger: Sure. So to put it in perspective, we reduced our overall 2019 demand growth by about 100 basis points in July. And the reason why we did that was we saw some weakening both in China and in the rest of the world. And in China, where we saw the weakening were a couple of key large end markets. Construction was one. Electrical grid construction was the second, and specifically, transportation and automotive. In the rest of the world, the primary driver was largely automotive. When you look at longer demand trends, demand in aluminum has been a very good story over the last decade. We've seen average demand growth of 5% over the last decade. We're projecting that future demand growth over the next 10 years, is probably more in the 3.0% to 3.5% range. So, demand continues to be very, very strong for aluminum.

You highlighted one of the areas that that is a growth opportunity for aluminum. The aluminum can – and I'm sure you've heard a lot of the pitches for the aluminum can – but essentially when you recycle aluminum you use 5% of the energy to recycle 1 pound of aluminum versus making new. When you recycle a can it takes approximately 60 days from when you put it in the blue container to get it back on the shelf. So there is a lot of value in recycling aluminum specifically in the packaging business. And packaging is a growth opportunity over the next decade.

Unidentified: And talking about that how can Alcoa benefit from this more recycle –would you use your casthouse to get more into that recycling business?

William F. Oplinger: So, we have the ability to re-melt in a number of locations. But I would point out to you the reason why I highlight the importance of recycling of aluminum is just that recently – that aluminum should be the product of choice in the future, because it is infinitely recyclable. For us, we're very pleased to make primary aluminum to support the industry because over time that will get used as scrap and it'll get recycled. So we are a big scrap user in our rolling mill in Warrick. We have the ability to re-melt in a number of our facilities around the world but we're really touting the overall environmental nature of the metal itself because that's what's important.

Carlos F. De Alba: Any other question from the audience? So, Bill, given all the work that the company has done the last three years since it separated from Alcoa Inc. or Corp. or...

William F. Oplinger: Inc. So, we were Inc.

Carlos F. De Alba: Right.

William F. Oplinger: We split into Arconic and Alcoa Corp.

Carlos F. De Alba: That's right. So what other initiatives or levers does the company have or management have to further improve the results and the returns of the company?

William F. Oplinger: Sure. If you look at where we came from when we launched in 2016, we had a trailing EBITDA of approximately $1 billion on a carve-out financial basis. We were able to achieve $3.2 billion of EBITDA in 2018. We had a lot of market help. We had better prices. We were able to use much of that cash flow to be able to address many long-term liabilities. We've made significant improvement on our pension and OPEB funding status. We were able to extinguish some long-term contracts that were negative. We've been able to exit Spain on our two small smelters that we just announced in the second quarter. We were recently able to get out of the interest, or divest the interest, that we have in the rolling mill in Saudi Arabia. So we have done a lot to reposition the company over the last three years. We're not stopping.

You saw the announcement earlier this week. The announcement earlier this week should provide, not only better decision-making, faster decision-making, faster end to end process management, it will also allow us to reduce costs. And we'll continue to move forward. When you look at the levers, and you know our company well, when you look at the levers in our industry it's managing costs on raw materials, making sure that we have good labor productivity, making sure that that we're driving to the lowest cost position and then managing the portfolio successfully.

And I should highlight – we talked a little bit about it – but we did, we're able to get to labor agreements in Québec. That sets us up for a long-term success in Québec. So a lot of progress over the last less than three-year time period, and I would suggest to you that we're not going to sit back. We're going to keep moving forward.

Carlos F. De Alba: All right. Well, if there's no further questions, thank you. Thank you very much, Bill.

William F. Oplinger: Thank you, Carlos.

Carlos F. De Alba: All the best with the continuing restructuring and improvement.

William F. Oplinger: Nice to see you.

Carlos F. De Alba: All right.