Alcoa Corporation

Fourth Quarter and Full Year 2018 Earnings Presentation and Conference Call

Wednesday, January 16, 2019, 5:00 PM Eastern

CORPORATE PARTICIPANTS

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

James Dwyer - *Vice President of Investor Relations*

PRESENTATION

Operator
Good afternoon, everyone and welcome to the Alcoa Corporation Fourth Quarter and Full Year 2018 Earnings Presentation and Conference Call. All participants will be in a 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, and to withdraw your question, please press "*" then "2." And please note that today's event is being recorded.

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

James Dwyer
Thank you, William, and good day, everyone. I'm 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 EBITDA means adjusted EBITDA.

Also, a note on our financial statements. Consistent with our three previous 2018 earnings presentations, all comparative prior periods have been updated in accordance with the Financial Accounting Standards Board's recent change to the presentation of non-service pension and OPEB costs. This change resulted in Alcoa moving such costs out of EBITDA and into other income/expense.

Finally, as previously announced, the earnings release and slide presentation are available on our website.

With that, I'll turn it over to Roy.

Roy Harvey
Thank you, Jim, and thank you to everyone for joining today's earnings call. Our fourth quarter and full-year 2018 results reflect our determination to accelerate the strengthening of Alcoa. Despite sequentially weaker markets, we had a strong fourth quarter with higher profits in our Bauxite and Alumina business units. And with the help of higher market prices earlier in the year, we increased annual profits, addressed liabilities, significantly strengthened our balance sheet and began to return cash to stockholders. We've built upon the progress we've made since our launch, and by executing our strategic priorities to reduce complexity, drive returns and strengthen the balance sheet we're better positioned to thrive through market cycles.

But as we turn to 2019, markets have trended lower and there is increased uncertainty surrounding global trade. This has created a dynamic environment for input pricing and product pricing. Our businesses, however, are ready for these challenges, and we are determined to drive improved operations, react smartly and with urgency to changing market conditions and to further strengthen our company's foundation.

With that, let's get started with an overview of the fourth quarter. We reported net income of $43 million or $0.23 a share. On an adjusted basis, excluding special items, net income was $125 million or $0.66 a share. On an adjusted EBITDA basis, excluding special items, we generated $749 million and reported solid cash generation.

Turning to our businesses, and beginning with safety, the fourth quarter was free of serious injuries. We're very happy with this achievement and we look forward to building upon it as the year progresses. Operationally, in Alumina, our Pinjarra refinery in Western Australia, one of the largest in the world, attained a fourth quarter production record. Our Alumina segment also reported a rise in quarterly profits.

In Aluminum, last month we curtailed half of the one operating pot line at the Bécancour smelter in Quebec, Canada. This will enable our salaried employees to continue to run this portion of the line safely with a smaller workforce. Meanwhile, we continue to work on reaching a new labor contract with the unionized workforce.

Also this quarter, we began to buy back shares under the stock repurchase program announced in the third quarter, and we successfully amended our revolving credit agreement, reflecting our improving financial profile.

Lastly, overnight in Spain, we reached a tentative agreement with the workers' representatives at our Avilés and La Coruña aluminum plants related to the collective dismissal process that we announced in October. The workforce is expected to vote on the tentative plan by the end of the month.

The plan calls for the curtailment of the smelters at both plants. The casthouses at each plant will remain in operation and the paste plant at La Coruña will continue to operate. Our social plan included in the tentative agreement preserves a portion of the jobs at the two facilities and includes retirement packages and potential relocation to our San Cipriári facility.

Taking a broader look at 2018, as I mentioned earlier, we can see a strengthening Alcoa, and it's visible across safety, our balance sheet and our financial performance. Compared to 2017, we grew revenue and net income, and we increased adjusted EBITDA, excluding special items, by 27%, reaching $3.1 billion. We reduced our pension and OPEB net liabilities by a third, enhancing our balance sheet, all while maintaining a healthy cash balance.

In safety, we experienced three serious injuries in 2018, but we were grateful to have no fatalities last year. Our focus across the year has been to revitalize our safety program and we look to improve safety further this year and beyond.

Despite operational issues earlier in the year, we saw annual production records at two of our aluminum plants and two of our bauxite mines. We completed the partial restart of our Warrick smelter to support profitably growing our can sheet business and we launched a joint venture to develop our carbon-free aluminum smelting technology. We're proud of what we've accomplished in 2018 and how this work has positioned us for the coming years.

Furthermore, with two years of actual results now behind us and given industry practice and market volatility, we are amending the way that we provide annual outlook information to more fully describe business drivers rather than point-in-time estimates. Bill will offer more details on this change.

With that, I'll turn it over to Bill for a detailed review of fourth quarter results.

William Oplinger
Thanks, Roy. Let's start with the income statement. Sequentially, revenues are down $46 million on lower aluminum and alumina prices. Compared to last year, revenues are up $170 million, primarily on higher alumina prices. In the quarter, the net income attributable to Alcoa Corporation was $43 million or $0.23 per share on 188.2 million shares outstanding.

Special items in the quarter totaled $82 million after-tax and noncontrolling interests. Of the $138 million of restructuring before tax and noncontrolling interests, $107 million was to establish an allowance on Brazil state VAT credits. While the company retains the ability to utilize the credits in the future, only the restart of our Sao Luís smelter provides the opportunity to monetize the credits.

Amid unfavorable market conditions and with the current inability to obtain a favorable power contract, we felt it necessary to stop recording additional VAT credits and to establish an allowance on the current balances. We still believe the Sao Luís smelter assets are valuable for the future and continue to maintain the smelter assets. Other restructuring charges of note include $12 million for pension and OPEB actions and $8 million for take-or-pay contracts at idled facilities.

Now, let's look at the income statement, excluding special items. Our fourth quarter '18 adjusted net income, excluding special items, was $125 million or $0.66 per share. Adjusted EBITDA, excluding special items, was $749 million, down $46 million sequentially primarily due to lower metal prices. Our fourth quarter EBITDA margin was 22%.

A few other items of note on a sequential comparison basis: other expenses increased $25 million due to the losses in the Aluminum side of our Saudi joint venture and lower foreign currency benefits. Our operational tax rate in the quarter was 38.8%, 6.8 percentage points lower sequentially. In the third quarter, we had a higher tax rate to catch up our full-year rate as rising alumina prices changed our mix of taxable earnings and nontaxable losses.

Our share count decreased half a million shares due to stock repurchases and a decrease in common share equivalents. In the fourth quarter we repurchased 1.7 million shares for $50 million, an average price of $29.01.

Commodity pricing changes had both positive and negative impacts this quarter, and even with improved volume, drove slightly lower sequential results. Negative drivers were lower metal prices, unfavorable contract pricing true-ups in our Alumina segment compared to favorable true-ups last quarter and lower energy prices in Brazil.

Major positives came from improved sales volume due to higher production in all three segments. The other major benefit came from lower quarter-end prices driving positive corporate inventory accounting impacts compared to negative impacts last quarter. Raw materials cost increases have moderated and even provided a slight benefit this quarter.

Now let's shift our focus to the segments. In the segments, Bauxite adjusted EBITDA improved $4 million on increased production from the Huntly and CBG mines. Alumina adjusted EBITDA improved $23 million. Strong production recovery and higher API prices were offset by the favorable pricing true-ups from last quarter turning negative this quarter. The Aluminum segment was down $126 million, primarily on lower metal prices and lower earnings from our Brazil hydro assets. Higher alumina costs continued to flow through the segment, which offset the volume gains from the business.

Outside of the segments, for the quarter, non-segment impacts netted to positive $9 million. Corporate inventory accounting was a benefit as alumina and aluminum prices dropped at quarter-end.

In the fourth quarter, we ended the year with cash of $1.1 billion, up $91 million sequentially and down $245 million year-over-year. As noted earlier, $50 million of share repurchases took place in the quarter, with a matching amount used to reduce debt and make pension contributions.

A quick review of our major cash sources and uses for 2018. Our total sources of $2.2 billion were comprised of $1.6 billion in operating cash flow and $600 million of debt issuances and other sources. Uses were in three major categories: pension and OPEB, minority interest distributions, and capital expenditures and other.

We funded $1.1 billion in the pension and post-retirement benefits programs, including $412 million of required funding, $225 million related to annuitizations and discretionary contributions, and $500 million building a pre-funding balance with proceeds of May's $500 million bond offering. Separate from pension, the largest outflows of cash were net distributions to our joint venture minority interest partner of $678 million and roughly $400 million of capital expenditures.

Now let's take a look at the balance sheet. This quarter, we continued strengthening the balance sheet. Our net debt to adjusted EBITDA is down to 0.2 times. Return on capital for fiscal year 2018 is 11.9%. Our fourth quarter days working capital was 22 days, down four days from the third quarter and an 11 day increase year-over-year, reflecting higher raw material prices, lower buy/resell activities and timing of vendor payments.

Most importantly, our pension and OPEB net liability ended the year at $2.3 billion, down $1.2 billion year-over-year. Sequentially, it was up $200 million after a year-end remeasurement, as unfavorable asset returns due to the global market decline in the fourth quarter overshadowed slightly improved discount rates. The year-end remeasurement offset earlier favorable interim remeasurements.

We've completed our 2018 capital allocation framework. And as previously mentioned, we started a stock repurchase program and repurchased 1.7 million shares. These shares were retired and not held in treasury stock. Our future capital allocation framework follows a theme similar to 2018. We will continue balancing many factors in light of expected market conditions, challenges and opportunities, but foremost will be maintaining liquidity and managing investments to sustain the business and drive value.

We will also continue our drive toward attaining an optimal capital structure, returning cash to stockholders, and when appropriate, investing in value creating growth projects. To measure attaining an optimal capital structure, we're using an adjusted net debt metric on a proportional basis. At year-end 2018, it was $3.3 billion and our target over the next three to five years is to reduce it to $2.0 [billion] to $2.5 billion. It's important to note that this range can be achieved by making our minimum required pension and OPEB payments, assuming we achieve our expected asset return and no change in discount rates. We have $150 million remaining under our existing $200 million repurchase authorization. As with our adjusted net debt target, we will execute the repurchase program based on cash flows, market conditions and other relevant factors.

Now, let's review the full-year outlook for 2019. As Roy mentioned, due to its limited utility to investors and unprecedented market volatility, we're eliminating the quarterly point-in-time full-year EBITDA outlook, instead adding more cash flow information on the outlook page and adding another page of business commentary in the appendix.

Starting with the income statement, in the segments, compared to 2018, we expect that 2019 Bauxite shipments will be flat to up 1 million tons[1] and Alumina shipments will be flat to up 100,000 tons. Alumina production gains will translate into fewer purchased tons in 2019. Aluminum shipments will decline 500,000 to 600,000 tons year-over-year, partially a result of the expiration of the Tennessee tolling agreement.

Outside the segments, we expect transformation to be in the range of $10 to $20 million, primarily due to lower power revenues in Suriname. In 2019, we will stop using LIFO inventory accounting and metal lag will be included in the Aluminum segment, leaving intercompany profit eliminations as the sole corporate inventory impact. We plan to restate 2018 financial results in the first quarter, but the impact will be insignificant for the year. Moving forward, intercompany profit eliminations will vary based on ending period prices and inventory levels, and we are including a sensitivity in the appendix.

Other corporate expense will increase approximately $20 million due to higher resource unit and labor costs. Below the EBITDA line, there are anticipated improvements in depreciation, depletion and amortization down $33 million to $700 million, and net pension and OPEB expense is improving roughly 20%, down $24 million to $115 million. Interest expense is essentially flat year-over-year.

We expect our 2019 operational tax rate to range from 45% to 55%, a result of losses in non-tax-paying jurisdictions and that's dependent upon market conditions. Based on today's spot prices, we would be toward the top end of that range.

In our expanded cash flow section, we have some key expectations. Minimum required pension/OPEB funding is down 27% from $412 million to $300 million. Additional liability optimization via debt reduction or pension funding as well as stock repurchases will be based on market conditions and cash availability. Sustaining and return-seeking capital expenditures are set the same as last year's targets at $300 million and $150 million, respectively. Because we saw higher earnings in 2018 in tax jurisdictions paid on a lag basis, we expect previous period tax payments to increase by approximately $200 million to approximately $360 million in 2019.

We have completed our payment schedule for the DOJ/SEC settlement. Environmental and ARO spending is expected to be back to its previously targeted range of $110 million to $120 million. And cash impacts of restructuring charges, for example, our Wenatchee power payment, were $103 million in 2018.

As Roy noted earlier, we have reached tentative agreement with works councils at our Avilés and La Coruña smelters. Upon ratification by the workforce, we would expect 2019 restructuring cash impacts to range from $90 to $115 million. In addition, depending on the

[1] Editor's Note: Any reference to "tons" in the document should be regarded as "metric tons".

ultimate outcome of the process, the company could incur further charges, ranging from $125 to $135 million, of which 75% would be non-cash. The remaining 25% would result in cash outlays after 2019.

In the appendix, you'll continue to find the cost and EBITDA sensitivities as well as a discussion of key business considerations. Those considerations include, for example, the expected sequential impacts of favorable alumina contractual pricing of approximately $30 million and lower alumina costs in the smelters of $40 to $45 million, as well as anticipated unfavorable impacts of increased maintenance activities in the Aluminum segment of approximately $30 million and roughly $15 million lower earnings in the rolling business.

So with that, I'll turn it back to you, Roy.

Roy Harvey
Thank you, Bill. Turning to our market outlook, first, I'd like to highlight why we're excited about the future of our aluminum market. Beginning on the left-hand portion of the slide, long-term demand growth is expected to remain robust in the next five years. When looking at expected consumption growth, aluminum continues to outpace competing materials. We expect that demand growth for primary aluminum will remain strong at a 3.4% compound annual growth rate through 2023.

We're also fortunate to have a well-diversified base of sectors that consume aluminum. In fact, no one sector makes up more than about 25% of aluminum demand. The three largest sectors, construction, transportation and packaging, are each expected to have significant growth worldwide in the next five years. We expect transportation demand for aluminum, for example, to grow at a 3.9% compound annual growth rate, supported by trends that include rising wealth in emerging economies and the light-weighting and electrification of vehicle fleets. The electrical sector is also expected to contribute significant demand growth by 2023, especially in India, a country that is responsible for almost 1 million tons of growth during this period.

In the developed markets of North America and Europe, where most of our production is located, aluminum consumption growth is expected to outpace positive overall GDP growth. Positive economic growth in both mature and emerging markets will therefore provide a steady source of demand growth for the many critical end products that rely on aluminum and their supply chain. While new aluminum supply will come online over these five years, in the near term particularly, we expect that supply growth will not keep up with consumption. Given the more restrictive approach to operational permitting inside China and a clear capital cost disadvantage restricting new supply outside of China, 2018 saw a primary aluminum deficit worldwide, and we expect another deficit for 2019.

Now we'll look more closely at our balance estimates for each of our three markets. Starting with the bauxite market, we see the 2018 bauxite surplus continuing into 2019, as exports from Guinea, Australia and Indonesia climb year-over-year. Chinese customers stockpile bauxite strategically due to uncertain sourcing both within and outside China, and this surplus will likely enable them to grow that stockpile again this year.

In alumina, as you know, 2018 was an extraordinary year, as third-party supply disruptions in Brazil and other factors pushed the market into a deficit. For 2019, we're forecasting an alumina surplus in China, driven by refinery expansions and lower than previously expected smelting production due to economic and environmental reasons. In the world ex-China, we expect the market to be approximately balanced, as refining expansions keep pace with rising demand. Lacking concrete information about if or when third-party disruptions may be resolved, our estimates assume that the status quo will continue.

Finally, we continue to see aluminum in a deficit as we did in 2018. Lower margins have led to many economic curtailments of smelting plants during 2018, including several in China that curtailed all or part of their capacity during the fourth quarter. As I mentioned on the previous slide, demand growth for primary aluminum in 2019 is expected to be robust, with global consumption growth in a range of 3% to 4%, driven by continued strong growth in China as well as in developed and developing markets elsewhere.

While the global aluminum market is projected to be in deficit again this year, prices today are creating unsustainable margins for the aluminum industry. We estimate that between 30% and 45% of global smelters are cash negative at recent prices. China exported 5.8 million tons of unwrought and semi-finished aluminum products in 2018. That's a 21% increase over 2017. What's more, those exports are enabled by outsized government support, the weakening Chinese yuan and an unlevel playing field. 5.8 million tons is a very significant quantity, equivalent to about 20% of ex-China primary consumption in 2018. That large outflow of metal competes with ex-China semi-finished production, lowering primary aluminum demand, and contributes to depressed pricing.

The depressed margins we're currently seeing have also occurred in the past several years, but only for short periods of time. Today's low margins cannot sustain our industry and are therefore not viable over the long term.

Looking back, since November of 2016 we've made great progress in our first two full years as an independent, publicly-traded company. As we prepared to separate from our parent company in early 2016, aluminum prices were at multi-year lows and aluminum prices remained weak. To improve our positioning to be a standalone company, we executed a comprehensive strategy to strengthen our portfolio as we continually strived to be a low-cost industry leader across bauxite, alumina and aluminum products. In November of that year, we began operating as an independent entity with excellent prospects for the future.

With the launch behind us, in 2017 we introduced three strategic priorities, reduce complexity, drive returns and strengthen the balance sheet, as the building blocks for a stronger Alcoa. We've used these priorities to streamline our processes and procedures and drive returns from our assets. With the benefit of favorable markets, we were also able to address a significant portion of our legacy items, most notably, our pension and OPEB liabilities, but also other major items such as the long-term power contract associated with our closed Rockdale smelter that was an annual drag on earnings of approximately $60 to $70 million.

We closed 2018 with $3.3 billion in adjusted net debt, down from $3.8 billion in 2016, and we've grown our adjusted EBITDA, excluding special items, nearly 3 times that of our 2016 carve-out financials. Due to our financial performance and as proof of our strategy's success, we've started to execute our announced stock repurchase program, a key component of our 2018 capital allocation framework.

As we enter our third year as Alcoa Corporation and with a focus on strengthening our company for the long term, we'll begin to use our solid foundation to judiciously creep and grow our assets where sustainable value drivers exist. We'll also use innovation, like our Elysis technology, to disrupt the aluminum industry of the future.

Lastly, we'll lead with our reputation, our values and our expertise, which is what makes us uniquely Alcoa, to be the partner of choice on new projects, all with the goal of providing consistent returns for our stockholders.

In closing, as markets trend lower here at the start of 2019, we will continue to drive improvement so we can be competitive through all cycles and react smartly and with urgency to these dynamic conditions.

As 2019 progresses, we'll continue to prioritize safety across the company. We see a direct connection between an efficient and effective safety system and our operational and financial performance. We'll also remain focused on our strategic priorities. We plan to increase operational performance, improve the stability of our alumina operations, increase or creep volumes in all our businesses and resolve labor issues in a way that enhances the long-term viability of our operations.

We plan to drive improvement in controllable areas within the business, but be flexible and nimble enough to react to either favorable or unfavorable changes in market conditions. Throughout this year, we'll evaluate and prioritize future growth options, while we continue to optimize our capital structure. Bill and I are proud to be supported by our employees across the globe and what we've accomplished as Alcoa this past year. We stand ready with an even stronger company than the prior year to address the challenges and seize the opportunities that 2019 may bring.

With that, Bill and I would be glad to take your questions. William, if you could please remind us of the protocol and we can get started.

QUESTION AND ANSWER

Operator
Thank you. And we will now begin the question and answer session. To ask a question you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys, to withdraw your question please press "*" then "2." And at this time, we will pause for a moment to assemble our roster.

And the first questioner today will be Timna Tanners of Bank of America Merrill Lynch. Please go ahead.

Timna Tanners
Hi, Happy New Year, guys.

Roy Harvey
Hi, Timna
.
William Oplinger
Hi.

Timna Tanners
Thanks for all the great detail. I had to laugh when I saw that simplification is still a priority because I went to slide 31 and I got really confused. So I was hoping you could help, without getting too into the minutiae, sort through what those components are. Are those above and beyond the discussion that Bill gave us earlier or are those already in guidance? For example,

when you talk about the mix and the pricing, is that something that would already be reflected in your sensitivity charts or tables or is that something that's separate?

William Oplinger
Timna, it's probably a little bit of a combination. So if we just briefly run through it, the first bullet talks about the operational stability and improvement that we expect to see out of alumina, which we highlighted that we had some difficult times this year and we're expecting to recover from that. We're overcoming some of the negativity we saw in the fourth quarter on the alumina price mix column, so picking up $30 million there, giving you an estimate of the flow-through of alumina into smelting and that's the $45 million. And then the next two are really outside of sensitivities. We don't give you a sensitivity on maintenance spend or what flat-rolled products is going to look like in the first quarter. So we've provided that here for you.

And then the second-to-last one is about raw materials. There's so much uncertainty around raw materials right now. It's very, very difficult to predict where raw materials are going to end the year, so we're just trying to point out to you what they look like in the first quarter. And then the last bullet point is really a substitution for some of the prior guidance that we've given around intercompany profit elimination. You know now that we're off of LIFO. I alluded to that in my comments. So LIFO is now gone. So this is just something that will help you understand where the intercompany profit elimination will be based on different API prices. So it's a mixture to answer your question.

Timna Tanners
Okay. That's helpful, and I'll go through that in more detail separately. And then I was just wondering…I know that it's really fresh talking about the advances in Spain. But just as you talk about the landscape over the past year, it had me thinking about where the company's footprint wants to be going forward in current market conditions. You've talked down the potential to restart the refinery in Brazil. You're producing less in Canada. Can you talk a little bit about how you see the footprint evolving or is this the ideal footprint for the company in the current circumstances? And can you give us any color on the impact of the Spanish shutdown for operations? Thanks.

Roy Harvey
Yes, Timna. So let me start at a high level and then I'll get a little bit more granular because I think it becomes a different question and a different answer for each of the facilities. When we look at our portfolio right now, I think we feel that in the world in which we've been living for this past year, it's the right portfolio, and I'd remove Spain from that because we've obviously been having the discussions around the Spanish restructuring. However, that doesn't mean that we are[n't] very focused on both looking at our current facilities given this new set of price and conditions and also looking at our footprint and thinking about what is it that we're trying to do with the future. And so very simply, we see that the value isn't in the number of tons that we produce but in the fact that we have a low-cost, high-quality portfolio that allows us to both weather the downturns but also do a smart job at strengthening ourselves and also improving our production capacity at our current locations when times are better. And that is a constant process.

So when you then zoom in and look at this on a case-by-case basis, and so one example that you mentioned was in Brazil where we have an idle smelter. It's a relatively competitive smelter but that lacks a power contract that makes it competitive in today's world. That's something that can shift relatively quickly. It depends on the Brazilian real. It depends on market conditions both inside of Brazil and outside of Brazil. And it also depends on our ability to negotiate with the government, both the regional and national government of Brazil to find a long-term power contract. We continue to look at each of our locations to see what can we do to make them stronger, whether there is any justification for a restart, and additionally, and this becomes particularly important at times like today where we see relatively strong alumina prices and weaker aluminum prices, we also look at our portfolio to do two things.

Number one, make sure that when we restart failed electrolytic pots, whether we choose to bring them back online again, which is very much a variable cost exercise or whether we actually choose to look at a longer-term curtailment of a part or all of the facility. So it's a rather long-winded answer to your question. However, it really is a constant exercise and something that we ask each of our businesses, Bauxite, Alumina and Aluminum, to be constantly evaluating where they are and ensuring that that then matches up with what we see as the long-term fundamentals of our business.

Timna Tanners
Okay. Thanks for that.

Operator
And the next questioner today will be Alex Hacking with Citi. Please go ahead.

Alex Hacking
Yes, thank you for the question. The first question would be around the adjusted net debt goal. You mentioned that you can get to that target just based on the mandatory minimum OPEB [and] pension payments. What would trigger you, or what would trigger you to pay above those levels in order to accelerate that target? Would it just be based on free cash flow levels? Thanks.

William Oplinger
Yes. A good question, Alex. So as I said, we've got a target that is three to five years out there. If we achieve our expected return on assets in the asset portfolio for the pensions of 6.75% and discount rates don't change, then we would be able to achieve that target without making any discretionary contributions to the pension above and beyond the mandatory. If we were to find ourselves in a position where we don't achieve the expected return on assets or discount rates were to decline from where they sit today, we would have to make contributions to achieve that net debt target. So that's why we basically are putting the net debt target out there saying, “Hey, we should be able to achieve it with the mandatory contributions,” but if we don't get the expected return on assets or if discount rates change on us considerably we would need to make contributions.

Alex Hacking
Okay. So just to clarify, therefore you would anticipate making no voluntary contributions this year or in 2019 unless there's unexpectedly poor asset performance?

William Oplinger
Yes, the only caveat that I would have on that is, if we choose to do some level of further de-risking…you know we've done de-risking in the pension plan in 2018. We contributed, what, over $1 billion of cash into the pension plan to be able to take a considerable amount of the liability off the balance sheet. But at this point, I'm not anticipating that we would make considerable contributions beyond the mandatory.

Alex Hacking
Okay, thanks. And then just my second question on flat-rolled, are you still comfortable with the guidance that you gave on the last call of around a $25 million run rate? I noticed in the commentary that in the first quarter you expect it to be quite a bit weaker than that, but you did say last quarter that it would be weaker in the first half. So is that previous guidance still good?

William Oplinger
Yes, we gave previous guidance of about $100 million for the year. We're still targeting for $100 million for the year. And as we say, the first quarter will be a little bit weaker than the fourth.

Alex Hacking
Thanks a lot.

Operator
And the next questioner today will be Chris Terry with Deutsche Bank. Please go ahead.

Chris Terry
Hi, Roy and Bill. Yes, I just wanted to feed off the question that Alex was asking around the cash flows just now. On slide 15 and 16, in terms of the $150 million you still have remaining in the buyback program and just tying that to what you actually bought back in the latter part of the fourth quarter, is the speed of the buyback program that you spend entirely dependent on the EBITDA you're actually generating at the time and also the minimum required pension of the $300 million that you're going to spend during this year? Just trying to get an idea of how you prioritize the buybacks against the other buckets that are mentioned on slide 15 for the excess cash. Thanks.

William Oplinger
Yes, so it will be based on having excess cash. So I think to answer your question, you said, “Hey, will it be based on EBITDA?” Yes, ultimately as EBITDA translates into cash flow it will be based on having excess cash. And during the course of the year we will make the determination, if we have that excess cash we will weigh it versus the other options that we've laid out in the capital allocation framework, and that's the three things that we talked about there, which is returning cash to shareholders, potentially further de-levering and looking at long-term growth opportunities and make a determination. So if there is excess free cash flow, we will evaluate those three given the long-term capital allocation program that we've announced.

Chris Terry
Okay, thanks. So looks like slide 16, just going down the right hand side of the FY19 outlook, the $300 [million] sounds like it’s pretty fixed and all the capital expenditures. So just thinking about the buyback program, it really would just come down to what you generate during the year. You're not, for example, going to backpack CAPEX or look at other items within that framework?

William Oplinger
Yes, the $300 [million], if you look at us historically it's been pretty steady over the last few years, $300 million of sustaining capital, goes up or down a little bit over the last few years, but $300 [million] is a pretty good number. And then the $150 million of return-seeking, we came up with $150 million return-seeking target for 2018. We underspent that as the return-seeking projects came available, we made decisions around how quickly to implement those, but that would be the target for 2019.

Chris Terry
Okay, thanks. And just the last one for me, the slide 19, balances on each of the end markets. What have you assumed for Alunorte on the alumina balance? Thanks.

Roy Harvey
So on the alumina balance, we assume essentially status quo as of today. So there is no assumed restart and not because we're taking a position on that but simply because we wanted to put a stake in the ground as what does the market look like prior to the return. And it's the same impact on aluminum as well with Albras, which is connected over to Alunorte.

Chris Terry
Okay. Thank you. That's it for me.

Operator
And the next questioner today will be Matthew Korn with Goldman Sachs. Please go ahead.

Matthew Korn
Hey, good evening, everybody. Thanks for taking my questions. A question on the situation in Spain, could you explain a little bit more next steps on the worker negotiations there? You say in the release; there is a vote at the end of the month. Does that need approval by the provincial government? Are there any other hurdles that you are going to need to clear before you can move forward there?

Roy Harvey
Yes, Matthew, let me take a stab at that one. So essentially the process is pretty well laid out from here going forward, and I will give you some caveats about what will happen. So first of all, we have an agreement with the workers' representatives and so that is a very positive step. The next step, and this will happen in about a week, is that the workers will then have their option to opine about that. So assuming that they agree and that essentially means we go into the program as it's already defined. And so, we start curtailment and the workforce will participate in those activities and then we will continue on to the rest of what you've seen there. We will continue to operate the casthouses. We will keep those plants for six months until the end of June in a position where it can be restarted, and we will look to see if there is someone that wants to step into those operating positions. If the workforce would choose not to agree with the program as laid out, we then have 15 days in order to decide how we react to that choice. Again, that's a very prescripted legal process inside of Spain. However, I wouldn't want to try and foreshadow what the decision would be at that particular moment.

Matthew Korn
I appreciate it. Thanks for the clarity. I also want to dig in a little bit more on some of your market outlooks on the different commodities. In alumina, China is ever the linchpin there. How much additional refining capacity are you counting on in that base case for Chinese alumina supply in 2019, and then because it's connected, what's your net view on Chinese smelter production into next year?

Roy Harvey
Yes, it's hard to pin down what should the exact number be. And I think you are touching on this Matthew, because the fact is, the Chinese, if anything are very reactive to the way that the pricing happens to be pointing them. And so, we saw very quickly at the end of this year that when that gap between global pricing and Chinese pricing was in their favor they were able to export and when that gap closed they very quickly stopped exporting. And so, as we build our

balances we always take into account how we think conditions should develop on the ground. And so, that's a bit of a caveat of how we try to build that. And inside of that, we then think about what new capacity has been announced, how will the capacities then adapt to that particular situation that we find ourselves. So for alumina, I am trying to think back. I don't have the number right in my mind and I don't have it right in front of me, either. Essentially what we've done is we've taken the announced new facilities coming online and there have been a few of those, we have taken it into consideration also the relatively short-term winter curtailments and we did have one curtailment that was announced and has been acted upon. And we then brought that into what we think that supply/demand balance would be inside of China.

Matthew Korn
I appreciate it. Good job with everything, guys, in what's been a really challenging year.

William Oplinger
Thank you.

Roy Harvey
Yes. Thanks, Matt.

Operator
And the next questioner today will be Piyush Sood with Morgan Stanley. Please go ahead.

Piyush Sood
Roy, Bill, congratulations on the quarter. A couple of questions, first one, you were forecasting a deficit in aluminum in 2018 and now a bigger deficit in 2019. Just want to understand how do you account for China's 5 million ton plus exports in this? So without Chinese exports, would the...world ex-China be in a much bigger deficit? Just want to understand how you account for those flows. And also, why do you think aluminum prices are where they are right now despite these large deficits?

Roy Harvey
Let me answer your deficit question first and then we can step in and talk a little bit more about the price question. So remember when you look at that page, it is specifically dealing with primary aluminum balances, and so that has advantages and it has disadvantages. It's a relatively simplified world view.

Inside of that, let's take the China balance very specifically, inside of that, if they are producing semi-fabricated products that are actually intended for export, it still counts as Chinese demand because it's consuming primary material either as that first, very basic primary product or as molten metal that's included in Chinese demand. If that then is exported that then becomes an input into what is being consumed outside of China.

When you look at the rest of world demand, there is actually an impact of those 5.8 million tons that are flowing out, there is a negative impact because now you are not just demanding primary aluminum to go into those semi-fabricated products. You're actually consuming some of that Chinese material. So essentially the impact on the global balances is negligible because it is embedded in the way that we are doing these primary aluminum balances. However, it does serve in two ways; it serves as a connection between the two markets. But then it also allows this overcapacity in China to be turned into products and then those products are then exported and sold outside of China. And so it does very much have an impact on what's happening with global supply and demand balances, but it also has an impact on what's happening in aluminum pricing. So I'll use that to move right into your second question.

First and foremost, I think it's obvious that there is a lot of talk right now about global trade, about what investors feel about future demand and economic activities, et cetera. So certainly there is an overarching overlay of what's happening in the general market. Inside of our market specifically, I think it's very much the discussions that are happening right now about overcapacity that's having an impact on short-term prices. When you look at some of the most recent developments, the OECD study that looked at subsidies inside of the aluminum industry that found that China was very much an outlier, both on the size of the subsidies that are given to producers but also the availability of those subsidies to its own specific domestic producers.

As we see that overcapacity develop, and as China essentially moves from being just a primary producer into a semi-fabricated producer, it tends to give a negative pall to the broader market. And so, as we saw that extra million tons being exported in the form of semi-fabricated products, we believe that it's had a negative impact on pricing as the market has seen that material that doesn't necessarily flow to the U.S., for example, but can flow into the global market, whether it's in Eastern Asia or Europe or other parts of the world.

When we look at both the broader economics, but then also the dynamics of this over-capacitization and over-production inside of China, we believe that those things are having an outsized impact on prices.

One more comment though, and I'll link this back to my comments at the beginning, the simple fact is in the pricing environment in which we live today, and when you look at the economics of producing aluminum, these prices cannot be sustainable. They can't be sustainable because half of all capacity in China is now losing cash. And again, China tends to act pretty economically rationally when it comes to these types of decisions. When you then look at the whole world, it's somewhere between 35% and 40% of all smelters and weighted toward China, that are currently losing money as well. And so, that means that the pricing as it is right now certainly doesn't sustain continued production at these levels, much less ever incentivize new capacity to come online. And so, it's an unsustainable margin trend that we found has occurred in prior years, but has been pretty quick to self correct simply because it is not something that can continue and therefore justify by continuing to produce.

Piyush Sood
That's helpful, and a question on slide 16. The prior period taxes of $360 million, just want to understand if what's attributable to you versus Alumina Limited, should we assume a split around 60/40, or anything you could talk about that?

William Oplinger
Yes, it's a great question. And you should note that it's a line item that we haven't provided in the past, and we're making sure that people understand that we do have trailing tax payments that have to be made largely and predominantly in Australia, because our AWAC enterprise makes a lot of the money that it makes in Australia. So a big piece of that would be a 60/40 split because it's in the AWAC enterprise. Good question, Piyush.

Piyush Sood
Alright and thank you. Last one, slide 31, when we think of Alumina operational stability, should we think of it as a second-half transition, or can that happen in maybe 1Q or 2Q?

William Oplinger
I'll let Roy talk about it, but my view is we started to see some of that stability come back in the fourth quarter already. If you look at the fourth quarter numbers, we started to see that stability versus what we had seen in the second and the third quarter. And in my view, we've largely regained much of the stability that we have around the system. So I think we should start to see that in the first half already.

Roy Harvey
Yes, I completely agree with, Bill. Our expectation is that we see a stable Alumina business through the entire 12 months.

Piyush Sood
Thanks, guys, and all the best.

Roy Harvey
Thanks, Piyush.

Operator
And the next questioner today will be Lucas Pipes with B. Riley FBR. Please go ahead.

Lucas Pipes
Hey, good afternoon, everyone. Wanted to ask a quick question on the buyback of $50 million during the fourth quarter. Could you share with us at what price you were buying back stock and then also, why not more? When do you intend to increase purchases again? Thank you.

William Oplinger
Sure, I think the average price was $29.01 in the $50 million that we spent. And the question of why not more? We had a capital allocation program that wanted to target a minimum threshold of keeping $1 billion. We were really looking at cash as it was coming in during the course of the quarter. And then the other key aspect is that we had a fairly short window in which we could buy back. You know we renegotiated our revolver in the fourth quarter also. In renegotiating our revolver, we were blacked out. So we had only a short period of time in the fourth quarter in which we were able to be buying back before we then went into the blackout period associated with earnings at the end of the year. So that's the reason why we did not do more.

Lucas Pipes
Got it. That's helpful. Hopefully, you will not get another opportunity to buy at $25, but...

William Oplinger
Yes, $29...$29.01.

Lucas Pipes
No, I was being facetious.

William Oplinger
I know, I'm with you, I hope we don't get an opportunity to buy at $25.

Lucas Pipes
But just another follow-up, I think it was page 16 where you give the operational tax rate. I am a little confused about why it's higher in 2019 given the lower alumina price. Could you maybe

share a little bit more color on what's driving that increase for the 2019 guidance versus 2018? Thank you.

William Oplinger
It all comes down to where you make your profits and the jurisdictions in which you are making profits. And so, clearly we didn't provide you a full-year EBITDA guidance, but given today's prices with alumina and aluminum where it's at, we would anticipate that tax rate. So we are essentially just basically taking the current market prices for aluminum and alumina, trying to determine where we are going to make profits and also have losses. And that's what generates that 45 [percent] to 55 [percent]. I would point to you that I did make it clear in my comments that at today's prices we would probably be at the upper end of that. So at the 50% to 55% range.

Lucas Pipes
Got it, okay. Well, thank you very much and best of luck.

William Oplinger
Thank you.

Roy Harvey
Thanks, Lucas.

Operator
And the last questioner today will be Justin Bergner with Gabelli and Company. Please go ahead.

Justin Bergner
Thank you for fitting me in, Roy and Bill. Good afternoon.

William Oplinger
Hey, Justin.

Justin Bergner
Just. Hi, a couple of quick cleanup questions. Is the cash tax in the book tax, is the cash tax rate also expected to be in that 45% to 55% range?

William Oplinger
I would have to look, Justin. I think the really key thing for the modeling purposes is that you understand that cash tax catch-up. So that's why we pointed it out that it's an incremental $200 million of cash tax catch-up that was associated with profits that we made in 2018 that we have to pay in 2019.

Justin Bergner
Okay, great. Yes, I was asking ex the catch-up, but I assume I will loop up for some more clarity later. In the press release, you mentioned a $70 to $80 million benefit from the curtailment proposed in Spain. I assume some of that benefit on the net income line is related to the impairment and reduced depreciation. So can you give a sense as to how much that should aid EBITDA?

William Oplinger
I don't have it off the top of my head. So you have to circle back with Jim on how much of that. One thing to keep in mind that in Spain, pre-tax and post tax are largely the same because we've got a valuation allowance on the tax rate in Spain. So the $70 to $80 million of net income, the $70 to $80 million of pre-tax, how much of that is EBITDA, how much of that is depreciation? I'm not certain of that off the top of my head.

Justin Bergner
Okay, thanks. And then lastly, the maintenance spend tick-up, is that just a first quarter phenomenon or is that going to continue throughout 2019 relative to what you spent in 2018?

William Oplinger
That's a first quarter phenomenon. To circle back to some extent where we started with Timna's question. The reason why we provided that extra page of bullet point guidance, is because given the fact that, as Roy said, we are not providing the full-year EBITDA guidance, we felt compelled to try to give you some much better insight into both the first quarter and the full year. But to specifically answer your question, that's as a first quarter guidance item.

Roy Harvey
And just to add one more piece of information, Justin, just to give you a little bit more of an explanation. The largest part of our facilities in refining happen to be in the southern hemisphere. And so, we tend to see a reverse trend it is now the summer months, when we tend to see more of maintenance happening or some of the larger maintenance activities. So it tends to be pretty cyclical that the beginning of the year tends to be one of the most important maintenance months for us.

Justin Bergner
Okay, great. Thank you for taking my questions.

Roy Harvey
Thank you, Justin.

Operator
And this will conclude our question and answer session. I would now like to turn the conference back over to Roy Harvey for any closing remarks.

CONCLUSION

Roy Harvey
Great, William. Thank you. And once again, thanks to everyone for joining our earnings call today. Today's results reflect the success of our strategic priorities and how much stronger Alcoa is today than when we launched in late 2016. We have more opportunities to drive value for stockholders this year and we look forward to updating you again at the end of the first quarter. So thank you, and William, back to you.

Operator
And the conference has now concluded. Thank you for attending today's presentation and you may now disconnect your lines.