Alcoa Corporation

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CORPORATE PARTICIPANTS

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William F. Oplinger: Let me get started. I'm Bill Oplinger from Alcoa. Thanks for being here today. I just wanted to take a few minutes to tell you a little bit about Alcoa. Then we'll take some questions and answers. Hopefully, you know Alcoa Corp. We were launched in 2016. We're a global vertically integrated aluminum company. We have about 40 operating locations around 10 countries. We're on every continent except for Antarctica, have 14,000 employees in 15 different countries.

We are an industry leader in all aspects of the upstream aluminum value chain. And when we launched, we launched with two sets of guiding principles. We've got our Values; we've got three Values that are very simple to remember that guide everything we do. We Act with Integrity, we Operate with Excellence, and we Care for People.

And then we have our three strategic priorities. Those strategic priorities have not changed since we became an independent company, and those three strategic priorities are to reduce complexity and cost, drive returns from investments, and strengthen the balance sheet.

So let's take a look at our operating segments. We have three operating segments. Those three operating segments are Bauxite, Alumina, and Aluminum. Let's put those in perspective. In 2019, we'll mine approximately 46 million metric tonnes of bauxite from seven wholly-owned or JV mines. Our portfolio is solidly in the first quartile and spans four continents. And we have options to grow in many of those mines.

We're a world leader in sustainable bauxite mining and land rehabilitations, and we've been doing that for decades. We've earned the right to responsibly mine in sensitive areas like the Jarrah forest in Australia and the Amazon rainforest in Brazil.

If I move to refining, we have the world's premier alumina refining portfolio. We have eight refineries on four continents with capacity of over 15 million metric tonnes to produce annually. The portfolio is large and low cost. Where in aggregate the portfolio is in the first quartile of the global cost curve, with a number of our facilities in the first decile of the global cost curve.

In the smelting business, we have 14 smelters that span the cost curve. Some of our facilities, specifically in places like Canada, Iceland, Norway, and Saudi Arabia, are globally competitive. In aggregate, the smelting portfolio typically bounces between the second and the third quartile of the global cost curve, depending on alumina prices in China. When alumina prices in China are high, the portfolio improves to the second quartile. When they're low, the portfolio typically is at the bottom of the third quartile. Important to note that this segment includes results from our rolling facility in Indiana and our hydro investments in Brazil.

As I mentioned, we split off from Alcoa Inc. back in November of 2016. We spent 2017 and 2018 really addressing many legacy liabilities, and we generated free cash flow that allowed us to do that. I'll tell you in 2019, we further accelerated our efforts, both operationally and on the portfolio, and we've made great progress. This slide covers some of the progress that we've made in 2019. I'm not going to go through all of these, but I'll point out a couple of important ones.

We've hit record production results in the refining system in the second quarter. At the same time, we completed major mine maintenance and installed a new residue filtration system in our flagship facility in Pinjarra.

In the aluminum space, we took a number of strategic actions in the second quarter. We divested our interest in the rolling mill in Saudi Arabia for a cost considerably less than the projected future cash requirements of that facility. We also divested our two small smelters in Avilés and La Coruña, Spain. They were high-cost facilities, they were inefficient, and they had been curtailed earlier in the year, and we were able to divest those to a firm by the name of PARTER.

In addition to that, in the second quarter we made major strides on the labor front around the world. We have new long-term agreements in place in Quebec at two of our facilities there, Baie Comeau and Bécancour. And we've just recently come to agreement with the USW in the United States, although that agreement has yet to be ratified. So overall, so far through the first half, an extremely productive 2019.

But you probably saw our announcement from yesterday. We're not resting at this point. We announced a major organizational change for the company yesterday. Just briefly, what that organizational change means is that we eliminated our business unit structure. We'll continue to report segments. We feel it's important to have the transparency around the three product lines that we have, and we'll continue to report Bauxite, Alumina, and Aluminum. But what this does is it makes for a much leaner, more integrated, operator-centric organization. We've had a goal to be more operator- and customer-centric over the last 3 years, and this is the next step in the phase of that transition.

I will harken you back to 2016. When we launched the company, we had six business units. In 2017, we reduced that to three business units and eliminated a number of overhead offices around the world. We're now taking the next logical step. We're eliminating the business unit layer and having the top layer and the plants. And what that does is it allows us to connect better between operationally *[sic]* and the executive offices with the plants. And it's important to note that we're continuing to focus very heavily on safety and operational excellence. And at the same time this will allow us to reduce some overhead and put the company in a better position for sustainable profitability.

Transition quickly to capital allocation. Our capital allocation program was reiterated at the beginning of this year. We essentially have three steps to the capital allocation process.

First and foremost, our goal is to maintain liquidity of the company. That's especially important in times like today, where the market isn't as strong as it had been. We prefer to keep roughly $1 billion of cash on the balance sheet because we're a cyclical business, and we see cycles like we're seeing today. We weren't able to do that in the second quarter. We dipped under $1 billion. We had a couple of large payments that occurred in the second quarter. We had a trailing tax bill that was largely in Australia associated with profits that we made in 2018. We paid that in the second quarter. And as I said in the aforementioned slide, we exited the rolling mill in Ma'aden, which cost us about $100 million to do.

The second step in the capital allocation process is to maintain the assets, sustain the assets and improve the operations. We originally had an outlook of $300 million for sustaining capital. We've cut that back this year to $290 million of sustaining capital. We had an outlook of $150 million of return-seeking capital at the beginning of the year. Due to the market situation, we've taken that down to $120 million, so we're managing cash wisely.

Once we've done those two key points of the framework--maintaining liquidity and sustaining the operations--there's three uses for excess free cash flow. First and foremost, we've got a net debt target of $2.0 billion to $2.5 billion. We plan to achieve that net debt target over a 3- to 5-year timeframe. We think that we can get to that net debt target via making the mandatory pension contributions, but that will clearly, that clearly will depend on what interest rates and discount rates do during the course of that timeframe.

Secondly… and I should have said these are not necessarily in rank order of uses of cash. We will balance between these three items over the coming years for use of cash, and we'll balance that based on what we think generates the most returns for our shareholders. The second is to return excess cash to the shareholders, and we have an existing authorization for a $200 million share buyback. We executed on $50 million of that in 2018.

And then thirdly, investing in value-creating projects that are larger than the return-seeking projects that I alluded to in the box up above. We have opportunities specifically in our refining business in both Western Australia and Brazil for some larger debottlenecking projects, and we'll consider those at the beginning of next year.

I'd just briefly transition to the market that we see ourselves in. We provided this slide during our second quarter earnings release. It has not changed since then. At the time we were noting a deficit in primary aluminum. That deficit is 1.0 billion to 1.4 billion, and I will address how that deficit is bringing down global inventories on the next slide.

In the alumina market we continue to expect a slight surplus, albeit with a lower Chinese surplus than previously anticipated, given a series of environmentally related curtailments in China driven by some red mud issues, bauxite supply concerns, and refining upgrades, so our view on alumina is a slight surplus of 500,000 tons to 1.3 million metric tonnes.

Finally, in bauxite, we continue to expect surplus with additional supply from Guinea and Southeast Asia headed to China. I would note that in the second quarter we lowered our global aluminum demand growth projection. We took that down to globally, 1.25% to 2.25%. We did that with a lower projection in China and world ex China due to trade tensions and macroeconomic headwinds. These headwinds resulted in slower aluminum end use sector activity, particularly in the automotive sector, but consumer durable growth remains resilient.

So, I mentioned the fact that inventories continue to come down. If you have consecutive years with deficits in the aluminum space like we have had, and we're projecting again 1.0 million metric ton to 1.4 metric ton deficit in aluminum, you would anticipate that aluminum inventories would come down. Global aluminum inventories have trended down nearly every year since the global financial crisis when you look at it on a days-of-consumption basis, and we're projecting that the year would end at 56 to 59 days of inventory by the end of the year. So this is certainly a positive trend with potential impacts on pricing.

So, to sum it up, we have a premier asset base. I hope that's clear from the presentation. It's large, it's low cost, vertically integrated. We play in every part of the primary aluminum upstream value chain. We've made significant strides in every year since we launched as an independent company. And that pace of change is accelerating in 2019. I think if you look at what we accomplished in the second quarter—between record production, the fact that we were able to divest a number of facilities in the metal business, and then the further steps that we took yesterday on the announcement of the reorganization to make it leaner and take out some costs.

But I would tell you that there's two things that haven't changed since we announced in 2016, the separation. We still have the same underlying values that run the company, the three values that we have, and our strategic priorities haven't changed.

So we're positioning the company to be successful through all parts of the market cycle. I think you've seen by the actions that we've taken, we're doing the things that will make us successful throughout the cycle.

So with that, Curt, I will turn it over to questions from either the audience or from you.

Jim, how are you?

James Brown: I want to get your thoughts on a potential Indonesia bauxite ban coming in sooner, and also what does that make you do? Does that affect your capital allocation? Will you start investing more in bauxite?

William F. Oplinger: Yeah, thanks for the question, Jim. The potential bauxite ban that you're referring to is very new information. It came out, I believe, over the last 24 hours. To put it in perspective, our view is that Indonesia exports around 12 million metric tonnes of bauxite annually, and so on a global traded seaborne market of around 300 million metric tonnes in bauxite, that's a sizable change to the marketplace. So if there were an accelerated ban of bauxite out of Indonesia, it would potentially impact the deficit that we have--I'm sorry, the surplus that we are projecting for bauxite in 2019.

As far as whether it changes our capital allocation, you know we're very focused on potential growth in both the bauxite mining and the refining segments. So we have projects that we're currently reviewing, especially on the refining side, that we'll have better insight into at the end of the year once we've run through all of the capital costs. So I would tell you more to come on the potential growth opportunities going into 2020.

Curt Woodworth: Can you just elaborate a little bit more on the potential expansion of the refining system? I know that there has been, I think, some environmental work or permitting work done, I believe, in Australia. And you mentioned that, I think, some of your facilities are in the first decile of the cost curve. So logically, it would make sense to grow that part of the business over time. Do you expect to have that due diligence completed by the end of the year? Can you just kind of talk to what we can expect going forward there?

William F. Oplinger: So when you look at our refining portfolio, we have three of the world's best refineries. And to call them out by name, we've got Pinjarra, we've got Wagerup, and we've got São Luís in Brazil. Pinjarra and Wagerup are in, depending on whose cost curve you look at, the lowest decile of costs in the world. So there are opportunities for growing each of those three. These are not necessarily large brownfield step-outs, so not new units, but essentially debottlenecking work that will increase the capacity of those three.

We are in the midst of engineering work to determine what the returns look like. However, as you know, Curt, the calculation that we'll be doing is essentially, what's the capital cost per tonne to expand those refineries and what type of returns can we get over the long term? So that work's ongoing this year. More to come as far as a view on whether we'll execute upon those in early next year.

Curt Woodworth: Thank you. Could you give us a sense of the magnitude of the debottlenecking opportunity?

William F. Oplinger: They are around each, I believe, about 1,000-tonne-per-day opportunities. So that puts it around 350,000 tonnes each. When I say each, specifically in Western Australia.

Curt Woodworth: And then with the restructuring announced yesterday –can you give us any kind of rough estimation in terms of sort of the cost of the restructuring, cash impact, kind of how you see potential savings over time and if there are certain key buckets that, be it productivity, commercial synergies, headcount, how we can better try to quantify that action?

William F. Oplinger: Yes, so what I would tell you, Curt, is the announcement yesterday allowed us to inform the organization that we're making a major change. As part of informing the organization that we're making a major change, we are now going through with the new organization and doing a detailed review of all overhead functions. So we will give you better transparency into how much reduction of overhead will occur and whether there will be, or how much of a one-time charge there will be associated with that, at the end of this quarter.

What I would tell you is a couple of things. Look at our overhead structure today. We spend about $75 million of SG&A a quarter. We are fairly lean to begin with, but we think that there's still opportunities to get leaner. This change is not only about reduction of costs, but it's about making sure that our plants are integrated, and our plants are more agile and connected to the top of the organization so that we can be more nimble, more agile, and really more operator-centric.

One of the mantras that we've had over the last 3 years is that the operators, the plants generate a lot of the value within the organization, and this is the next logical step toward making sure that those plants are integrated from an end-to-end perspective.

Curt Woodworth: And then can you comment on any other sort of strategic option sets that you're looking at? You do have a number of non-core assets. You got out of the Saudi rolling mill. You have a rolling mill also in the United States. You have hydro assets. Are there–I know everything's always sort of on the table at the right price, but is part of the medium-term plan to help continue to simplify the business, which I believe is one of your core mantras and also would help fund the net debt target?

William F. Oplinger: Yes. So it's important to keep in mind what are the three strategic priorities of the company. First and foremost is simplify and reduce costs. The second is to earn a return from the investments that we make. And the third is to strengthen the balance sheet. When we look forward, I think the best indication for you as you look forward is that we are willing to take the right decisions on our asset portfolio. Look at what we've done over the last couple of years, culminating in the second quarter, where in the case of the Spain facilities, they were small, inefficient facilities. We originally curtailed them. We were able to get a deal with PARTER that allows the ex-employees to continue to work as PARTER works through what their options are. We always do it with an eye towards kind of minimizing the impact on our other stakeholders. But we're willing to take action on assets.

We exited the rolling mill in Ma'aden. The opportunity there was that there were significant cash outflows associated with that rolling mill that were upcoming and we took the opportunity to exit at what was a pretty fair price.

As you look forward, there are assets that could be monetized, and we'll consider that. We constantly evaluate all of the assets in the portfolio, and if it makes more sense for someone else to own them, we'll take that action.

Unidentified: You talked about earning a return on your investments. Could you quantify that a little bit? How do you think about the right return level for the existing portfolio? Is it ROIC, return on net assets? How do you think about it internally?

William F. Oplinger: Yes, so internally, we think of return on capital and we report return on capital each quarter. Return on capital currently for the entire asset set is below cost of capital, so it's not a place that we want it to be. As we look forward to investments, as we were discussing with Curt as far as investments in Western Australia, we're looking at a hurdle rate, which we don't disclose, but a hurdle rate that's in excess of our cost of capital to try to create value.

Curt Woodworth: Can you provide an update on kind of currently what you're seeing in the aluminum market? There's been a variety of disruptions in China and Chinese aluminum production, if you believe the NBS. The NBS data has actually gone negative for the first time in a very long time. So it does seem like there's more environmental pressure as well as other things at work. Do you, from a global supply perspective, do you think that sort of supply-side discipline and/or sort of mandated discipline from environmental action in China is a kind of viable positive outlook? Which seems a lot more realistic today than it did at any time that I can recall in the last several years.

William F. Oplinger: Yes, so let's start with 2019. In 2019 in China, specifically around smelting, we are, as I said, we're projecting 1.0 million to 1.4 million tonne deficit in global smelting. That's composed of a slight surplus in China--100,000- to 300,000-tonne surplus. To put that in perspective, the Chinese operating capacity is around 37 million metric tonnes, so it's a very slight surplus.

In the rest of the world, we're projecting 1.3 million to 1.5 million of deficit. That's what's driving global inventories down. So the rest of the world is in a deficit that's driving that. We have not seen, necessarily, the Chinese exporting significant amounts of primary metal. But to your point, Curt, there does seem to be more of a focus around environmental controls over the last few years. That's a positive for our industry.

Since we've made, since the second quarter, there have been a series of items that have occurred in China that has taken some excess capacity offline. One competitor had a major transformer outage, took off about 0.5 million metric tonnes. Another competitor was hit by the typhoon. That took off some capacity. So that has really, at least in the near term, been a positive impact on the supply-demand balance in primary aluminum. So that's our view of 2019.

Curt Woodworth: And then maybe just on the alumina side as well, there's the announcement that the Alpart facility, I think it's 1.7 million tonnes, is going to now shut down. They were ramping up. But then you have some other restarts going on. Did you see any change to the aluminum market going forward? Obviously, there's been a big gap down in price as some of the new supply came on in the restart of Alunorte. But do you feel like that market is getting back into balance? And could you just remind us again on what the flow-through is on when the smelters will benefit from that lower alumina cost on the P&L?

William F. Oplinger: Yes, so for the market situation in alumina we're projecting a surplus in 2019. That is actually a surplus in both the rest of the world and in China. I will tell you that in China, that surplus will depend on whether the arbitrage window is open or not. We typically see the Chinese providers be very sensitive to whether there's an ability to export or import alumina.

Some of the things that you mentioned--for instance, Alunorte--we've known that Alunorte will be coming back online. That is built into our estimate of the 2019 supply-demand balance. The JISCO is fairly recent news and by the time they get it curtailed, if they do get it curtailed, I believe it will have minimal impact on our supply-demand balance.

What we have seen is alumina prices have come down as this surplus has occurred. 2018 had a bunch of very highly unusual items that occurred in 2018, between the Alunorte curtailment and some of the other items. So we have seen alumina prices come off. As far as it flows through to our financials, since we got off of LIFO at the beginning of this year, there is more time that it takes through to flow through the financial results. I think the number that we give is approximately 6 months by the time it flows through the financial results for us.

Unidentified: Hi, thank you for being here today. I know that restructuring will be a major focus going forward in the future, but I was just curious if you could remind us what regional markets are going to be important for you, maybe in a 3- to 5-year time horizon.

William F. Oplinger: Sure. Both alumina and aluminum are globally fungible products so when we look at the growth in the marketplace, I think it's important to consider China and the rest of the world. So China growth has historically, from a demand perspective, been very, very strong. We're projecting China growth this year to be at the 1.75% to 2.25%, a little bit slower than what it has been historically. We're projecting the rest of the world growth to be at 1.0% to 1.5%.

So as we look forward into the future for aluminum, there are a number of key areas. Transportation continues to be key. If you were to look at the demand growth over the last decade, transportation has driven much of that demand growth. Aluminum penetration in automotive has been very strong and continues. It tends to take market share from steel. And then the other major markets that aluminum plays in are construction, electrical, and packaging are the key markets.

So we look at it both from an end market perspective– those continue to be strong; a regional perspective– North American market continues to be strong, European market is a little bit weaker as some of the demand slows down a little bit; and the Chinese market has been weaker than what it has been, but it's still, China's a very big marketplace.

Yes?

James Brown: Does the Arconic spin present any risks or opportunities for you?

William F. Oplinger: You know Jim, I'm probably not going to comment much on the Arconic spin. Arconic is a big customer of ours. We have a good relationship with them coming out of Separation. We wish them the best in their separation and we hope to retain them as a great customer. And we'll watch as they separate and try to do as much as we can to continue to serve them well and keep them as a premier customer.

Curt Woodworth: Just back to the bauxite point, if that comes to fruition with Indonesia, do you have spare capacity to capitalize on that and increase production?

William F. Oplinger: Yes, I will-- we have the ability to increase bauxite shipments out of a number of mines around the world. Specifically, we have excess capacity in our Brazilian mine in Juruti, we have the ability to ship third-party bauxite out of Western Australia, and we ship third-party bauxite out of Guinea. So we have that ability.

What I would tell you is the Indonesian bauxite ban, if it were to go into effect, currently we view Indonesia as exporting approximately 12 million to 13 million metric tonnes. We've got a surplus in the world of 13 million to 17 million metric tonnes on an annual basis. So, if all of that supply were to go away, on a run rate basis, it would quickly tighten up the third-party bauxite market to much more of a balance. We have seen those projected surpluses the last couple of years. We've seen a stockpile build in China. The stockpile is fairly large in China so it would not have an immediate negative impact on Chinese imports. But over time it would tighten up the market.

Curt Woodworth: Just a technical question. Your tax rate jumps around quite a bit, quarter to quarter. Can you just kind of help us better understand how that works, and do you have any kind of updated guidance on that?

William F. Oplinger: Sure. Our tax rate is difficult to understand, I think, for people that follow us externally. The reason being is that we have jurisdictions around the world where we have different tax rates. We have operating income in certain parts of the world where we have a tax rate of, let's say in Australia, 30%. And if we make profits in Australia, we've got a tax rate of 30% on that.

We've got losses in places around the world that are fully reserved. So, for instance, like in the US and in Spain, we don't get a tax benefit from those losses. So what then happens is that as that proportion of income changes from quarter to quarter of where you're making the income, the tax rate can fluctuate fairly quickly.

The second component to that is that you're always projecting a full-year tax rate, and so as that income fluctuates in any given quarter, you can have a catch-up impact in the quarter. In the third quarter, it's probably the best example of that. Given the changes in prices that have occurred during the course of the year, we would anticipate our expected tax rate in the third quarter to be basically 60% to 65%. That will drive a catch-up tax cost in the third quarter, I believe, of approximately $50 million, so that is what we would see in the third quarter. It all changes depending on where the profits are made and the tax rates in those profit jurisdictions.

Curt Woodworth: Great. That's very helpful. Thank you. Alright I think that's all we have time for, so thanks very much, Bill. Appreciate it.

William F. Oplinger: Thank you, Curt.