Alcoa Corporation

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Dave Gagliano Our next presentation is Alcoa. Alcoa ranks among the largest aluminum, alumina producers globally, vertically integrated. Bauxite, alumina, primary aluminum. Assets spread throughout Australia, Europe, Iceland, South America, North America. Joining us today from Alcoa is President and CEO, Roy Harvey.

Roy Harvey Thank you, Dave. And thank you everybody for joining me. I do appreciate it. It's been an interesting conference. Yesterday was certainly not the day anybody wanted to have in our markets, whether from the aluminum pricing perspective or from the share pricing perspective.

However, as we look at a day which is a little bit less red and a little more green, and as we think about the long-term fundamentals, what I would like to concentrate on over these next 20 minutes is to really think about where are our markets going. Aluminum particularly because it is our commodity of choice as we backwards integrate into bauxite and alumina. But more importantly, also think about what is it that Alcoa is doing for the long-term to face a changing market in front of us? And then, even more importantly, what are we doing in order to confront these next critical couple years or few years.

And so with that, I'm going to jump right in. Cautionary disclosures you can see right there. It's in your presentations.

So, let me start, and because I do recognize some faces in the room, but I also realize that there might be people that are relatively fresh to the Alcoa story. let me start with a very basic distillation of what I think is important to know about Alcoa, what I think makes a difference about who we are, and to be quite frank, which is the reason that I've been with the company for 20 years. And I'm actually quite pleased to be part of it.

So, let me start with values. So, in a world, in a market, and in a set of discussions here in the US and globally that are becoming more and more sustainability, ESG focused, I would argue that Alcoa, in its 130 years of history, has been focused on a lot of these issues through time.

Yes, climate change is relatively new. So, carbon content is something that we need to very clearly articulate our position. But at the same time, I would argue that the way that we approach our markets, the way we approach mining bauxite in the Amazon rainforest or the Jarrah protected forest in Western Australia, the way that we drive for energy efficiencies, for relationships and connections with our suppliers, with our employees and a drive to ensure that we're creating value for our stockholders. All of these things are contained inside of our values. And just to leave it at this point, it is the reason that I'm very proud to be part of Alcoa.

The second piece, and I think Dave alluded to this in the very beginning, we're a global business. We have operations that span Australia to Iceland to Norway to the United States, Canada, Brazil. We have 14,000 Alcoans working around the world. I would argue that creates, number one, a lot of ability to share best practices. So, when you think about great ideas that are developed in Brazil, because of the cultures that have developed inside of our plants in Brazil, or in Australia, or in Iceland, whatever location you happen to be in, part of our job, as management of Alcoa, is to ensure that these best practices can be shared and can be adapted and improved as it goes throughout the system.

From a second point, I also think it's a lot of fun and really interesting to see how we operate across those cultures. I have personally had the opportunity to work in a number of jurisdictions, had the opportunity to travel around. It really is incredible the size and scope and abilities of our global system.

The third thing that I wanted to mention here is the fact that we are backwards integrated from aluminum into alumina and then into bauxite. Each one of those products has its own characteristics, but they are very much interdependent. There is a supply chain. There are a set of common initiatives that we can bring to each of those types of operations.

And some of the work that we've been doing over these last few months was to create a new operating model focused on our operational ability and focused on our commercial ability. And rather than separating it into its fundamental, divisible components, we're very focused on ensuring that we are sharing best practices not just between smelters, but also great productivity ideas across all three of our products and ensuring that we can leverage great customer connections across all three of our products.

So, let me now talk a little bit about aluminum. And use this as the foundation for then talking about what we're doing from an Alcoa perspective.

So, aluminum has been a great demand story now for decades. And when we think about this last decade following the global financial crisis, it has been the rise of demand and supply inside of China. But what we have consistently seen, and with the exception of 2008, and the exception of then last year, has been a very consistent demand growth story.

And so, when we look out these next 10 years, and again, I told you we weren't going to dwell just on the immediate impacts of coronavirus, as we look out these next 10 years, the fact is aluminum consumption will continue to grow. It will continue to grow for a number for of reasons. The first of which is the fact that it permeates all different pieces of the industrial supply chain. Whether it's transportation, consumer packaging and beverage cans, consumer electronics, building and construction, aluminum forms part of that entire story.

The second thing is that you have real growth potential for demand across all of the emerging markets. China absolutely has matured and continues to grow with demand growth, as well as its supply. But you also have good demand growth in India, in Southeast Asia, and in the future, in Africa. So, the fact is that this growth story isn't just diversified across the industry, it's diversified and with great opportunity to growth across the world.

The third thing is sustainability. It is this ESG focus. It is the fact that the characteristics of aluminum, lightweight, it can be easily alloyed with other metals, it is infinitely recyclable, and has recycling programs that have been well established through time. The fact is that as we build up our discussion about climate change, our discussion about social responsibility in each of our operations or in the regions where we operate, the fact is that aluminum is a solution of choice. And Alcoa, I would argue, is running ahead of that race.

So, for me aluminum, while challenged today, there's no doubt I would like that pricing to be higher, aluminum is a metal of the future.

So, let's talk a little bit about Alcoa and consider each of our products, and what I think are our strengths and our opportunities today, and then transition that into how we are developing that in the future.

So, let's start with bauxite. In bauxite, we are one of the largest bauxite producers in the world. We are extremely low-cost. I would argue we are at the head of the curve from a social responsibility and a reputation standpoint, because of where we choose to operate. And again, that's in the Amazon rainforest and the protected Jarrah forest in Western Australia.

We have developed practices on remediation. We have developed innovative approaches to how we choose to mine, and those mines happen to be located, for the most part, close to the facility that is consuming that bauxite. So, it limits the amount of freight cost that is necessary.

Bauxite is a business right now that has a lot of excess supply. As we look to the future, as China continues to draw more and more bauxite into China over the water, it also is driving more and more demand. So, I look at bauxite as great optionality. We have long-lived reserves. We can bring more of those reserves to bear for third party sales. It is an option. It is an opportunity that we can choose to collect, assuming that pricing, assuming that the recognition of quality, and assuming that we have the capital returns necessary to satisfy our investors.

Second business, alumina. Again, we are one of the largest alumina producers on the planet. We are also one of the largest alumina commercializers, particularly outside of China. We have best-in-class technology. We have assets in Western Australia and Brazil particularly that are highly efficient and that continue to have a significant amount of research and development invested so that they become more and more efficient.

We have an alumina cost curve that I believe has defensible margins. Partly because of all this bauxite being shipped to China, it tends to create import bauxite refineries that are higher cost. So when you look at the new refineries in China, they are good technology, but good technology that has a high cost of bauxite delivered. And thus, it tends to round out the top half of the cost curve, which in the end, helps to create a defensible margin, helps to support players like us that are first quartile producers of alumina.

As we look towards the future, again good defensible margins, we need to protect that location of first quartile on the cost curve. That is absolutely part of our strategy for these next few years. But we're also looking to drive the opportunities for expansion.

Market timing perhaps is not right as we sit in a conference and look at the impacts of coronavirus and how that will impact our markets. However, when we think about the ability to scale up at Wagerup and Pinjarra in Western Australia, when we think about the ability to grow in Brazil, we have many opportunities for expansion if we find the right engineering solutions and then have the right market in which to make those decisions.

Finally, from an ESG standpoint, I would also like to inform everybody here that we are the lowest emitter of carbon of all alumina producers. So, not only are we very big, but because of our natural gas exposure in Western Australia particularly, we produce very low carbon content alumina. In today's world, that is a great marketing point. In tomorrow's world, that could be a real store of value for us.

On the aluminum side, this is a portfolio where we find ourselves more challenged. The fact is we are at the 50th percentile, essentially the middle of the cost curve. It means that as the world swirls around us with all that turbulence, there are times when we are not generating as much cash as we'd like to be.

So, as we think about the future here, as we think about the changing ESG expectations of our investors and of our customers, it is our determination to drive that portfolio down the cost curve and down the carbon content curve.

So, as we think about aluminum of the future, the aluminum portfolio of the future, it will be smaller. We have a 1.5 million tonnes under review, which means we're looking for ways to improve those facilities, to fundamentally change them, or if we can't, to look for divestitures or for curtailments or closures.

As we drive through those 1.5 million tonnes, it will end up with us in the first quartile of the cost curve. So, much more economically competitive. It will also make us the lowest emitter of carbon dioxide across all aluminum companies operating today.

Now, that's driven by renewable energy. Right now, we produce our aluminum with 70% of renewable energy. We will be moving that up to more than 85%. So to me, that will be a fundamentally changed portfolio and it will be positioned not only to be able to move its way through the cycles, but more importantly, as we look towards the greening expectations of our consumers, it means that we're already ahead of the curve. We're already in first place.

So, let's talk a little bit about what we need to do in order to drive towards those conclusions. And typically, I talk in threes. In this case, I'm going to talk about a five-pronged solution. So, these are the things with varying timelines that we are doing to fundamentally shift Alcoa to be stronger and more competitive.

And while these are focused on the future, these are focused on five years from now to be quite honest, they also are applicable and are absolutely the right things to do in today's environment as well. So confronted with the unexpected outcomes of coronavirus, each of these five things are moving us in the right direction.

Let me start with sustainability. Sustainability is the foundation. It underpins the five things that we are working on. We have made a lot of steps recently to try and drive more transparency, more ability to communicate and explain what sustainability means to us. We've joined ICMM which helps us to articulate and explain the programs that we are driving to ensure that we are at the forefront of social responsibility, of tailings management, of all these different aspects of a sustainable operation.

We are also working to certify 80% of our portfolio on the Aluminum Stewardship Initiative, which is essentially a certification process that shows that you build in your values into every tonne of the product that you manufacture. Those are just a sampling of the things on the sustainability side that then help to buttress our five levers.

So, the first lever and the first thing I'd like to talk about are asset sales. And so, when you look across our portfolio, and we've been operating for 130 years, the fact is we find that some of our assets are non-core. They are not part of our portfolio of the future.

We have put out a target of $500 million to $1 billion of asset sales. As of today, which is around about 4 months since we started the program, we have already monetized the Gum Springs facility for $250 million total cash, of which $200 million is already in our bank account. So, we're halfway up to the lower part of our range. We have some more work to do in order to continue to fill out that asset sale program.

The second lever that we have is around portfolio. And I have embedded that into a lot of what I was discussing already about how we see aluminum particularly, but also alumina changing through time. I'll tell you right now, each of those decisions, each of those challenged plants, we have the best opportunity right now to try and drive sustainable change. Whether those are energy prices, renegotiation of contracts, etc. However, it is incumbent on us to move as quickly as we can through that asset review. It drives clarity to our employees, it drives clarity to the governments and local communities in question, and it helps us get to a stronger and better outcome more quickly.

A lot of work to do. That is a five-year program, however, we will be working as fast as we can in order to make those portfolio changes a reality.

The third lever, and really starts to flow in our next two levers, is to drive a lean mentality across this company. And so, the first action we took, and this was part of the first three levers, we announced in third-quarter earnings here, it seems like a lifetime ago, as the world seems to fundamentally shift every few weeks, is a new operating model, a new overhead structure.

So, as we look to the portfolio of the future, we recognize that there will be less plants, that we will have a smaller exposure to aluminum. And as we thought about driving better operational transparency, better connection across all of our customers, we drove a program that will save $60 million per year, starting in the second half of 2020, by essentially changing the fundamental way that we're managing our businesses.

So, that is actually in the rearview mirror. While there are some clean ups that we need to do, those are savings that have already been locked in and that you will start to see flow through as investors starting in the second half of this year.

That change to a more operational focused mentality, to a more commercial focused mentality, then have positive knock-on impacts. And these next two levers, lever four and five of a five lever program, are new items for this presentation and for this conference.

The fourth is about working capital. And so, when we think about a more holistic solution for how we manage supply chain across procurement and our plants and our commercial team, we will be driving $75 million to $100 million of working capital improvements over the course of 2020.

So, when you think about 2019 to 2020, we will see $75 million to $100 million of extra cash because we are driving sustainable improvements in inventories, accounts payable, or accounts receivable. And also because of the market as it swirls around us. So, real cash coming in the door.

The other side of that on the operational side, we are also talking about $100 million of improvements, of cost savings, that we will aggressively chase from 2019 to 2020. And so I'll tell you, we have line of sight, we have projects lined up. We will be going after and saving this money as part of our new operating model and as part of sustainable improvements that will then continue past 2020 into years beyond.

There's a lot going on to make this happen. It means driving our plants more successfully. Focusing on stability. We have a lot of other stuff that will be contributing for the year. A great example of that is Bécancour which was a restart that we're in midst of that will finish by the middle of this year. That is additional value that will come in addition to the working capital cash and the productivity cost cash that will be coming through the door as well.

So, while I told you this wasn't going to be about what we're seeing today, the fact is that driving out cost, at becoming more cost efficient, at strengthening our portfolio, all of these things help to make us a better company today and long into the future.

And so, we spend a lot of time as a management team managing operations, thinking about commercial contracts. But we've tried to build up a pretty simple shorthand for how we think we're going to create value for our shareholders. How we're going to make this company stronger.

And we've turned that into what we call our strategic priorities. And we've made them very simple. And you'll probably argue that they are simply evident, they're how every company should be run. But we remind ourselves the importance of staying simple in the way that we approach our markets.

We Reduce Complexity, which means that we are as lean as we can be on overhead. That we run our plants smartly, carefully and as efficiently as we possibly can. We Drive Returns, which means we focus on every dollar that we invest in capital or maintenance. But that we also look for ways to enhance margin. Again, ensuring that we have a commercial focus across our products is fundamentally important to help drive those returns.

And number three, and this one's a little bit different than the last time I stood up in front of this audience last year, is that we're going to Advance Sustainably. We used to talk mostly about our balance sheet. The fact is our balance sheet is part of being a sustainable company. We have work still to do on pension, although we've come a long way. We need to make sure that through trying times, through the bottom of the cycle, we have the cash so that we can make smart decisions. But we will also be making changes in our portfolio with an eye on this development of consumers and customers that are demanding greener or more sustainable products.

And so, everything I've talked about, in fact leads us to a stronger outcome, a lower carbon outcome, and I would argue is the right thing to do financially no matter what.

So, we've focused on those three things. We at Alcoa are absolutely enthusiastic about making these changes. None of them are easy, but I am determined and I am certain that these will make us a stronger and better company.

Thank you and I'll turn it over to you, Dave, for questions.

Dave Gagliano Great. We've got a few minutes for questions.

Any from the floor? I've got some from the app, but any from the floor?

So, I'm going to read them off here. So, first of all, the key reason in your view for the recent weakness in the Midwest premium.

Roy Harvey So, I think what we've seen is the outcome of supply and demand. So, as Midwest premiums came up, and some of that is in response to the fact that supply was constrained, some of it was corresponded to the implementation of 2-3-2 tariffs. We've seen a number of changes since that initial implementation. We saw Canada not excluded, and then excluded, which is very good for us because we generate a good amount of material in Canada. And just recently we've seen more imports.

So, as that Midwest premium has strengthened, the fact is there are more imports coming in from around the world, and. S so, the market is adapting. That Midwest premium is being impacted by basic supply demand fundamentals.

Dave Gagliano Okay. And somewhat related, I know you said you didn't really want to talk about it too much, but can you talk a little bit about what you're seeing in terms of anecdotal commentary around the coronavirus and how it's affecting your business?

Roy Harvey I said I wouldn't address it in my comments, but I'm happy to do it in Q&A.

So, let's look at it across the three products because I think it's a bit different on each of them.

So, from a bauxite perspective, a lot of the bauxite that is going to China is coming from either Guinea or Australia. The fact is that there really is no impact until now. So, you're still seeing that bauxite come to port in China.

The issue is once it gets to port to be unloaded, and once it's unloaded to get inland to China. So, the fact is for the refiners, and particularly those refineries inside of China, they are starting to see real supply chain bottlenecks. Whether it’s bauxite or caustic or coal gas, those very basic components, we're now seeing impacts on 3 to 5 million tonnes of capacity, refining capacity, that is lowering its production.

It's driving a shortage of alumina inside of China which is then starting to see the Chinese alumina price increase. And you see the knock-on impact in the rest of the world with prices also increasing, pricing up by about $20.00 per tonne over these last few weeks.

Now, that's a very good thing for alumina pricing, but it means that the aluminum smelters are demanding that alumina. So, smelting, we have not yet seen an impact on supply. Now, they will run short of anodes if they can't get them delivered. They'll run short of other carbon products. There are a number of things that they can start to run short of. Coal, if they're running coal fired power facilities. However, up until now we've not seen impacts.

On the demand side, the fact is because the Chinese did not come back after New Year when they typically would, our expectation is that we will see pressure on demand. Now, how stimulus, how that will be impacted, how long that will go on, is still I think a very hot topic of conversation for everybody here.

Audience Member Just a question about the Aluminum Stewardship Initiative. You mentioned that you're trying to get 90% signed up to that. Are you starting to see people willing to pay a premium or is it a question of avoiding a discount on certified aluminum?

Roy Harvey I think we're starting to see more and more customer demand. Now, that demand has not yet translated into significant premiums. It's still a niche product area. However, we are seeing more and more customers, and it started really in Europe and it's now starting to cross over into the United States, where people are asking about those certifications or asking about those special products that we have that are recycled content or low carbon aluminum.

And so, the ASI certification process essentially looks at your holistic supply chain for a plant, or for a series of plants in our case, and that is essentially that first calling card. It is that entry price to be able to start supplying those products around the world.

So, it's nascent. It's just growing now. But I'd say that over these last six months and the discussions that we've had with investors and with customers, it is a drum beat that is getting louder and louder and louder.

Dave Gagliano Question from the app, you had some bullish commentary I think around the bauxite demand from China over time. The question is obviously post the coronavirus issue, at what alumina price might you consider just selling bauxite given China's growing import needs?

Roy Harvey We are pretty market focused when it comes to Alcoa. Many years ago, we sat down and we said we are not going to subsidize from one product to another. So, we always look at our aluminum smelters at cost of market of alumina. And we look at our alumina refineries at cost of market of bauxite.

So, if we were to find that bauxite prices jump up, and we have not seen that impact right now, if we see that jump up then we could create more value for our reserves and for our shareholders by selling bauxite rather than operating an alumina refinery, we would do it.

Dave Gagliano And when you go through that iterative process, I'm not going to put you on the spot Bill, but is there some sort of breakeven price or a price for alumina specifically where --

Roy Harvey Looking over at my CFO, I'll field this one as the CEO.

The fact is we're in the first quartile of the alumina refining curve. And so while we do have assets that are not in the first quartile, we are pretty far from a breakeven price where you'd actually start to idle those assets and start to sell bauxite instead. And certainly at bauxite pricing like we're seeing today.

So, we are careful to make sure that we approach that and analyze that. But right now, that's not a realistic expectation.

Dave Gagliano And then one last quick one. On alumina market, you commented about China's position on the cost curve. In your view, what is the marginal cost of alumina production globally?

Roy Harvey It tends to move based on what's happening with bauxite qualities and with caustic. I think what we have was that the 85th percentile was sitting around $360. That will depend on freight rates, and I would argue it's probably going up because of the cost of logistics inside of China. But $360 is around 85th percentile.

Dave Gagliano And we're at $300 today?

Roy Harvey Yes.

Dave Gagliano Great and with that, we'll wrap up.

Roy Harvey Thank you everybody.