Alcoa Corporation

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CORPORATE PARTICIPANTS

Roy Harvey – *President and Chief Executive Officer*

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Timna Tanners Good day, everyone. This is Timna Tanners. I am the Americas Metals and Mining Analyst from Bank of America. It is my delight to welcome Alcoa to the 10:00 AM presentation slot here on our third day of this virtual Metals & Mining Conference, which I keep saying, hopefully, is our first and last, and we hope to see you all in Barcelona.

But with that, I'm going to hand over to Roy Harvey, President and CEO. We also have Bill Oplinger, Executive Vice President and CFO. He's going to make some opening remarks, and then we'll have a Q&A. Please feel free to submit your questions through the Veracast website. Roy?

Roy Harvey Great, thank you, Timna, and thanks, everybody, for joining us. I just wanted to try and put some of the questions that Timna will be asking and some of the questions we've heard over these last couple of days into a broader context. And I think it's helpful to understand where Alcoa has been, where we find ourselves today, and then connect that to where we are endeavoring to go. And so I think that really provides a little bit of structure as we think through everything that's going on.

First and most importantly, I'm just very proud of what Alcoans have done around the world in order to maintain stability, in order to continue operating at our essential locations around the world, and to continue to get our products out to our customers. I think the resilience that our people have shown, and our contractors, et cetera, I think has been really exemplary.

You know, I think the story really begins a little bit less than four years ago when we separated from the larger Alcoa Inc. And I think we had come into that process with a pretty clear view on how we wanted to retool and prepare this company for success through the cycle. And so when we think about the bauxite, alumina and aluminum markets and you imagine what those cycles could look like, we very quickly came to the realization that we needed to prepare ourselves, act smartly in the upside, but more importantly, act really smartly during the downside, as well. And be prepared for that.

And so a lot of the work that we've done, connecting our actions to our values, is very clear and very simple strategic priorities and, of course, a lot of work on our balance sheet. I think those have made a real difference, and they've helped to bring together all of Alcoans, all of our operating locations, and our headquarters that helped us to bring that all together so that we could, essentially, confront what faces us right now in this downturn in pricing, in supply and demand issues. And so that work has been fundamental.

Additionally, in 2019 we spent a bunch of time thinking about how our markets are acting and what they will look like in the future, and so that--and we've called it a strategic review – but it really culminated in our presentation at the end of third quarter earnings in October, where we launched a number of programs I think helped to put us in the right position for the long term in this industry.

And it was really focused on three things, and I know most of you know about this. But first was a pretty deep reorganization and restructuring of how we manage the company, and rather than having very strong business units, essentially, we moved into an operating model that separated operations from commercial. And it helps us and is continuing to help us to be very focused on operating stably, to drive for productivity improvements in each one of our operating locations, but then also to be very thoughtful about how we have working capital and how we drive the commercial business. This is important because it gives us better control, but it also had a $60 million savings on a year over year basis.

In addition to that, we had about $500 million to $1 billion of non-core asset sales, the first of which we've already completed, $200 million, and then a pretty broad impacting portfolio restructuring. Again, focused on one very important thing: the ability to be successful through the cycle and into the downwards part of that cycle. So I'd argue that that downside came more quickly than we had imagined back in October, but at the same time, having a clear view on the actions we needed to take in our portfolio and, essentially, four and a half million tonnes in refining and one and a half million tonnes in smelting was to focus on whether those operating locations have paths to improve or fix some of the issues that they have from a competitive standpoint or to move into a curtailment or divestiture.

And so those three programs really helped us to think through who do we want to be as the world changes around us and as we modify Alcoa. At the beginning of this year, in 2020, we started to see that market conditions were worsening. We saw pricing impacts, and at the same time, were also seeing some supply-demand dynamics that could indicate that that pricing wouldn't recover quickly.

So we launched two additional programs, really, that are the outcome of the work that we had done on operating model, the first focused on sustainable operating cost improvements of $100 million, and those are meant to last through the cycle and are focused both on driving stability and the ability to have small, essentially capital-free creep projects and also cost savings, finding ways to be smarter about maintenance or about how we manage our operations.

At the same time, we launched a program on working capital to generate cash between $75 and $100 million, which turned out to be a pretty smart move. At that time, really, and in January of 2020, we were just starting to see the impacts of COVID in China. Certainly, didn't predict to have the global impact that we've now seen that it's had.

And so coming into this particular situation where we find ourselves, our operating locations are operating, in many instances, in a different manner than they have, but because they've all been declared essential operations, we continue to operate, we've adjusted our shift patterns, and we continue to adjust the production that we have so that it has customers at the other end.

And so I think, as we move our way through this crisis, the important thing is that we are acting very smartly and aggressively about how we manage our cash, and so with all of our operating locations on track, we are very focused on the five programs we already had in place, but have also layered in a number of cash-generation activities that helps us to move through the downturn smartly and swiftly and emerging out the other end as strong as we possibly can be.

So what makes me very pleased, as we go through this, is that because we put so much effort over these last four years to prepare the Company, because we had a deep look into our markets in 2019 and thought about the portfolio that we choose to operate, it means that we can accelerate and move very quickly to try and ensure that, as we move through this market, we're making decisions that not only support short-term cash-generation needs and liquidity, which I know we'll talk about, but more importantly, also set us up and help us to reach that great strategic outcome that we've pointed at more quickly and realistically to do it in a way that is well connected to our values and well connected to our strategic priorities.

So again, really great work around the system, and we are very focused on not just surviving this crisis, but actually emerging from it better and stronger. Thanks, Timna.

Timna Tanners All right, Roy, thank you for that. I think that really shapes the discussion that we want to have. There's certainly a category of things that Alcoa can control and things that Alcoa cannot control that I know we've talked about over the years. And having followed the company for years, I can definitely attest to Alcoa's continuous look at operations, what should operate, maybe what is not as competitive or-- and also, ways to cut costs is a continual thing, not something that just cropped up, obviously, because of the pandemic.

So, getting into the area of what you can control, can we dig in a little bit more specifically to Alcoa's recent steps to respond to COVID-19 and weak aluminum prices? You've been one of the few to actually idle capacity in a substantial way. And can you just review the measures you've taken recently?

Roy Harvey Sure. And so I think it's pretty broad based, and as I've said, we continue to operate the locations. The fact is that our operations have been simplified greatly because, first of all, you take out whatever activities that aren't absolutely necessary. And you can see that both in our maintenance program for large overhauls particularly, but also for some of the capital projects. And we have had a reduction in total capital spend versus where we thought we were going to be at the beginning of 2020, as well.

So simplification means that we can be a bit smarter about who comes to work and how they are acting. That also drives a lot of stability. And so at times like this, very stable operations, simplified as much as they can be, helps not only to ensure that the production that we have is quality and is at the right quantities that we expect, but also, more importantly, helps to simplify the cost structure.

So we continue to drive for the operating cost improvements. We continue to drive on working capital, and to be quite honest, that is something that we can be even more aggressive on as we go through this year as you see some of the raw material prices, et cetera, come down. We also made the decision in the Pacific Northwest to move towards curtailment by the beginning of the third quarter at our Intalco smelter in Ferndale, Washington.

Unfortunately, it is a smelter that is uncompetitive. It had already had a pretty significant loss over the course of quarter one. Obviously, prices have come down, so quarter two would be even worse. And so as we look at that operation and we think about where it sits on the cost curve, the best opportunity for us was to bring it into a curtailment, and so that will remain in a status that it can be restarted down the road. We're in the midst of discussions with our workers and our unions so that we can do that in an intelligent and thoughtful way.

It's always a difficult decision to have an impact like that on our workers. However, given the fact that we have the dynamics within supply and demand, essentially an oversupply both in China and the rest of the world at this point, it is critical that we take action and that we start to adapt to the situation that we find ourselves.

And so really, I think it is a program that stretches across the company. We'll continue to look at each of our operations to make sure they're operating stably and in a competitive position that can continue during this type of a downward crisis. And I'll tell you that as we examine what's happening in the market, we can also take additional actions.

Timna Tanners All right, well, that's a setup for the next question, then. Can you give us a flavor of what those additional actions could be? And maybe if you could also comment broadly on the industry as a whole, so taking a step back from what Alcoa can do and looking at the broader industry, do you expect that there'll be other actions by some of your peers if prices stay at this level? It's quite depressed, and there haven't been a lot of smelters shut. There's a couple in the US that have been identified as vulnerable, but I haven't seen anything. So if you could comment on maybe your further actions and the broader industry, as well.

Roy Harvey Sure. And so that's a pretty broad question, so let me try and answer it, and we can dig down into different pieces that might be of interest. Let me start with looking at the industry and where we find ourselves, and then I can use that to talk a little bit about what we can expect, both across the industry and then also for Alcoa.

From a bauxite perspective, still a lot of demand inside of China, but also a lot of supply-- we've had a lot of growth both in Australia, but more importantly, in Guinea, and we continue to see that market to be relatively stable and very dependent on freight costs. So it's all about, essentially, that supply line that goes over to China.

From the refining perspective, part of what we've seen over this last five years is that China has grown significantly. But they've grown with import bauxite, so it tends to make the higher cost facilities sitting inside of China. And they tend to act pretty smartly about how they balance both supply and demand and then also from the standpoint of whether it is more economical to buy rest-of-world alumina, rather than to produce it inside of China.

So right now what we find is that alumina prices have been challenged. They have recovered a bit from about $225 up to about $240 per tonne right now. That recovery really is based on the fact that China is starting to come back into what stands for normal operations today and also because Chinese prices have come up, and thus some of the Chinese operators are starting to idle their facilities and buy externally.

From a smelting standpoint, aluminum-- I think that's where we see the most issues because of the interplay between supply, demand, and then inventories. In the first quarter of 2020, it was obvious that China was having a deep impact on the manufacturing of aluminum products, but not so much on smelting. And so we built up something along the lines of two or a little bit more than two million tonnes of inventories, which then acts as a source of supply.

When you think about what we're starting to see now-- and we've seen about 400,000 to 500,000 of those tonnes come off inventory here in Q2-- it's because we're starting to see the green shoots and, realistically, a lot of those manufacturers coming back. Now, how that then connects with the rest-of-world market-- that is the important question that sits in front of us.

But what we find is that, number one, China is starting to recover, but it is the rest of the world where we're starting to see that those manufacturers, particularly automotive, which are large plants that can easily be seen, have been idled. And the question is when they start to return. And I know there's a lot of talk about those facilities coming back up again here over the next couple of weeks. It'll be good to see that actually happen and then start to see the recovery.

But where we find ourselves is very much in the fact that we were in an oversupply position in China coming into 2020 because of COVID. We now find ourselves in an oversupply position in the rest of the world, and so we see it in our portfolio-- our customers have asked to delay shipments until later in the year, hoping that there is a recovery in economic activity. And we've also had to move some of those products into commodity grade, which essentially means you're selling to traders, you're selling into warehouses, or you're selling to people that want more commodity grade material. And so it means that we find ourselves generating and producing more aluminum than is actually needed.

So when you think about further actions that Alcoa can take, I think we have outlined a million and a half tonnes of review inside of our smelting portfolio, of that 900,000 tonnes were operating. So if you imagine, we've already announced 230,000 tonnes in the Intalco plant out of the 900,000 tonnes, it means there is additional capacity that needs to be addressed.

And so each of those is a very special situation, and I'll tell you, our first action is always to try and find ways to fundamentally shift the competitiveness of each of those plants. However, again, when you have a crisis sitting in front of you and when you have significant cash losses at your high-cost plant, it becomes fundamentally important for us to take action, as Alcoa.

I'd also argue that there's other cash actions that we can take. Right now we are very thoughtful about how we spend each maintenance or capital dollar. Depending on how this crisis stretches out into the future, we might have to become even more conservative in the way that we operate those. As of now, we are very careful to ensure that our operating locations, and particularly those that have long lives ahead of them, that we are spending smartly and that we are not starving the system to then create stability problems down the road.

As to the rest of the industry, Timna, I think it's clear that one of the issues facing aluminum is that it is costly to bring down smelting capacity and even more costly to bring it back up again. So I think it has tended to be a relatively slow process for producers to come to those decisions. I would also layer in the fact that it has an important impact on workers, and so I have no doubt that is weighing heavily on people's minds. It certainly did on ours when it came to Intalco.

But this industry is right now producing more aluminum than it needs, which means that it extends out the difficult pricing environment because you'll have that new source of supply of inventoried metal that comes in later. So I think it needs to be a clear call for action that-- I think it really demands people think about the competitiveness of their smelters and ensures that we are smartly acting as an industry through this cycle.

Timna Tanners OK, appreciate that, and not really very fair of me to ask about what your competitors might do, but I think you summed it up. The demand is starting to come back, especially in China, but the supply is still an overhang. Can you comment a little bit on your feeling for inventories? You mentioned that they were building and that was a problem, or they were overbuilt. But can you comment on inventories of commodity grade and also for any sense of downstream finished products?

Roy Harvey Yeah, we don't really have a good sense on what's happening from a finished product standpoint, about whether customers are holding significant inventories or not. I think most of our customers have tried to be pretty careful about pushing off their committed volumes. And if you remember, in North America, the value added product sales, essentially, are done in an annual calendar basis, and in Europe, it's done in a quarterly negotiation.

Those volumes we've seen, and you can see it on the impact that we announced with a 20% reduction year over year from a value added into commodity grade metal standpoint. I think customers are being careful about what they are purchasing, and that's because they're trying to conserve cash, as well. So I think it becomes a question about when they can get back to work, and start to draw down existing inventories already, and really start to order again. I just don't see a significant slew of aluminum sitting out there as finished goods just because people don't want to use their cash to hold those inventories.

On the commodity side, I think the story is that you saw those inventories build in China in the first quarter. I think we're on a similar run rate right now in the rest of the world, and so if you imagine, we built up around two million tonnes inside of China, and some of that has come off again, however, you're starting to see a similar type of build in the rest of the world. Some of it going into the LME warehouses, and then some of it stays in other types of inventory schemes.

And so it becomes a question of when did that demand return, how much of the stimulus spending that will eventually happen, both in China and the rest of the world, how that then starts to stimulate demand, and whether that is very aluminum-centric. Often because of its connections into automotive, and building and construction, et cetera, et cetera, it typically has a very good, positive impact. It just becomes a question of how quickly we can staunch that oversupply or whether you see additional actions from the supply side to bring down productive capacity.

Timna Tanners OK, I think that's a fantastic overview. It makes a lot of sense, not an easy situation, of course. But there's some follow-up questions from people dialed in, so I just want to address those. One is, you did mention and you mentioned on the call that you've got more sales than normal to the traders and warehouses. Can you just quantify that a little bit? Remind us what percent would be normal and what percent is your current run rate.

Roy Harvey Yeah, and I'm trying to think back to the typical run rate, and I think it has historically been around 55%.

William Oplinger That's right, Roy. It's 55%, going to 45%. And that's that 20% decline.

Roy Harvey Perfect.

Timna Tanners OK, thanks. And then another question that came in was, what changes in customer behavior have you seen in the last three weeks, and how does that compare year over year? And I know you're not as close to the end-to-end customer, but again, asking if you have any flavor for that in terms of the demand changes.

Roy Harvey Yeah, I think over these last three weeks we have not seen a lot of change in behavior simply because, while a lot of our customers are thinking about how those back-to-work protocols occur and maybe in Europe and in some countries a little bit more advanced than what we have in the United States right now, I don't think we've yet got the clarity, nor do we have the orders on the books to signal that there is a definitive recovery coming.

And I don't think that represents the fact that nobody plans to restart. I think it represents the fact that there is not yet certainty that that restart is going to happen, and so I think we'll need to watch what happens in each of the states in the United States and, of course, each of the countries and jurisdictions in Europe. We really need to watch to see how those back-to-work plans come to fruition.

Timna Tanners Right. I want to ask something kind of high-level. And I think that, as you look at different commodities, you see that there has been different responses on the supply side, and I just want to ask, thinking about future downturns, is there anything that can change in the aluminum industry that could allow it to respond a little more aggressively or quickly? And then I guess that goes to the power agreements, could they be structured differently? Could there be some greater flexibility, somehow, in smelter operations such that they don't have the degree of cost they do to take offline and online? And if, actually, in that discussion, you can remind us of the exit costs or the idling costs.

Roy Harvey Yeah, so it's a tough question to answer, Timna, because every jurisdiction and every plant's going to have a different set of factors that sit in front of us. I think it has always been the issue with this industry that it is costly to restart a potline, and typically you might have two, or three, or more potlines at a plant. And that can be on the order of $25 million per line.

And so the issue that I think faces us and faces other plants around the world is that once you make that decision to start idling the pots, it is a significant cost to be able to bring it back up again. And that doesn't even get into the regulatory side, and how severance might work, and different types of programs between short-term and long-term layoffs in different jurisdictions, and as you can imagine, Europe more complicated than the United States. Or take or pay power contracts.

I think Alcoa-- what we've done is we've tried to build flexibility into the agreements that we choose to make, and whether that is a power agreement or the agreements that we make with our workforce, the fact is that we need to have that flexibility so that we are not forced to continue to operate uncompetitive capacity that consumes cash; in the end, it is simply adding extra production into a market that simply doesn't have a customer for it.

So, I think trying to drive, (A) the ability to not have those barriers to exit sitting inside of contracts, and then (B) look for ways to be able to more smartly bring down capacity and then bring it back up again. I think the Chinese have been working on being more flexible and quicker about doing that. I don't think they've found-- outside of a pretty good and smart approach, economically speaking – I don't think they've found a different way to do it. But I think it's something that this industry can continue to look for.

Timna Tanners OK, fair enough.

William Oplinger As far as cost goes, Timna --

Timna Tanners Go ahead.

William Oplinger Sorry, I didn't mean to talk over you. But as far as costs go, the costs vary widely. You saw for Intalco, we announced it was a $25 million curtailment cost. Given the fact that that plant lost $24 million in the first quarter, it's not a huge cost in relation to the losses that we're seeing there. When you then compare it against a refinery, for instance, refineries are typically higher costs to curtail. We had about $170 million expense associated with the curtailment of Point Comfort, of which about $115 million was going to be cash expenditures. So the costs can vary pretty significantly by plant.

Timna Tanners OK, great, that gives a good flavor. Thank you for that. So in the remaining time that we have, I wanted to take you off the hot seat a little on asking about hypotheticals and things out of your control and talk a little bit more about two things. One is Alcoa's position, its balance sheet, and if you could touch on the pension. And the other is just any update you have on ELYSIS™, which is the world's first carbon-free smelting technology. So I think this audience would like to hear a little about both of those.

William Oplinger Sure, I'll take the balance sheet question. You know we've done a lot of work on legacy liabilities on the balance sheet over the last three and a half years. Probably most importantly, we've tried to address the pension issue. Over the course of a number of years, we've been able to annuitize around 12,000, either annuitize or buy out around 12,000 retirees out of the pension system. We've been able to lower our overall net pension and OPEB liability to around $2.4 billion.

The way we've done that is we immediately froze the pensions for the salaried population. We've changed our asset allocation significantly over the last few years to go to a much more diversified, much more passive asset allocation. We prefunded the pension by going out and borrowing $500 million dollars and established a prefunding balance, which gives us great flexibility. And all of that, I think, has put us in a better position in this current situation.

As we talked about at the end of the first quarter, we had seen about a 7% decline in assets, but at the end of the first quarter, we had actually seen an increase in the discount rate. It's important to remember that the discount rate's based on a corporate bond rate, and so that can fluctuate significantly based on treasuries and spreads. But I feel, Timna, that we're in a better position today than where we have been over the last few years. Roy, do you want to address ELYSIS™?

Roy Harvey Yeah. So, first of all, to zoom out a little bit, I think one of the refreshing things we saw as part of our strategic review in 2019 is that as we approached it, first of all, from a financial standpoint of how do we drive financial sustainability in this company, we also realized that those same actions would end up driving a much more quote, unquote, "sustainable" and greener company.

We're already the lowest carbon emitter inside of our refining operations around the world, and as we move to this portfolio review and shift, we'll end up being the lowest carbon emitter on the smelting side, as well. And so you end up really starting to address not just the financials, but also to address the fact that the world is moving to a space where there will be an advantage to acting smartly throughout your entire value chain and, particularly, in carbon emissions.

The most important step of that or what is the greatest potential for change in this industry is all around ELYSIS™. ELYSIS™ is a joint venture of 50% and 50% with Alcoa and Rio Tinto, and also some support from the government of Quebec in Canada. The fact is that it is a revolutionary process. We've been working on it for a number of years. Those that have followed Alcoa know that it has been one of our passions for a very long time. It essentially, instead of emitting carbon dioxide, it emits oxygen.

We are in year three of a six-year research and development program. This is essentially scaling up the process to be one that can be retrofitted into Rio or Pechiney technology. And so it continues on course. We continue to do work up in Canada in order to prepare and operate that next scaled up size, and we're pretty enthusiastic that that's going to be a game-changer as far as a way to produce metal that fundamentally matches with what the world needs from a carbon standpoint. So good progress there, Timna.

Timna Tanners OK, thanks for the update. We are unfortunately out of time. I think we could have kept chatting for a while there. But do appreciate Alcoa's support of our conference and Roy and Bill's time, and want to thank you again, and look forward to seeing you in Barcelona next year.

Roy Harvey Good, thanks everybody.

William Oplinger Thanks, Timna.