

Alcoa Corporation

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Carlos de Alba: Good morning, everyone. Thank you for joining us to the second day of the 2021 Morgan Stanley Virtual Conference. We're going to host this morning Bill Oplinger, Executive Vice President and CFO of Alcoa. Many of you are familiar with him already. They had been attending this conference for several years now.

My name is Carlos de Alba. I cover metals and mining here at Morgan Stanley. And before we begin, let me just mention some important disclosures. Please, for important disclosures, see Morgan Stanley's research disclosure website at www.morganstanley.com/researchdisclosures. If you have any questions, please reach out to your Morgan Stanley sales representative.

With that, Bill's going to have some opening remarks, and then we're going to start a conversation to hopefully address some of the key debates and topics for Alcoa as well as the aluminum and aluminum-related markets. Thank you, Bill.

William Oplinger: Thanks, Carlos. So I'll just add some brief opening comments. Just by way of introduction, hopefully you know Alcoa Corporation, but we're a vertically integrated upstream aluminum company. We've got three business segments. We are a large bauxite miner with a first quartile cost position. A very large alumina refiner also with a first quartile cost position. And then we've got an aluminum smelting segment that is a second quartile cost curve position, but in today's market environment is very profitable.

So, over the last 5 years, we have spent -- since we separated out from Alcoa, Inc. -- spent time in repositioning the company, strengthening the balance sheet. We've done a lot of work around the balance sheet, pensions and repositioning the asset portfolio.

As we roll into the latter part of 2021, the markets for aluminum are very strong, as strong as I've seen them over the course of my 21 years at the company. Demand growth on a year-over-year basis is 10% globally, and that's coming from all regions of the world and essentially all industrial sectors. And we're starting to see some supply side constraints show up in places like China where with their focus on carbon neutrality going into

the future and energy efficiency, they've actually started to slow some of the growth of primary production. And therefore, we've seen increases in pricing recently.

We then fast forward to the work that we've done on the balance sheet, and the question that's on many investors' mind is how we'll be allocating capital in the future. As I said, over a 5-year time period, we've fundamentally changed our balance sheet position. We have a net debt target of \$2 [billion] to \$2.5 billion of proportional net debt. We ended the second quarter at \$2.1 billion of proportional net debt. And our pensions globally are greater than 90% funded. That was a big issue for our company. And in the U.S., which is where the lion's share of our pension is, that's now 100% funded. So in a much better situation than we found ourselves over the last few years, especially going into this market with significant tailwinds.

So now that the balance sheet is in the position that it's in, we'll focus on three remaining areas for capital allocation. They're not necessarily in rank order, but we have growth opportunities. I would tell you that the midsize growth opportunities that we've talked about in the past, we've got three growth opportunities in our refining business. At this point, those growth opportunities are on hold simply because they're not meeting the return hurdle that we would like to see. We have continued asset repositioning. We've talked about a 1.5 million metric ton review that was launched back in 2019. We're partially through that review. And during that time period, we've curtailed some high cost assets. We've actually been able to extend the life of one of our assets. And so we'll continue to work on that. And then returns to shareholders. So we're working through what the appropriate mechanism for returning cash to shareholders.

I then transition to the third quarter outlook. Second quarter was a record quarter for the company. Third quarter should be another record quarter for the company. We would anticipate that EBITDA is approximately \$100 million higher than the second quarter. And it's important to note that we are fully exposed to higher metal and alumina prices. We don't have a sell forward program. So as these metal prices have run up and alumina prices have run up, that will flow through to the bottom line following the appropriate lags that we typically talk about. So, a record quarter, in the third quarter.

There are a couple of things that are going on in the third quarter. We've got -- we had a ship unloader failure down in Brazil. That restricted output of the Alumar facility. And that's going to cost us about \$25 [million] to \$30 million in EBITDA in the quarter. And the strong earnings that we have mean that we'll have a higher tax provision. So our tax provision was estimated to be \$100 million. Given the fact that earnings are going to be

so much stronger than what we had anticipated at the beginning of the quarter, that will be approximately \$125 million.

So if I were to summarize before we move on to the Q&A, very exciting times in the market. The market is very strong. There's I would essentially say a confluence of factors that are coming together for positive market dynamics, both in the near term and in the long term for the company. And the company's very well positioned to take advantage of that. The company's in a much better shape than we were over the last four or five years, and now we are really well positioned to succeed throughout the cycle.

So if I turn it back over to you, Carlos.

Carlos de Alba: Thank you very much, Bill. That was quite useful. Just let's go to clarify some of the comments that you just made, if you don't mind. First, in terms of the delta for EBITDA, you sort of mentioned it could be around \$100 million higher versus the second quarter. Is this including also the increase in prices, in market prices with the lags? Or it's just based on the cost and volumes, which is typically how you guys guided for the next quarter?

William Oplinger: It includes what we know about market prices up until now, Carlos. Given the fact that we're in the middle part of September with the lags, pricing is largely set. We will still see some higher metal prices flow through to the bottom line in September, but for instance, alumina pricing is set at this point for the month of September. So it is inclusive of all the factors: pricing, the Alumar issue that I alluded to, raw material cost. It's just a projection of where we'll end up for the quarter.

Carlos de Alba: All right. And then in terms of the capital allocation topic that you addressed, the company has announced some plans to increase their renewable energy to around 85%, and there's other ESG initiatives that Alcoa's working on. Are those included in CapEx? What is the level of sustaining CapEx, ESG CapEx that you are thinking in the coming years? Given that maybe growth is going to be a little bit subdued, how much -- what is the level of ESG-related CapEx that you envision for the company?

William Oplinger: It's a good question, Carlos. We don't typically provide a long-term projection of CapEx. But what I can tell you is that given some of the mine moves that we have in the bauxite business and some of the ESG CapEx that you're referring to, for instance, increased spending on impoundments, we would anticipate the 2022 spend to be slightly higher than where we're at for 2021. Haven't put a fine number on it yet, but we will see some higher CapEx spending going forward on some of the ESG initiatives. Now that's the downside of some of the ESG initiatives.

The upside of that is that I think the market is starting to realize that that needs to be done across the entire industry. So spending on things like impoundments and improving the impoundments in the industry we believe will occur for Alcoa, but it'll occur for other companies also. And we think we're uniquely positioned to take advantage of that. So that's why some of that spending will go up.

Carlos de Alba: All right. Last gear. And then still on the capital allocation discussion, you alluded to the fact that the balance sheet is quite strong. You've done a lot of homework on the pension liability. Markets are very strong. Prices, both alumina and aluminum are significantly high. So what -- how should we think about or how should investors think about the inclination of the company between dividend and share buybacks? And is there any maybe time frame that you foresee the company making a decision on returning money to shareholders?

William Oplinger: Yes. So let's step back. The company has a four-pronged capital allocation strategy. And we talked a little bit about it in my opening remarks. You got the debt reduction, returns to shareholders, repositioning and growth. So we walk through each one of those. We are within our target range of debt reduction. So the balance sheet is in much better shape. We've been above that target range from time to time. We may end up being below that target range from time to time, depending on where we are in the cycle. And so given the strong cash generation that the company has, I can envision that we will go below that target range.

That leaves the other three pieces for capital allocation. We've talked a little bit about growth. We have some small return-seeking projects that are available to us over the next couple of years, but no massive growth opportunities over the next couple of years. And so that narrows it down between asset repositioning. And as you know, we've been able to do some of that repositioning in a more cost effective way than what even we

had anticipated. By the repowering of Portland, for instance, we didn't have to curtail Portland. So that leaves returns to shareholders, and it's an ongoing discussion. And we'll let you know when we're ready to have that discussion.

Carlos de Alba: All right. Fair enough. But there is no then, as of yet, a clear preference or inclination between dividends or share buybacks, right?

William Oplinger: Let me tell you how I think about dividends and buybacks. If -- and we're speaking hypothetically -- if the company were to announce a dividend, it will be a signal that we believe we've repositioned both the balance sheet and the asset portfolio to be able to be successful through the cycle. If we announce a dividend, we want to be able to pay a dividend through the cycle. I think it would -- if we were to announce that, it would be a very strong signal to the marketplace that we're convinced that we can generate cash through the cycle.

For share buybacks, we're thinking about share buybacks as simply a return of capital to shareholders. Given the fact that the strength of the cash generation of the company would be simply returning that to shareholders and allowing them to do what they want to do with that cash.

Carlos de Alba: Fair enough. And then that's a good segue to the portfolio repositioning, restructuring and optimization. A lot has changed in the market since you announced it a few quarters ago. A year ago or so. How are you thinking about San Ciprián? Any updates there? And also about a potential restart of the Alumar smelter. And also considering not only the market is strong, but also maybe the energy situation in Brazil is challenging at the time.

William Oplinger: So let me take each one of those.

In Spain, the fundamental issue in Spain is the energy situation. Energy is extremely expensive in Spain. Over the last couple of months, going into the end of this year, energy has been anywhere from EUR 100 to EUR 125 a megawatt hour. And if you do the math, as you well know, Carlos, if you do that math, that just simply does not solve for a smelting situation, even given the high metal prices that we're seeing. So we're in

discussions with the government and with the stakeholders there and trying to work through the situation. We announced a collective dismissal process quite a while back, and we're trying to execute upon that collective dismissal process. And so we will update you as we get more information.

If we then transition over to Brazil -- and I'll take each piece of the question that you had -- energy situation for our hydros in Brazil have been very, very good. Energy prices have been high, and our hydros are doing well. We had from time to time looked at selling one of those assets. I'm very pleased that we did not sell it because they're in a very good situation currently.

If we then go to Alumar, Alumar is a facility that as you well know, it's a facility that is a good technology, great labor force, is co-located with the refinery there. And we are -- have looked at the opportunity to restart the Alumar smelter and continue to work on getting a mid-term power contract that solves. So we will work on that, get in line the right resources. And if we can get Alumar to the point where we think it will be successful through the cycle, we will potentially announce a restart. But at this point, we haven't announced any restart.

Carlos de Alba: All right. Let me move on a little bit more to the alumina business. You addressed the questions about the issues, the present issue that you had at the Alumar refinery. What about -- well, this is the bauxite alumina I'm thinking about. Any comments on the bauxite situation for Alcoa and the JV that you guys have in Guinea in light of what happened recently there?

William Oplinger: At this point the CBG mine is operating, and no issues there. I think the coup in Guinea highlights the fact that some of the supply lines in our industry are pretty long. And Guinea's a strategically important part of the industry. Guinea provides I believe over 50% of the bauxite into China. So in the near term, we're not seeing fundamental changes in how the mine is being operated. In the longer term, I think it just highlights how important and how long some of those supply lines are in our industry.

Carlos de Alba: And just to confirm, the mine is operating. And what about exports? Have you been able to ship the alumina -- sorry, the bauxite out of Guinea?

- William Oplinger:** No changes to the current operations of the facility at this point.
- Carlos de Alba:** All right. Fair enough. Let's move on a little bit to the market or coming back to the market. The Midwest premium is very strong, record levels. What is your outlook there? And if you could elaborate maybe also on the different end markets that Alcoa reaches in North America, but also globally. Any comment would be very useful for the group, for investors.
- William Oplinger:** Midwest premium is very strong. We believe it's an indication of a tightness of metal in the North American market. North America imports metal, and it's structurally net short of metal. And given the fact that premiums around the world are fairly high, transportation rates are high, we feel that the premium is pretty well supported at the price that it's at.
- As far as strength of demand goes, as I said in my opening comments, a banner year for demand in the aluminum industry, 10% globally. It's being driven across each of the end markets, and each of the end markets have its own set of dynamics. But we see strength in transportation, continued strength in transportation, continued strength in building construction, and especially in the packaging industry for aluminum. So just a very good 2021. We believe that will persist going into 2022. So as we go into negotiations with our customers around value add products going into 2022, we believe this market situation will persist and is a real positive for our company.
- Carlos de Alba:** All right. And just going a bit deeper maybe in the transportation sector. A lot has been said about the shortages of semiconductors in the automotive sector. Has Alcoa experienced any disruptions in that end market?
- William Oplinger:** No. Not at this point, Carlos. Our demand in automotive continues to be strong. I believe the industry's probably underestimated the length of the semiconductor issue. But at this point, we're not seeing a decline -- a material decline in automotive demand.
- Carlos de Alba:** All right. Fair enough. I wanted to tackle your NOLs in the U.S. Clearly, the level of profitability in 2021 is going to be, as you just said, quite

strong. What can you tell us about your NOLs? I think they're fully valued. If these fundamentals persist, could you reverse this valuation allowance, and how quickly could that happen?

William Oplinger: So the valuation of the NOLs is approximately \$2 billion, and that's the fact that we've had significant losses in the U.S. for a number of years. And they're fully reserved at this point. So any income that we're making in the U.S. from an accounting perspective essentially is tax free. The likelihood of those getting reserved -- getting reversed -- is pretty low. Given the order of magnitude of the size of the reserve and the fact that our earnings, even in a really good year like this one, our earnings have to overcome the overhead that we have in the U.S. and pension contributions, our pension expense that we have in the U.S. So I think the likelihood of a reversal of that reserve is pretty low, Carlos.

Carlos de Alba: All right. Excellent. I wanted to touch base on green aluminum. And Alcoa has a very differentiated unique position in alumina, certainly. So what kind of traction are you seeing with this product? And why type of premium are you commanding or would you expect to maybe get in the future?

William Oplinger: So the growth of demand for green aluminum for the industry is very rapid. And you can say it's exponential growth, but that's from a very, very small base. So at this point, it is a burgeoning market for green aluminum. We have a unique product offering in that we've got a full suite of products that covers a low-carbon aluminum, a recycled aluminum, but also a low-carbon alumina, which no other industry provider can provide. So we actually sell a low-carbon alumina to smelters that's a certified low-carbon product, and it can also be ASI certified. So if a customer is looking for a carbon improvement, they can simply buy our alumina and get a carbon improvement.

So it is just a burgeoning market. The premiums themselves are now small, Carlos. But we see with the growth over time that that market will be one where hopefully premiums evolve into a better situation. And the amount of demand is growing quickly.

Carlos de Alba: All right. And just to get maybe to this topic. It might be that an elegant solution or exit of the Section 232 10% import tariff on aluminum products could be a border carbon tax. What can you comment on that? Is one of these two alternatives better than the other for Alcoa and for the industry in the U.S.?

William Oplinger: Well, if we start at the very beginning, and equating 232 and carbon border adjustments I think to some extent is equating apples and oranges. 232, we've said from the very beginning that we believe that tariffs distort the marketplace and drive some supply chain changes that probably shouldn't exist. However, with 232 having been in place for as long as it has been, we've learned to live with it, and I think the industry's learned to live with it. So at this point, we don't foresee changes on 232 in the near term.

As far as the carbon border adjustment goes, fundamentally, if we come back to kind of first principles again, we think that having a carbon charge, whether it's in Europe or globally, is a benefit to the industry. And we think it would incent the right opportunities in the industry to make changes in the processes and the products. And we feel that any type of a carbon charge anywhere in the world should be positive towards moving the industry towards valuing carbon. And we've -- the CBAM proposal, we still need to see how it will be completely implemented. But at this point, we think that any move towards a carbon charge is favorable.

Carlos de Alba: All right. Maybe we're coming close to the end of our conversation, but any comments on what is happening in China? Obviously the energy situation there has been challenging and the government has been asking companies to rationalize their production. What are you seeing there? How sustainable do you think that these restrictions on power/aluminum/alumina production could last?

William Oplinger: So the Chinese over the last number of years have become very serious about environmental concerns. A few years ago, they implemented a process in which the ability to grow new production was contingent on having operating permits from existing production. So the permit swap market originated, and they stuck to that, Carlos. They really have stuck to not growing their industry as quickly over the last year or two as they had been over the last 5 to 10.

Fast forward to today, and they have put in place what's called the Dual Control system, which is a stoplight system for the provinces around electric intensity. It covers the actual intensity per GDP unit plus overall usage. And we're seeing consistently that the Chinese are enforcing that and trying to lower their overall electrical intensity and their overall carbon emissions. So it's a real positive for aluminum, but it's also we're seeing it in the refining side recently, too. We believe that they're committed to making fundamental change, and this is the first step towards it.

Carlos de Alba: All right. Excellent. Well with that, we have come to the end of our session. Thank you very much, Bill, for joining us. Thank you for Alcoa being at the conference. And if there is any questions amongst investors, please reach out either to your sales rep, Mark van der Pluym, or directly to me or Serena. We're happy to address any discussions or questions that you may have. Thank you very much, Bill, again, and good luck with everything.

William Oplinger: Thanks, Carlos. See you.