Alcoa Corporation

Bank of America Merrill Lynch
Global Metals, Mining & Steel Conference

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CORPORATE PARTICIPANTS

Roy Harvey – *President and Chief Executive Officer*

William Oplinger – *Executive Vice President and Chief Financial Officer*

OTHER PARTICIPANTS

Timna Tanners – *Bank of America Merrill Lynch*

PRESENTATION

Timna Tanners
Welcome, everyone. We're going to switch gears and shift over to aluminum. For those of you who are not up to speed with this company, this is Alcoa Corp, a new company for our conference, not to be confused with Alcoa Inc.

With that, it's my distinct pleasure and honor to introduce our speakers; Roy Harvey is President and CEO and William Oplinger is CFO. Thank you.

Roy Harvey
Thank you, Timna. As we get started, I just wanted to take just a very few brief minutes to give you an introduction to Alcoa Corporation and then we're going to jump right into questions and answers because I think that might be more helpful for everybody in the audience, and Timna can throw us some either very easy questions or some slightly difficult questions.

We've spent a lot of time in Alcoa Corporation trying to simplify, simplify, simplify from what used to be Alcoa Inc. As a much simpler lines of businesses, as a smaller company and one that's tied to commodity cycles in aluminum, albeit with some value added, we tried to eliminate as much complexity as we possibly can.

I just want to speak to you about a few lists of three, again, as – with the privilege of being CEO, that means my mind doesn't think in more than three items so I'll keep it relatively short and sweet.

Let me start with our three values. It's the way that we make decisions. We Act with Integrity which means that we do the right thing, which we believe will be a sustainable, competitive advantage to us as we build new mining operations or operate around the world. We Operate with Excellence which means that we never are satisfied with the way that things are.

Number three, we Care for People. We understand the humanity behind the decisions that we make. Those are the basic outlines and perimeters to which we make decisions and it's the three things that, for me, it's what makes me be truly proud of being an Alcoan for these last 16 years.

Second, we've been very focused on trying to build a very clear set of strategic objectives – essentially what is our destination? What are we trying to reach over these critical first few years?

Number one and most important, reduce complexity. We need to squeeze out all the stuff that we don't need and continue to drive a very lean and efficient overhead and plant operational model – reduce complexity.

Number two, we need to understand that we are wise stewards of capital and we need to push each and every single one of our employees, whether they be plant managers, department heads, operators, all the way up to business unit presidents, et cetera, to realize that we need to drive returns on the money that we invest in our business, which in the end helps us to make a better outcome for our shareholders.

Number three, and this prepares us for the long-term, we need to strengthen our balance sheet. We need to make sure that everything that we're doing makes sense so that when that next downturn confronts us, the next time prices start to slide or economic growth starts to slide around the world, we are prepared to confront that situation.

We strengthen the balance sheet, we work on things like pension, we work on things like the funded debt that we have around the world, and we make sure that we are ready to act so that we don't just survive when bad times come, but we can truly and actively thrive and improve the business during tough times. Another place that we've simplified is to go from six segments to three segments so we now have three product families.

We have the largest first quartile bauxite business in the world with significant growth opportunities and have just started to build our third party merchant bauxite business. Number two, we have the largest and again first quartile, and I believe, technologically unrivaled alumina system around the world.

Third, we have an aluminum business which has been very purposefully restructured and has driven us down the cost curve – we now find ourselves in the middle of the second quartile. That aluminum business encompasses not only the commodity grade aluminum, but also into value-added products, as our rolled product division or into our cast product division, as well as a smattering of energy resources that we have around the world.

These three businesses then fuel our three main markets, and each of these markets has submarkets underneath them. But for the most part we look at bauxite, alumina, and aluminum as the three places that we have truly an impact and that we can have a differentiated understanding of what's happening.

When we look at the world today, we think about the impacts that China is having on the entire aluminum value stream. We see a constructive market. We see a bauxite market that is balanced and any excess bauxite that might be produced; there's an insatiable appetite in China to bring that in-country in either stockpile or use. We see our ability to deliver at the right moment with the correct grade and without political risk of our bauxite not being able to be exported to China, it gives us competitive advantage to grow that very quickly.

From an alumina standpoint, we continue to see a balanced market to a small surplus.
We've seen some ups and downs in prices over the last 12 months, from the end of 2015 where we saw simply too much alumina in the market, to a period of time in the middle of 2016 where prices have recovered very significantly, to the latest headwinds that we see today, although it starts to look as perhaps we've reached a plateau as China starts to buy alumina again.

And third, aluminum where we've seen a significant price recovery from the end of 2015 and where we see the great potential for change, particularly in China. I suspect a number of the questions are going to be around what's happening in China and how much do we believe some of the latest rhetoric that's been coming down the road. I'll leave some things to talk about in Q&A, but essentially, I feel that we're at a pivot point where we have all of the right rhetoric coming out of China, and very particularly about taking action to try and improve the environmental side – whether that be the air that the Chinese citizens breathe, whether it be the environmental regulations for permitting, or for residue disposal, et cetera – we're at a moment where the Chinese are saying the right thing to deal with overcapacity.

The question is, do we find that pragmatic and practical application and actually see either some of those high costs or additional tons come offline or whether expansions are slowed? So we see these three constructive markets, each one of them feeds into the next, bauxite into alumina, alumina into aluminum, but across the board, I see a lot of opportunities for the future.
However, we also prepare ourselves for what might come down the road. Again, we need to see pragmatic action from the Chinese, we need to start addressing some of the overcapacity issues, and once that's addressed, start dealing with some of the inventory issues.

When we look back and we think about the split of Alcoa Corporation from Alcoa Inc., we've been given the opportunity to launch a brand new company. I like to think of us as a startup company that happens to have 128 years of heritage and history. It's given us the chance to rethink everything that we do. We have a management team who is excited, not only about the businesses we have today but the businesses that we'll have long into the future. We're excited about the growth. We have a lot of things that we can do to continue to simplify this business, and we are raring to go and to continue to make this Company different.

And we've also built the governance structure that supports and is specifically directed towards our shareholders, and we've also realigned top management incentive structure to make sure that our interests are clearly and firmly aligned with our shareholders. We believe it's the right recipe for success.

Timna, I'll turn it over to you to ask some questions.

QUESTIONS AND ANSWERS

Timna Tanners
Thanks, Roy. So in line with the gentler questions we'll start with… So coincident with your separation from the predecessor Alcoa Inc, nicely timed with a rally in the aluminum price, so well done there, it's been really stable and positive to see aluminum where it's at.

And a lot of the correction in aluminum can be attributed to your own adjustment of your operations, and to your point, some of the adjustments in China to address the smog and also some licenses and whatnot that we've written about actually in China. Do you think you have the right profile of operations going forward or do you think there's more adjustments that Alcoa should make in this environment?

Roy Harvey
Good, so let me start at the first part of your question, talk a little bit about the story as we separate. And I think timing worked out very well for us, because when separation was announced, we saw that we had a bit of a difficult aluminum price, we had very strong aluminum price, but we were in very good shape.

Coming into the end of 2015, we entered into what was a pretty difficult moment, and we stepped back and we realized that separations simply wouldn't be possible with the cost structure that we had at the beginning of 2015.

We drove $290 million of operational improvements that drove what we call net performance, essentially everything outside of alumina to aluminum prices and currencies. We drove $290 million to the bottom line because, as I like to say, as our team talked about, we had a hard won separation. But we did emerge out the other end and since we split from Alcoa Inc, we've seen more constructive markets. So that's the first part of what you were talking about.

In the second part where you asked about what happens from here on out, I believe our portfolio has been strengthened greatly. But that doesn't mean that you can start to progress to think that you're in the right spot no matter what happens. We've driven our way down the cost curve. The fact is we have reached our potential at a few of our facilities. We take no restart decision lightly. To be quite honest, it has to do with price and expectations to future price with power contracts, with currencies; it has to do with all those things as well as an understanding of what's happening in the local, regional and global supply and demand. But we also have a few areas that we need to continue to work.

Here in Spain, we have a set of facilities that only have essentially 12 months of life through an interruptibility program that's sponsored by the Spanish government. Those are places that we have to find longer term solutions so that we can either invest or we can choose what to do with those facilities over the long term. And we need to continue to strengthen the operations that we have. And as we read what's happening in the larger markets, we need to make a determination between where do we continue to invest.

I think we have a clear mandate right now to invest in our bauxite and grow it relatively quickly. Once we find the customers on the other end, a great technological advantage is alumina; and in aluminum, so many question marks about where future capacity will be, I think we're very careful to ensure that we continue to strengthen the plants that we have today but also be thoughtful about what the future looks like.

Timna Tanners
Okay, makes sense. So switching to the uglier topic of alumina, we were just talking with Teck about met coal volatility and that's been enormous. But if you look at alumina volatility, it's been up there -- and I think its less transparent -- but what did it peak at, like 360, and now it's down to the 270s.

And yes, I was curious about your comment about how you think it sort of plateaued, so can you just provide some comments on the alumina market and why you think it might be stabilizing?

Roy Harvey
Certainly, and obviously we're very careful not to predict pricing, and we're also very, very thoughtful to make sure that we're ready to react to what comes at us. What we've seen in alumina over these last critical 18 months for instance before that is if you see a very quick reaction to what's happening in the markets. So you almost have an overreaction where a significant amount of capacity would shutter or [curtail when prices dropped below $200 and reached $197 atthe end of 2015.

We saw a bunch of capacity come offline and then you had a shortage of enough alumina, we had a lot more buyers than we had sellers, helped drive that very quick recovery. Over the course of 2016, you saw a bunch of alumina capacity come online and you also had a number of expansions with aluminum. And so you almost swung the other direction and saw that you had more sellers than you had buyers.

And the entire world market – we follow the Alumina Price Index but it's very much tied back to Chinese demand and the number of cargos going in there. So we watch that very closely, we've gotten back into a position where there's a lot of discussion about smelting coming offline, which is not as constructive for aluminaas you can imagine for the demand--

Timna Tanners
Right.

Roy Harvey
For the product coming out. So that means that we've started to see a little bit more of a bearish mentality in alumina. And the fact is they're -- every single alumina refinery that can be operating in China is operating right now. We've just started to see the Chinese and Chalco specifically talk about bringing off a million tons.

We have two refineries in China that are right now under maintenance, some of the overhaul that every refinery does, but could be extended as well. So we're starting to see the discussions about the fact that we need to have Chinese capacity offline – China almost specifically because they're the top half of that cost curve.

Timna Tanners
Right.

Roy Harvey
And at the same time, we're starting to see China look outside of China to start buying [it]. So the reason I say that we could be at a plateau or could be at that low point is that we're starting to see refineries in rest of world's tons, and that gives us a little bit of comfort because we now start to have that supply, demand normally. So certainly, we're ready for what has to come.

Timna Tanners
Okay, great, that's helpful. So shifting gears, I guess to round out the trifecta, talking about bauxite, so the deteriorating grades in China sound like a thesis but are debatable -- and you and I have talked about that. How do you see the bauxite opportunity evolving for Alcoa?

Roy Harvey
So first of all, I'll talk a little bit about global demand. So the vast majority of bauxite demand is in China. There is some third party demand outside. For the most part, it's always China imported. I think what we've seen over these last years and we'll continue to see is that China continues to struggle to find very high grade, very cost efficient bauxite mines to the point where they actually mine some bauxite underground.

So I think China will continue to make rational decisions about some sourcing that's done in China and I think they continue to find some reserve. They don’t tend to be the high quality, low cost reserves that you might find other parts of the world; Guinea, Australia, Brazil. But they continue to find some resources in country. But they're also very focused on looking outside of China for higher volume but also bauxite qualities that they can mix in.

I think particularly with caustic prices moving up slightly as well as coal prices which are directly tied to both alumina and aluminum in China specifically, you're starting to see that cost push that’s driving a higher cost and therefore they have a lot more thought about how can they run their plants more efficiently. And that drives them to be more selective about the bauxite that they've used and -- from an Alcoa standpoint – I'll get back to your – the last part of your question. We have a very proven track record of being able to mine and deploy the resources that we have whether it be in Australia, Guinea, Brazil, or elsewhere, we do it in a smart fashion. We understand the grades that sit there. Our refineries demand from an internal supplier customer standpoint that we get the grades they expect because that makes the refineries run better.

And so that makes us the perfect supplier of choice when the Chinese are looking for consistent quality, when they're looking for consistent supply and I think it will help them to preserve some cash because they won't need to have the large buffer of inventories sitting in China (Inaudible - microphone inaccessible).

So I think we have a great opportunity, we're now selling about 6 million tons per year, that allows us to build relationships with Chinese customers as well as other customers. And I think gives them a taste of what they can expect from a world class, very low cost, very (Inaudible - microphone inaccessible) technical supplier of bauxite.

Timna Tanners
Okay, very helpful. And for those of you who aren't aware, there's a new presentation that Alcoa has out if you want to see things in print and nice pictures and that's also available to you.

So Bill, I want to ask you a question because you and I have been in this forum with the former Alcoa and so I wanted to get your perspective on how the new Alcoa is different and maybe a little perspective on self-help and what type of changes you're seeing. And then of course, we hear your thoughts on addressing the pension and any news that you have.

William Oplinger
Sure. So as far as the new Alcoa, we've very, very focused, as Roy said, on cost control, focused on reducing overhead, simplifying the business significantly. The other area that we're focused on is prudent use of capital and being able to reinvest in the business; the business within Alcoa Inc for a number of years had really reduced a lot of capital spend.

We've increased the amount of return seeking capital significantly in 2017. We'll spend $150 million on return-seeking projects in 2017. So just much more of a focused story than what Inc had been and we're excited to have the opportunity to run Corp. When you think about the uses of cash, we've talked a lot about it over the last 6 months. We're currently a BB- rated credit. We think we could be significantly higher than that. We've got a fairly stringent revolving credit facility, its $1.5 billion revolving credit facility.

But it limits the amount of cash that we can give back to shareholders in the near term. One of the first uses of cash for, as Roy was saying, the business will be to pay down debt and de-lever.

And whether that's via paying down some of the funded debt that we have in Brazil or contributing further to the pension plan, we are looking to de-lever. Beyond that, we would increase our return-seeking capital. We've got a lot of great projects that have returns that at today's pricing, generate 20% to 30% IRR. That'll be the use of cash in the near term.

Timna Tanners
Okay, excellent. We probably have room for about a few minutes of questions from the audience if we have any? The one in front? Oh, we have -- Okay, they're starting in the back, then we'll come to you.

Unidentified Audience Member
Hey guys. Can you talk a little bit about the can sheet market in the US? Maybe to follow-up from the Rexam and Ball transaction or -- and maybe some renewed participation from AB InBev?

Roy Harvey
Sure. So let me -- let me start with an overview of how we see the future for can sheet and it starts back to the asset strategy that of course connects to our market strategy. As part of separation, we ended up with the North American can sheet business, it essentially is the Warrick Rolling Mill.

We also have a connection back over to the Tennessee Rolling Mill in that this whole -- this whole wide-body can sheet of Tennessee, that is being transitioned over to our other plant which is our joint venture ownership in Saudi Arabia plant with Ma’aden.

So those two form our can sheet core. And as I like to describe it, it is a fixer upper, it’s a fixer upper that we're now in the process of fixing up. We're driving volume, we're pushing out cost running it like a commodity business and we're just looking for ways to try and sharpen that business and run it with a little bit of ingenuity and thoughtful ways like we have the rest of our portfolio.

So one of the reasons that we thought this could be a constructive market is quite specifically because so much of the rolled capacity moved to automotive and aerospace. And so that started to create what looked like the potential for recovery in can sheet.

Warrick Rolling Mill as a supplier to North America -- one of the major suppliers of (Inaudible - microphone inaccessible) in North America, it gives you two ways to be successful there. Number one is drive volumes, and then number two, to start to drive improved prices.

So right now, I think you've got a number of announcements coming out about new automotive facilities. It’s a potential warning signs or the potential concern is that you start to see North American capacity, some of the -- if there's too much capacity for automotive, you could see some slide back in can sheet. So that's a bit of a warning signal.

But for right now, what we see is that we have a constructive market, these are long term contracts. We're not too concerned with the latest consolidation from can makers except for the fact that if they start to look overseas, the larger is the purchase, the more that they can use imports.

The fact is we'll be importing material from our Saudi Arabian joint venture, it is a great technology. They're just bringing it up and starting to qualify now. But we see it as a market where we can do a lot of significant improvements to that business, even if we don’t have a market recovery and if you pare that with a market recovery it can be a really good business -- a really great business.

William Oplinger
And to emphasize one point, we are running that business differently -- and I think Roy said that -- we're running that business differently than it had been run in the past. We are anticipating a 20% volume increase at the Warrick facility in 2017. We'll add another 10% volume increase on top of that for 2018.

And so we're aggressively filling the mill, taking costs out and improving profitability. That business was around an EBITDA breakeven in 2016 and it will be significantly better than that in 2017.

Timna Tanners
One more question?

Unidentified Audience Member
Congratulations and it must be great to be out from underneath complexities of the old Alcoa. (Inaudible - microphone inaccessible) If you have a range of (Inaudible - microphone inaccessible)? How much (Inaudible - microphone inaccessible)?

William Oplinger
I’ll address that one, Roy. I think you’ve conflated a couple of different areas that I don’t know that I would necessarily put together. I think we have the financial wherewithal at this point if we needed to do further restructuring in the business then we can. That doesn’t concern me. The pension liability is a large pension liability.

To put it in perspective, we have a $3 billion pension and OPEB liability and around $1.45 billion of funded debt. Our funded debt is very low but our pension liability, pension OPEB is fairly large. When you then further break down that $3 billion, roughly $1.8 billion is the pension.

We have a number of things that we're looking at doing for the pension so we're evaluating clearly how to manage the liability side, and there's a number of different ways to manage the liability side, everything from freezing pension benefits to annuitization for current pension plan participants but then also increases in the asset side.

So we're aggressively going after the $1.8 billion. I would say to you though that I do think back to your original question, we have the ability to manage currently with our cash flows, if we were to decide to restructure further.

Roy Harvey
I can just add to that really quickly. If you think about Timna's original question was we came out at a good point in the cycle so we've had the opportunity to generate cash here in the beginning. The better we have of a start, the more cash we can either use to pay down funded debt like the BNDES or do things that allow us to be prepared for when times turn against us.

And part of that is to have very rational, thoughtful decisions about what we do with some of these plants that are on the bubble. The Portland smelter in Eastern Australia is a plant that has a much – a significantly increased energy price here for the short term. However, we've been able to build a package with the government that gives us four years to find a long-term solution.

We're not going to flinch from doing the right thing when it comes, but we're also going to put a lot of effort into trying to fix these things now that we have the chance to. But we're going to make sure that we have the strength of balance sheet to be ready to act should the time come when it's necessary.

Timna Tanners
Okay, with that I'd like to ask you to join me in thanking Alcoa for joining us.