

Alcoa Corporation

Goldman Sachs Metals & Mining Conference

Thursday, November 16, 2023, 1:50 PM
Eastern Standard Time

CORPORATE PARTICIPANTS

William Oplinger – *President and Chief Executive Officer*

OTHER PARTICIPANTS

Karl Blunden – *Analyst, Goldman Sachs & Co. LLC*

Karl Blunden:

Hey fantastic and thanks for joining us at this afternoon's panels here for Goldman Sachs Metals and Mining Conference. I'm Karl Blunden, I look at the sector from the fixed income side. And a pleasure to have with us here Alcoa Corp., and Bill Oplinger, who is the Chief Executive Officer of the company. We have a couple of different topics to cover today. We'll look at strategic priorities, the earnings outlook, specific operating initiatives, and also capital structure and returns. But before we jump into specific questions, I'll turn it over to Bill for an overview and an update.

William Oplinger:

Thank you very much, and thanks for having us here at the conference, we were just reminiscing that this was the first conference we did after separation, and now the first conference that I'm doing as the new CEO. So thanks for having us.

Hopefully you're familiar with Alcoa, we're a 135 year old aluminum company. We're a vertically integrated, primary aluminum company. We have assets globally. So we have assets in Australia and Europe and Brazil and North America. So widely – geographically – diverse.

As far as our portfolio goes, in bauxite mining, we're in first quartile cost position, alumina refining, first quartile position also, and aluminum smelting second quartile. So globally diverse and in a very strong cost position for the company.

Since we – over the last few years since we separated from Alcoa, Inc. had priorities of significantly strengthening the balance sheet. We've done a good deal of that over the last few years and made the portfolio stronger and leaner. So a lot of progress over the years. As far as capital allocation goes, and I know we'll probably address this a little bit further later on, we've got really three capital allocation priorities.

First, is debt reduction, essentially a strong balance sheet. We've made the balance sheet much stronger over the last few years. Balance sheet could be – potentially be – a little bit stronger than it is today.

Secondly, is returns of capital to shareholders. We initiated a dividend. So we're actually paying a dividend now, which I'm particularly pleased with. We bought back shares over the last couple of years, as the cycle was stronger back in 2022, we did share buybacks.

And then the third use of capital is repositioning of the portfolio. We've done that over the last few years, and we'll continue to do that in the future.

If you're wondering what near-term priorities are, I would say that I have really four near-term priorities that I'm looking at delivering upon. And then a couple of longer-term priorities.

The first near-term priority is to gain our Western Australia bauxite permits. We've been having some problems on permitting in Western Australia, and we've targeted by the end of the year to have those permits finalized.

That's what the government is telling us. So targeting for the end of the year to have that resolved.

Second near-term priority is around competitiveness of our facilities. Each facility globally has a productivity target and is looking for significant improvements in productivity. It's not necessarily been a primary focus of the company in the last few years and it is now becoming a primary focus of the company.

The third is that we have a restart of a smelter down in Brazil. That restart has not gone as well as we would have liked it to have gone and so we're anticipating that that will get completed in 2024. Has a major earnings swing for us, once we get that completely restarted. It's about two-thirds restarted currently.

And then, lastly, we've got what we're terming financially troubled operations, or FTOPS, our financially troubled operations lost about \$90 million of EBITDA in the third quarter and we're targeting improvement programs at each one of those operations. There's about a half a dozen of those around the world. Those are the near-term objectives for myself.

Longer term, there's really two things that we need to deliver upon. The first is our breakthrough technologies. We have a suite of breakthrough technologies that we're working on that will significantly change the aluminum industry.

The first is the ELYSIS™ project. ELYSIS is a joint venture with us and Rio Tinto, that is a zero carbon producing smelting process and that's anticipating a commercial package by 2024, first hot metal by 2026.

The second is what we term ASTRAEA™. And ASTRAEA is a technology that uses post-consumer scrap and converts it into high purity aluminum. That would be Alcoa's ability to entrée to the scrap business.

So that's going on and then the third technology is really a suite of technologies in the refining business that are focused on decarbonizing and significantly improving the residue footprint of the refining business.

So that's one long-term priority. And then, the second priority is really to change fundamentally the culture of the company trying to drive a much more performance-oriented culture within the company and that started really when I became COO and we were driving that through the operational organization. Now, we get to drive those standards through the rest of the company also.

With that, I'll take questions, Karl.

Karl Blunden:

Fantastic. Thanks, Bill. And we'll have questions from the audience toward the end. I'll just kick off with a couple here.

Maybe I'll start with the cultural change, and you brought it up here as a long-term priority. But as you progress on that, what should investors look at as milestones as we move forward?

William Oplinger:

Yes. So you started with a pretty hard question, and I think we'll know it when we see it and essentially what I would ask investors to track is our overall performance on a number of different factors.

First of all is safety, we've made a step change in our safety performance at Alcoa in 2023. We're looking for a further step change in 2024. You don't have great transparency to that, but I do. And I sit there and watch our recordable incident rates, our DART rates, our all injury frequency rates, we've probably improved that by anywhere between 15% and 30% this year, depending on which metric you look at.

The second is operational stability. We had operational stability issues in 2022; largely with the exception of the smelter down in Brazil, those have been eliminated in 2023. So we've been able to achieve operating rate records in Quebec and I'm looking to drive that type of a performance across the entirety of the system.

And then the third would be underlying cost structure. We talked about productivity, but a big piece of the performance culture is, how do we get better year-in and year-out on stability, on cost, on safety.

Karl Blunden:

You mentioned on some of the environmental pieces and decarbonizing the business, it was a big discussion point. I'd say probably two or three years ago. And we kind of got away from that during COVID operational initiatives took the focus. When you think about the economic opportunity there, how are you framing that for the business?

William Oplinger:

So, the economic opportunity I think is developing over time. There is now a premium being paid for low-carbon aluminum. It's not a large premium. It's anywhere between \$10 and \$30 per tonne. And the reason being is that there is a decent amount of supply of low-carbon aluminum as it's defined today versus demand that is really starting to grow and grow rapidly.

As we go out into the future, I think having a suite of low-carbon products will be table stakes to some extent. Today, we have a suite of low-carbon products that are not just on the aluminum side but also on alumina. We offer an alumina product that is the lowest carbon producing alumina in the world. And so, I think it will be critically important. The economic side of it is yet to develop as largely as I think it will over the coming years.

Karl Blunden: What is – is moving parts in earnings, some of them are controllable, some of them are to do with the cycle, and we're at a lower point in the cycle at the moment. As you think about the earnings power of the business and kind of bridge through controllables and the cycle, how should investors think about earnings power of Alcoa Corp?

William Oplinger: It's a tough question. And what we do is we provide investors a series of sensitivities, so that they can model the earnings themselves. A lot of time investors will want to ask us, hey, what does mid-cycle earnings look like? And our earnings are impacted by metal prices, alumina prices, currencies, energy costs, raw material costs. So modeling necessarily a simple mid-cycle earnings is really difficult. I think each investor needs to determine what they think are going to impact the earnings and build that into the models.

However, with all that said, when you consider our four initiatives in the near-term, three of those four initiatives will deliver earnings improvements fairly quickly, and fairly substantially. I say three out of the four because the WA bauxite permits, given the situation that we're in, in Western Australia, assuming that we get our permits, the lower bauxite grades that we have today will persist until we get to the next mine phase.

But the other three items, productivity, the financially troubled operations and the Brazil smelter restart, will deliver meaningful and significant earnings improvements to the bottom line. We've put a number around the financially troubled operations. They were approximately \$90 million in the third quarter. We won't get all of that back immediately, but we'll be working towards it.

Karl Blunden: To focus in on some of those operating initiatives. You mentioned the steps towards bauxite mining approvals in Australia. In mining, things seem pretty certain and clear, until they're not. How should investors get comfortable with the timeline there and the ramp?

William Oplinger: So we've been working on the mining approvals for quite a while at this point. And we went out in October in our earnings call and reiterated what the government has said, which is they believe that we will have both a combination of the mine permit resolution and also the EPA assessment process that's ongoing. We should have clarity into that by the end of the year. So, that's their target. That's their deadline. And that's why we've reiterated it.

Karl Blunden: As you think about the CapEx profile for the business and getting to higher grades, what should we be incorporating into modeling.

William Oplinger: So, we will give good guidance at the beginning of January of 2024 when we have our earnings call. There are a number of things that affect our capital spend – our capital profile. There are things like residue deposit areas which are large, and expensive mine moves. And that we talked about the fact that we will be having a mine move in Western Australia in the 2025 time-period, impoundment management and making sure that we don't have issues around our impoundments. So, all of that will provide better insight into that spend in 2024, beginning of 2024.

Karl Blunden: Could we talk now a little bit about the Alumar smelter progress and milestones there that investors can measure the company by?

William Oplinger: So, the Alumar smelter has been tough. The restart has been tough. And we are now saying we should have it fully restarted in the calendar year, next year. It's around two thirds, 65% started today. We had a little bit of a setback in the third quarter. We had a power outage that covered roughly two thirds of Brazil. It took the smelter down for around three hours. A well operating smelter can withstand a three-hour power outage; a smelter that's in the restart process: we ended up losing some pots in that power outage. So it set us back.

We're now in a position that I believe we will deliver on that restart. We really had, as I reflect on some of the issues that we've had in that smelter, there really were three issues. The first was that the equipment wasn't up to the standard that it should have been. And so we've spent a lot of time and a lot of money over the last two years, making sure that the basic operating equipment is in better shape, primarily the crane system.

The second issue that we've had there is raw materials. We did not have the right quality of bath in the facility. We now have that today – as of today. And really, the third was the knowledge level of the people running the smelter. We curtailed that smelter, I forget how many years ago – 8 to 10 years ago. Much of the knowledge of operating the smelter left and went to work in other places. And so that's the limiting factor as of today.

Now, I can assure you that we still know how to restart smelters. This one's just been difficult. We are in the process of restarting some capacity out in Indiana, and we are starting one line at the Warrick facility and we anticipate that to be done by the end of the first quarter of next year. And it is actually ahead of schedule at this point and going very well and has been done safely on time and on budget. We've learned a lot through the Alumar restart that we're applying in the Warrick restart.

Karl Blunden: Kind of going around the world here. I just want to talk a little bit about Europe. It was in focus about a year ago with very large power costs and

some power shortages. As you think about the business and resilience to volatility in that region today, what comes to mind?

William Oplinger:

So, the power situation is still difficult in Europe, both from a gas price and electricity. And for us, really, when I think about Europe, we've got assets in Iceland, Norway and Spain. In Iceland, we have a long-term energy agreement and that is going well. So, Iceland is not – our facility is not being impacted by any of the energy shortages across Europe in Iceland. So, that's going well. And if you're wondering about the volcanoes and the earthquakes, it's on the other end of the country. So, our facility is on the eastern part of the country, whereas the volcanoes and earthquakes are in the western part.

We then go to Norway. The northern plant that we have, Mosjøen is in very good situation as far as energy goes. Southern Norway, we're exposed to energy prices to some extent in southern Norway. And so it's a smaller facility. It's been challenged by higher energy costs, and we're working toward resolving that. And then in Spain, we have curtailed – a couple of years ago, we curtailed the smelter in Spain. And we're looking at working on the viability of that smelter in Spain. And then on the refining side, it's been negatively impacted by higher gas costs. And that facility is running at half capacity today. And it struggles at the higher gas prices.

Karl Blunden:

As we think about heading now into the winter, what's the sensitivity of the business there to additional gas price increases? It's probably unlikely to get to where we were last year if you look at inventory and stockpiles but...?

William Oplinger:

So, the gas exposure that we have in the region is largely at the refinery. There's a little bit of gas exposure in some parts of the smelters associated with bake furnace gas. But the big exposure is in the refinery. And a further increase in the gas prices would negatively impact that refinery. That refinery today, from an EBITDA perspective, is in one of those financial troubled operations that we talk about addressing. And it probably loses at today gas prices anywhere between \$80 million and \$100 million of EBITDA. So, it's a facility that is really negatively impacted by the energy. Otherwise, it's a very well-run facility. But just it's difficult at the gas prices that we see.

Karl Blunden:

Just want to complete the circle around the world here and talk about the U.S. More on the trade and policy environment, we're about a year away here from a presidential election. How should we think about the importance of that one to Alcoa?

William Oplinger:

It's a good question. If we step back and look at Alcoa's footprint around the world, the U.S. is a much smaller footprint for us than it has been historically. We have two smelters in the U.S. that are operating, one in Upstate New York, Massena, one in Indiana, and that's called Warrick. And

then we have a third operation called Lake Charles, which is a coke calciner down in Louisiana. So, we have a fairly small footprint.

I don't know that a change in administration is going to make that big of a difference in our perspective around the US, whether it changes or it doesn't. We've been working with the Trump administration when it was in and the Biden administration now. So, I don't know that it will have that large of a difference. If we look at some of the opportunities that we do have in the US, I mentioned the fact that we're restarting a line at Warrick. We're really focused on improving the overall profitability of Warrick through a number of things. But the one area that would help a lot is if we get the 45X through the IRA that will help both the Warrick facility and the Massena facility.

Karl Blunden: Shift now to the capital structure and returns. You mentioned in your opening remarks that you'd like to see a little less debt for the business. How do you think about the optimal capital structure here?

William Oplinger: And you and I have talked about this, so we'll just tell everybody we target an optimal WACC. We don't necessarily target a rating. Historically, we have said we're fine if we're a high yield – a strong high yield or a lower investment grade, but we're targeting a WACC; when we target that WACC, I would like to see a little bit less of proportional net debt.

We've worked our proportional net debt down from approaching \$4 billion all the way down to about \$1 billion at the end of 2022. It's crept back up a little bit in 2023 due to the weakness of cash flows. But, just to reiterate, we're looking at targeting a WACC that is the lowest that provides for the highest equity valuation.

Karl Blunden: You mentioned capital returns for shareholders and being proud of the dividend and happy that the dividend is in place, a lot of initiatives that you are working on to improve earnings, what does the capital return framework look like over time?

William Oplinger: So, the capital return framework probably won't change from where it is today. So, we have those three parts of the capital return framework. It's optimal capital structure potentially deleveraging a little bit more, returns of cash to shareholders and repositioning the portfolio. Repositioning the portfolio tends to cost money. So if you curtail or close a facility, you generally have to accelerate the remediation and pay severance costs. So, that costs us some money. Those are the three areas for capital allocation in the future at this point.

Karl Blunden: I think we'll open out to the audience.

- William Oplinger:** It's a quiet audience.
- Karl Blunden:** The one in the back there.
- Audience:** Hey, Bill. Thanks. I was just wondering, your Refinery at the Future program. Can you just give us an update on the MVR work you're doing at Pinjarra in Australia?
- William Oplinger:** So, yes, I'll give you an update on both Refinery of the Future and the MVR work that we're doing at Wagerup, not at Pinjarra, but Refinery of the Future out of the three breakthrough technologies that we have, Refinery of the Future is currently the least developed of the three. ELYSIS is real. It's happening. You can actually see it. And so that's going on.
- ASTRAEA, we're making metal with ASTRAEA on a benchtop cell at this point. Refinery of the Future is going through an ideation phase and we've taken roughly 1,500 ideas and worked through those ideas and have really begun to focus on two areas for the future of Refinery of the Future. One is decarbonization, which is – I'll get to the MVR project in a second. – but one is decarbonization, and then the second is residue minimization, residue reuse, residue sale, maximizing the value out of our residue. When we consider the MVR project, the MVR project in Wagerup specifically was a return seeking project that we are looking at proving out the MVR technology in a specific refining application.
- That project is being slow walked today given the current capital constraints, and may ultimately be cancelled just because of the progress that we haven't seen on MVR there. However, we think that MVR could be a solution for a new refinery facility. In the case of a retrofit, we're really questioning whether it will be economic in a retrofit. And that's where we're thinking through the future of MVR at Wagerup.
- Karl Blunden:** Anything else for Bill?
- William Oplinger:** Maybe I was too brief in my answers. We have nine minutes left.
- Karl Blunden:** Well, I can give you one that may take some time. You've met investors now in a number of different capacities, CFO, COO, now as CEO. When you think about what investors don't appreciate about the business or, what you'd like to draw attention to, what would you highlight?
- William Oplinger:** Well, first, we do a lot of talking to investors. And so I think investors have a pretty good perspective of Alcoa. But with that said, I do think that investors need to understand that we have these four near-term objectives that we are aggressively going after.

And so I believe that they will pay fairly quick dividends. But we are really pursuing those four areas. And I would tell you that I will be measuring my performance against those objectives in the middle part of next year. How much progress have we made on WA bauxite permits? We need to have it made by the end of this year so that we can move to Myara North in 2027.

How much productivity will we get? So you should see improvements in the first and the second quarter. You will see improvements on the Brazilian smelter and we're starting to see it today already and really tough decisions need to be taken around some of those financially troubled operations and those decisions will be taken in the next couple of quarters.

So there's that. There's the breakthrough technologies that are available to us. And so I just think – and then lastly, this culture that I'm trying to change within the organization, you should see the benefits of that performance-oriented culture coming through fairly quickly.

Karl Blunden:

We'll go to a question at the back there.

Audience:

Hi. Yeah. Can we talk a little bit about the marketplace, how you're seeing different production incentives in different regions, especially in China and Europe? It's been a volatile year for European energy prices, and China's production seems to be more resilient as well, right. If you can walk us through how you're seeing production incentives in this region, please? Thank you.

William Oplinger:

So let me walk you through the supply demand picture as we see it for 2023 and 2024. Overall, metal supply demand, aluminum supply demand we see to be balanced slightly surplus in 2023. That has really been driven by a difficult demand year for aluminum. We've seen demand in construction depending on what part of the world you're in, drop by greater than 20% in Europe, greater than 10% in North America and Japan, and actually decline in China, not a substantial decline, but a real decline in China, which is a little surprising.

On the packaging front, we've seen a contraction in packaging demand in 2023. On the – in electric cabling, electric cabling started the year pretty strong, but has ended the year pretty weak. Durable goods, depending on what region you're in, are down anywhere between 5% and 20% around the globe. So the demand side of the picture has been pretty difficult in 2023.

As we then roll into 2024, we're not seeing further demand destruction and we project that 2024 will be balanced, again, slightly long on aluminum

production. So, how that breaks down is that we envision that China should be net short and so China will be importing some metal and the rest of the world will be net long.

If I then go by market, we don't see a substantial rebound in building and construction, but we don't see further weakness either. So if anything, there's some slight upside to building and construction, but albeit from a pretty weak base.

Packaging very similar. We'll see a demand increase in packaging that is driven by really destocking that occurred in 2023, and we think that that won't recur in 2024. So overall, our view is that metal supply demand should be balanced to slightly long.

We did see some curtailments in China this year, 1.2 million metric tonnes in Yunnan due to water shortages, that seems to be a recurring theme year-in and year-out, which limits the Chinese capacity. And if you're wondering, we do believe that the Chinese will stick to the 45 million metric tonne capacity cap.

And the reason why we believe that is up until now, they've not been issuing new production capacity permits. If you want to build new production in places like Yunnan, you have to buy an operating capacity permit, which adds significantly to their capital structure. So we do believe that long-term the Chinese production will be limited at 45 million metric tonnes.

We then transition to the long-term. We still think that the underlying megatrends are supportive of aluminum, massive consumption associated with solar and wind production. Electric vehicles use about 100 kilograms per car more of aluminum than an internal combustion engine does. So we think that the overall demand story for aluminum is still strong. And if the Chinese do stick to the 45 million metric tonne cap, should shape up for a pretty strong market environment in the future for aluminum. Thanks for the question.

Karl Blunden: Anyone else in the room? Think we're at about time, then. We'll wrap it there. Bill, thank you very much for being with us again this year and as your first conference as CEO.

William Oplinger: Thanks, Karl. Thank you.

Karl Blunden: Thank you.