Alcoa Corporation

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David Gagliano: All right. Great. Thank you for joining us for our next fireside chat with the President and CEO of Alcoa, Roy Harvey. Alcoa ranks among the largest aluminum and alumina producers globally, vertically integrated production base, bauxite, alumina, primary aluminum, asset spread throughout Australia, Europe, including Iceland, South America, and North America.

Joining us today from Alcoa is President and CEO, Roy Harvey. Roy has been Alcoa's CEO since 2016. Before Alcoa separated into two companies, he was the President of Alcoa's Global Primary Products business, and he's been with Alcoa since 2002.

Roy, thank you for joining us today and I'll turn it over to you for your opening remarks.

Roy Harvey: Perfect. And thank you, Dave. What I'd like to do today is a little bit different than the normal fireside chat. I've got some prepared remarks that I just want to walk you through. I actually believe they're very relevant for what we're seeing today in our market and I think will help us launch into a very effective question and answer at the end.

So, let me get started, and I will call your attention to slide number 4. You should be able to see it on the screen, but you can also look at the handouts that we've provided. These first couple slides, I will run through very briefly and are simply focused on giving everybody an idea of who is Alcoa and what we do.

So, Alcoa represents 28 operating locations. We're in 16 countries globally, around 13,000 employees. As a little bit of history, we actually invented the modern aluminum industry back in 1886 and have been operating for about 135 years. Interestingly enough, we've tried to simplify our decision-making inside of the business and have tried to set some very effective guardrails. You can see that here with what we call our values. And these are to Act with Integrity, to Operate with Excellence, and to Care for People. These have served us very well, as we've watched our space become more and more focused on sustainability and on ESG-related issues. So, this helps us to make sure our decisions are pointed in the right direction.

At the same time, we use what we call strategic priorities, which are simply a way to make sure that every decision that we make creates value for our company and for our stockholders. And here, we talk about three things: Reduce Complexity, which is about lowering our cost as a commodity player; Drive Returns, which means that we're always focused on using our investments for the best that they can and to drive and improve margins; and finally, to Advance Sustainably and to make sure that we continue to follow our values and to create value for everybody. And this includes both financially, operationally, but also environmentally and socially.

If you can slip down to slide number 5, a very brief overview of our three segments. In Bauxite, we are the second largest miner of bauxite globally. We are in the first quartile of the global cost curve. And this is where I think our approach to biodiversity, to rehabilitation, and to other community and ESG-related issues really differentiates us.

In Alumina, we also find ourselves in the first quartile of the global cost curve. We are the largest producer outside of China. And also, interestingly enough, the lowest carbon intensity producer of alumina globally.

In Aluminum, which is actually a story in the midst of change, we find ourselves in the low, second quartile of the global cost curve. However, to our portfolio review, we are on the way to the first quartile. From a renewable energy standpoint, we find ourselves at 78%. And again, with the changes that we're making, we'll find ourselves at 85% down the road. And finally, from a carbon intensity standpoint, we find ourselves to be one of the lowest carbon intensity producers. And, in fact, once again through our portfolio review, we'll find ourselves in the lowest position globally. So, great, strong position to get started.

So, let's step down to slide number 6 and talk a little bit about aluminum as a metal. So, we've talked a little bit about the sustainability issues that have certainly taken a lot of interest in this conference and over these last 12 to 24 months around the world. And the great news for Alcoa is that part of the solution to dealing with these issues is to make sure that our metal is incorporated into these solutions that drives lower carbon and an improved ESG approach to everything.

Our metal is lightweight, it's durable, and it is also infinitely recyclable, which really lends itself into all of these different applications and end markets. When you look at the resurgence in demand that we're seeing in 2021, our expectation is that this will continue, really, for the next five years. You can see that far and beyond in transportation, where interestingly enough, it is a key component of new electric vehicles, of hybrids and of conventional vehicles. So, aluminum is a solution across all of these platforms.

In addition to that, our view of the supply side when we think about where and what new capacity is coming online, this has been very much a story about China over these last few years. Well, the good news here is that in the last three- to four-year period, we have seen China very much focused on delivering on their commitments and promises as put into place inside of their regulations. So, when I look at the need to have an operating permit to, in fact, continue to operate, which is a big change that happened about four years ago, and how much discipline has been built into that system and into ensuring that that capacity does not top their own self-imposed limit of 45 million tons per year, we're seeing a very different view of growth, a much more disciplined approach to bringing on new capacity and retiring old capacity. And to me, that very much bodes well for a more balanced supply/demand long into the future.

The other interesting story here, at the bottom right, really deals with the prevalence of low carbon aluminum. Now, our product, which is what we call EcoLum™ is based off less than 4 tons of carbon dioxide per ton of aluminum produced. To us, it is the standard we should use to judge. And when we look at the Chinese industry, less than 3% of Chinese production can actually meet this carbon target.

When you look globally, in fact, only 10% meets this 4 tons of CO_2 per ton of aluminum. And in fact, when we think about the importance of this to the future of our planet, to the future of our industry, we think about Alcoa's productive capacity and productive capacity that can produce EcoLum™ brand aluminum. We, in fact, represent 25% of that global capacity of low carbon. So, very much an opportunity for Alcoa as we look at this changing marketplace.

Let's slip down to slide number 7 now, please. And this is looking more specifically at what happens as this new carbon pricing environment starts to take hold. Now, this is meant to be illustrative. It's not meant to be a prediction of what carbon pricing could be, but rather to demonstrate what are the inputs and what is causing these changes to take place. And then, what can happen to these cost curves.

Now, this example shows a carbon price of $50 per ton of carbon. It is meant to embed that into both the aluminum curve on the left and the alumina curve on the right. And again, it's meant to demonstrate what happens when this global pricing takes place or could also be happening should there be regional changes that also might occur.

The easiest way to understand the cost curves is to understand the steepness, which then helps to determine what is the right pricing environment for this metal. And what you can see is that it is incredibly steeper should this carbon cost be put into place. And to illustrate that, between the 20th percentile of the curve and the 80th percentile of the curve, there is an increase of more than $500 per metric ton if you simply embed this $50 per ton.

On the alumina business as well, you can see here on the right, using that same analysis from the 20th percentile to the 80th percentile, the step change is $50 per ton. So, very influential in what could be the pricing environment for the future.

And finally, just to understand what's driving this, look at the very bottom of the slide. And what these try to show is how much capacity is being driven by coal. Now, we all know the heavy carbon footprint that coal-fired facilities have. On the left, you can see the coal-fired electricity generation embedded inside of the aluminum industry, and on the right, inside of the alumina industry for generation of both steam and power. And so, because of this heavy dependence on coal and the high carbon content, it's really what drives this steepening of the cost curve.

Let's step down to slide number 8 now. And what I'd like to talk about is what Alcoa is doing. And much of our plans are based on ensuring that we can be the most profitable and the most productive possible in the world that we see today, but also prepare ourselves for the world of tomorrow. It's broken into three separate pillars. The first is to become more and more cost efficient. And this was very much driven by the decisions we made about a year and a half ago in order to drive what we've been calling a new operating model. It essentially eliminates the old bureaucratic business unit structure and focuses our commercial and our operations on what is most important to them and ensuring that we are operating stably and that we are realizing maximum value commercially. This is already into place. We've already got the cost savings locked in. And we're very pleased, in fact, that not only is this more efficient, it drives better outcomes.

In the middle, and this is another successful program, was a set of [non-]core asset sales that we set up. We were targeting between $500 million and $1 billion of cash coming into these programs. Between the sale of the Gum Springs processing facility and the Warrick rolling mill, which is to close at the end of this month, we've been able to achieve this target. And we still have assets, and Rockdale is the perfect example of this, that we can choose to sell should we find the right pricing environment.

And on the right, and again, I mentioned this briefly when I was talking about our product segments, we're in the midst of a portfolio review. We called out 4 million tons of alumina capacity and 1.5 million tons of aluminum capacity. This review is meant to look at whether we can have a step change in our cost environment or alternatively, a divestiture, curtailment, or closure.

We've made announcements over the course of last year. This includes the Intalco smelter that was curtailed, our Point Comfort alumina facility that was closed permanently. We're in the midst of discussions on a divesture in Spain for the San Ciprián smelter and in the midst of repowering our Portland smelter in East Australia. So, this is a program that is very active. It's what supports driving our Aluminum business to the first quartile, and also allows us to continue to drive improvements across our renewable energy and carbon cost targets.

So, with this and very briefly as we go to slide number 9, I just want you to remember three things from the presentation. First and most importantly, aluminum I think is the metal of the future. It is embedded in a lot of what's happening. We're seeing a resurgence in demand. And I continue to be enthusiastic about being an aluminum producer and the impacts it can have on our world.

Second, Alcoa is not standing still. No matter what confronts us from a market standpoint, we are driving to be lower cost, to being a simpler company, and to making sure that we can have a business that can function well through the cycle.

And third, as you put these trends together and you think about the bright future that aluminum has and about the strength that Alcoa is bringing and the fact that we can drive our portfolio to be lower carbon, and live up to our values on social sustainability, on environmental sustainability, I have to say it is a recipe for real success. And so, I'm excited for the future and also looking forward to questions that Dave might have for me.

David Gagliano: All right. Excellent. Thank you, Roy. That was very helpful. Just drilling down a little bit into the low carbon initiatives. Obviously, you mentioned EcoLum's™ ultra-low carbon footprint. How will this product specifically and just in general, these low carbon products throughout the aluminum supply chain, how will they be priced differently versus traditional pricing?

Roy Harvey: Yeah. It's a great question. And as I mentioned, we have products that stretch all the way from alumina down into aluminum. We're also ASI certified, which helps you understand not just the carbon content, but also the sort of the responsibility and sustainability baked in.

The pricing environment, one of the things we've been trying to drive is that we can truly differentiate each of these different products. And so, when you think about our EcoLum™ versus other products out there, we've tried to set aggressive and difficult targets so that our customers can differentiate themselves. What we're seeing is the development both of increased volumes, but also premiums. And I know there's some work in order to try and quantify them and to help the market have a little bit of transparency. And from our perspective, we've made sales of all of these products, and we've seen premiums associated with them. Right now, it's still relatively modest volumes and modest premiums, but it's a market in development and it's a market that, to me, is changing each and every day and we're having more and more conversations about it.

The next logical step, of course, is what we call our ELYSIS™ project, which is a joint venture with Rio Tinto and also with the province of Québec and Government of Canada. It is a project that takes aluminum that next step on direct emissions of carbon and actually releases oxygen rather than carbon dioxide in the process of smelting aluminum.

So, when matched with hydropower or other renewable energies, the idea is to differentiate that so that when you are a customer, one of our customers that's truly looking for that best-in-class carbon solution, that we cannot just have a single premium, but in fact, find the premiums that are associated with each of these different products that are being brought to the marketplace.

David Gagliano: A related question on the ELYSIS™ project, and maybe it's a bit early, I know it's early stages. But how realistically from a timing perspective would it take to move from essentially what was a recently constructed R&D facility to sort of a commercial scale type of product? And what are the early indications on production costs associated with something like that?

Roy Harvey: Yeah. So, we've been working on this technology for a number of years and what has made it so different lately is that we're making solid and firm progress. And so, we set up this six-year program. Essentially, the six-year program will end in 2024. It is meant to reach commercializable volumes and scale so that we can actually either choose to start to implement this in our fleet or actually start to commercialize it out into the broader marketplace. Those decisions are still to be made.

The good news is that as you see the announcements coming out about this new development facility that we have, the next phase of technology, what that indicates is that we're making progress and that we're able to tick off each of those different stage gates. And so, I have to say I'm really quite pleased with the progress there. It is an R&D project, so it still needs a lot of effort.

When it comes to what it's going to look like as a technology outside, the interesting thing is that we tried to build this without making the assumption that there would be a distinct premium for low-carbon aluminum. So, we've driven for a 15% operating cost reduction, which essentially is not having the need to constantly change over your anodes. And we've also tried to be 15% lower capital intensity by driving more productivity out of the cells.

So, for us, we've always been pointing on having a scalable, commercializable, financially solvent project no matter what. What adds the icing on the cake and what could make this truly an amazing project outside of what I've already talked about is the fact that if you can drive that differentiated premium again on the lowest carbon aluminum in the planet, that's what then creates the rush for people either to retrofit this or for the partners in this particular project to actually retrofit our own technology, our own plants, or actually start to build greenfields.

David Gagliano: All right. Interesting. So just switching gears for a minute to capital allocation. I think the targeted minimum cash balance remains $1 billion. And I think as of the end of the fourth quarter, the cash balance was $1.6 billion, we've had a nice recovery in pricing here. What should investors expect in terms of capital returns moving forward?

Roy Harvey: Yeah. We've tried to be pretty consistent and have a very clear and transparent capital allocation program and framework. And essentially, we took on added debt in the middle of the crisis to be sure that we'd have the liquidity necessary in case we didn't see the recovery that we did, but also to be able to pay back our 2024 set of debt issuances. So, that was pretty much [indiscernible] it's one of the reasons that we come out of the year with extra cash sitting on the books.

We have a set number of sustaining capital and small return seeking capital expenditures that we always look to provide cash for first. And we've already talked about that program in our last quarterly earnings announcement for 2021. And then, going forward, we really have four separate uses of the excess cash over the $1 billion. And these are not meant to be in order of importance, but rather are meant just to demonstrate that we will be managing between these four things.

First is our adjusted net debt target. Of course, the 2024s are a part of that, but also looking to our unfunded pension liability. Number two, to ensure that we can return cash to our stockholders at the appropriate time, and we started a program a few years ago and still have some of that program remaining open. We have work to do in order to continue our portfolio review, our portfolio transformation. As you can imagine, that becomes less cash dependent if you can have divestitures instead of curtailments, if that is the decision for one or more of these assets.

And then finally and the fourth is investing in larger, value-creating growth projects. And so, we'll balance between these four. It is a little bit dependent on market. With pricing environments like we see today, it certainly sponsors some good discussions inside of our Alcoa management team and inside of our board of directors on how we'll choose to manage that excess cash.

David Gagliano: Okay. And then, my somewhat related question, as you assess that fourth piece, what are the opportunities that you see or the best opportunities, I should say, that you see for growth for Alcoa over the next, say, three to five years through the supply chain?

Roy Harvey: Yeah. And so, we try and take a pretty agnostic view to the cycle and try and understand what does the middle of that cycle look like over these next few years. But, of course, where you find yourself is critically important to see how you can drive those returns.

So, when we look across our three businesses and start in Bauxite, we have expansion opportunities in a number of different areas. Juruti in Brazil is a great example where we could choose to scale up production pretty quickly and have many years' worth of high-quality reserves. At the same time, I would argue that the bauxite supply and particularly because of all the new growth coming in Guinea is a place where we're cautious and would look to make sure that we can drive the returns that are necessary before we invested more money in Bauxite, outside of smaller projects that we would do.

In Alumina, we have a series of medium-sized creep projects. So, important to us, important particularly to our Western Australian and Brazilian refineries as well. They are a good amount of extra production that can be brought online. They compete with new greenfields that would also be coming online. At the moment, we have them on hold. But obviously, as we watch the developments in this market, those are items that the engineering has already, for the most part, done and we could choose to move forward on. And again, these are creep debottlenecking-type projects, not sort of that next line of digesters.

But, of course, then we have the larger projects that we could consider, again depending on the market.

In Aluminum, and again with this changeover in portfolio, we're very focused on driving the improvements that we've already put into place. We have creep opportunities in places like Canada, where we have a very long-term and very stable pricing mechanism. So, we'll continue on those creep projects. We'll continue to drive some organic growth inside of our portfolio, and of course, continue to monitor the market to see whether we can solve the capital cost problem. And then, when ELYSIS™ becomes ready for use, we'll start making the decision about whether we do some retrofits or greenfields or simply commercialize the technology.

David Gagliano: Okay. That's helpful. As you think about the three main buckets of bauxite, alumina, and primary, you touched on primary supply/demand balances in your prepared remarks. What's your view on the outlook for bauxite and alumina supply/demand balances?

Roy Harvey: Yeah. Let's start from the beginning and then work my way down. From a bauxite perspective, I think there's been no shortage of supply. I think we continue to see really strong demand inside of China. In fact, are continuing to see that move to coastal refineries and a switchover from domestic bauxite into imported supply. However, there's plenty of material coming from Guinea and from Australia, of course, and Indonesia. So, we see it as a market that continues to have a surplus, but a surplus that is being absorbed by China in order to fill their pipelines and to make sure that they can confront any short-term disruptions that might happen.

On the alumina side, it's a market that stays very much in balance. It's a market where the Chinese tend to – as the marginal producers, they tend to ramp up or ramp down capacity depending on what's happening in the pricing environment. To me, it will continue to be balanced because you really can't build up inventories outside of silos and vessels that you can in aluminum.

And in aluminum, I addressed that briefly. I think we're still in a small surplus situation right now, but one where such strong demand coming back online and again, where we're seeing supply remain disciplined is a situation that can change very quickly. And I think we're seeing that represented in the pricing environment that we're experiencing now.

David Gagliano: Excellent. Well, great. I know we're bumping up against our time limit here, but I'm just going to end it with one question I've been asking each presenter this morning. When we host this conference down in Hollywood three years from now, what do you think the primary topics will be that we'll be discussing for Alcoa and for the industry?

Roy Harvey: That's a fun one, Dave, because it lines up with what we had put down, was a three- to five-year program of portfolio transformation. So, come three years from now, which will be four-and-a-half years from the start of that program, we should be either nearly complete or completed with all the work that we've been doing in order to transform this company. And so, we're already starting to think what comes next, what comes after we do this portfolio transformation where we have a company that has solved its debt issues, its liquidity issues, and in the end, is in the midst of what could be a very strong aluminum business because of all the characteristics I talked about in my prepared remarks.

So I think, it will represent a lot of strength. I think there's a lot of story yet to come, but there's work to be done in the meantime. And to be quite honest, I enjoy the work of making this company stronger each and every day.

David Gagliano: Excellent. With that, thank you very much. Appreciate you taking the time and hopefully, the rest of the meetings go well for you. Thanks again.

Roy Harvey: Great. Thanks, Dave. Appreciate it everybody.