



Final Transcript

CENTURY ALUMINUM COMPANY: 2nd Quarter 2019 Earnings

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SPEAKERS

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ANALYSTS

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Paretosh Misra – Berenberg Bank

John Tumazos – Very Independent Research

David Gagliano – BMO Capital Markets

PRESENTATION

Moderator Ladies and gentlemen, thank you for standing by, and welcome to the Second Quarter 2019 Earnings conference call. At this time, all participants are in a listen-only. Later, we will conduct a question and answer period. Instructions will be given at that time. [Operator instructions]. Also, today's conference call is being recorded.

I would now like to turn the conference over to your host, Shelly Harrison.

Please go ahead.

S. Harrison

Thank you, Anna. Good afternoon, everyone, and welcome to the conference call. I'm joined today by Mike Bless, Century's President and Chief Executive Officer; and Craig Conti, Executive Vice President and Chief Financial Officer. Pete Trpkovski is enjoying some much-deserved time off with his brand-new baby boy, who was born last Friday, and we look forward to having him back with us later this month.

As a reminder, today's presentation is available on our website, www.centuryaluminum.com. We use our website as a means of disclosing material information about the company and for complying with Regulation FD.

Turning to slide 1, please take a moment to review the cautionary statement shown here with respect to forward-looking statements and non-GAAP financial measures as contained in today's discussion.

With that, I'll hand the call over to Mike.

M. Bless

Thanks a lot, Shelly, and thanks, as usual, thank you to all of you for joining us this afternoon. If we could turn to slide 3, please, I'll give you a quick rundown of the last couple of months. I think it goes without saying that we continue to operate in a pretty complex and a dynamic environment in this sector, and of course, on a more macro level. In that respect, we find it difficult to say exactly where we are in the cycle with so many obvious cross currents at play.

That said, we think it's worthwhile to reflect on where we are from a fundamental standpoint. Craig will give you some detail in just a couple of minutes, as usual. Let me just make a couple of points to put the rest of my comments into context.

The primary aluminum market was in deficit in the second quarter, and this will continue into the second half of this year. That's forecast to produce a deficit for the entire year, both in China and in the rest of the world. Total global deficit is still expected to come in, in the range of one to one and a half million tons, that's globally for all of 2019. Stocks around the world continue to fall, both in warehouse and otherwise, and

they currently sit at levels generally considered to indicate real tightness in supply.

The balanced forecasts are underpinned by only modest consumption growth expectations. The consensus has China, for example, growing at less than 2% for the full year with the rest of the world essentially flat. So our conclusion is the balance of risk to the deficit appears to be still for the upside if global growth is better than basically flat line 2019 versus '18. It goes without saying, the next couple of months will be telling in terms of the various developments that can move the needle either way. The two most obvious ones being trade relations and global monetary policy.

Just a couple of quick comments on developments in the trade environment since we spoke with you in late April. As you're all very well aware, the US, Canada and Mexico reached an accommodation on the metal tariffs in mid-May. As we said at the time, we think the structure is well thought out, and we'll continue to support the remedy that's been in place since early 2018. As you've no doubt read, the agreement stipulates that imports to the US should not exceed historical levels. We believe all market participants understand that the Department of Commerce will closely monitor both the leading and real-time data, and

we're convinced the administration means what it says, that aggressive action will be taken quickly if this accommodation is abused.

Moving on, as expected, we've seen meaningful developments in alumina. Market participants, we believe, at this point, have digested the plan for the Alunorte plant in Brazil to ramp up production meaningfully. And of course, the plant has not even yet to take it up to full capacity.

Other supply developments around the globe are proceeding on pace. And as expected, the price has fallen reasonably precipitously. We see daily evidence the market is really well supplied, especially in the Atlantic Basin, and this should be exacerbated with further expected supply developments that will come online in the back half of this year.

The price is now close to what we believe to be the long-term fair value. The index price currently sits at \$303 a metric ton, and that represents just slightly over 17% of the spot metal price. It's not a certainty, but we continue to believe the price could very well fall below the long-term fair value range for a reasonable period of time until demand can grow into the new supply reality.

Turning to operations, I'll give you some detail by facility in a few minutes, but let me just make a couple of quick comments here. Our plants are largely stable. We're really proud of the teams, especially in the US, where we've got, obviously, some real heat in the southeastern part of this country over the last month, and a lot of activity at each of our plants. They've done a fantastic job.

As a reminder, Hawesville has three newly rebuilt potlines operating. The line we took down towards the end of the first quarter is currently in the process of being rebuilt. That process is on schedule. As a reminder, our plan is to begin bringing those cells back online in January and to have that line fully up and running by the end of the first quarter. The last potline to be continuously operating, so this is the last line that we haven't yet rebuilt, it's still limping along.

As we told you in April, we intend to run as much of that line as possible until late this year. The cells remain fragile, that goes without saying. They're way past their economic expiry date, I guess, I can say, and they continue to fail as expected. At this point, we remain confident we can keep a chunk of that line going for most of the remainder of the year.

And we intend, again, this is all part of the original plan we gave you a year and a half ago, when the line that's currently rebuilt is back up and running, we intend to take this last line down and rebuild it as well.

Given the age of the cells, there is a risk to the downside here. We do remain exposed given, again, their fragility to exogenous events like, for example, the degradation in raw material quality. We've already seen some examples of that this year. I'll give you some more detail in just a couple of minutes.

Moving on, we reached an agreement during the quarter to sell our 40% interest in our anode plant in Guangxi province. We sold it to our partner who is a major shareowner. Craig will take you through the economics and the cash proceeds we've received thus far and expect to receive.

For those of you who have been following the company for some time, you'll recall that our initial investment helped fund the construction of that plant in the late part of the last decade. BHH, as the company is called, has been a really consistent, high-quality supplier and a very good partner of ours, and we intend to continue to buy from them to supply what will be a very small short position at Grundartangi in anodes going forward.

The rationale for the divestiture is straightforward, and that's completion of the rebuild of the second big furnace at our anode plant in the Netherlands. We obviously own that plant 100%. As a reminder, we bought that plant out of bankruptcy early this decade. We immediately rebuilt one of the two baking furnaces there and have by design been operating the second one to the end of its life. We took that one down a couple of months ago.

Now with that rebuilt, the project finished a couple of weeks ahead of schedule and on budget. So now we've essentially got a new anode plant with best-in-class efficiencies, cost structure and environmental systems. And as I said, we can now supply the vast majority of Grundartangi's requirements. And importantly, that's at a landed cash production cost below that of supply from China. And one more time, as I said, we'll continue to buy the couple of tons that we need every year for Grundartangi from that plant in China from BHH.

And with that, I'll give you over to Craig to take you through a view of the industry.

C. Conti

Thanks, Mike. Let's turn to slide 4, and I'll take you through the current state of the aluminum market. Globally, aluminum inventories have been steadily declining, as we can see in the upper left of the slide. On a year-to-date basis, inventories are approximately 60 days of consumption, which is the lowest level in over a decade.

Looking forward, for the full-year 2019 on the lower left of the slide, we continue to expect a supply deficit of over one million tons globally. The structural aluminum supply deficit should result in the continued destocking of inventories and drive higher LME prices over the long term.

Moving to the upper right, the cash LME price averaged \$1,793 per ton in Q2, which reflects a 4% decrease from Q1. Aluminum prices have averaged \$1,821 per ton so far in 2019 and are currently sitting around \$1,757 per ton.

Regional premiums averaged approximately \$0.189 per pound in Q2 for the US, down 2% quarter-over-quarter and \$146 per ton in Europe, an increase of about 11% from prior quarter. Spot premiums are around \$0.175 per pound in the US and \$150 per ton in Europe.

Finally, as Mike mentioned earlier, alumina prices have been in decline, driven partially by the restart of the Alunorte refinery in Brazil and also by the ramp up of new capacity in various other locations. The current spot price of \$303 per ton is less than half of the peak pricing levels we experienced in 2018.

With that, I'll hand it back to Mike.

M. Bless

Thanks, Craig. If we can turn now, please, to page 5, I'll give you a couple of quick comments on the operations before I hand you back to Craig. He'll, obviously, take you through the financials for the quarter.

As I said before, we had a generally very good quarter in the plants, and that includes in safety performance. As we said for the last year and a half, we've been really pleased and proud of the safety environment that the folks have produced and maintained at Hawesville, especially that's true, given the complexity of the restart process. This quarter, we did have a couple incidents at Hawesville. None were very serious, but that really isn't the point. We're always looking at potential forward-looking indicators.

And in that respect, we've redoubled our oversight at Hawesville and put some very experienced personnel in the potlines, and they're watching the situation there very closely. Safety environment at the other plants remains quite good.

As you see, production, moving on, was essentially flat at Hawesville. There's a bunch of cross currents there. Let me just give them to you one more time. So again, you can have another view of the situation at Hawesville.

So as you remember, the last of those three potlines that we've rebuilt thus far came online a couple of months ago towards the end of the first quarter. So obviously, that gives you incremental production growth Q2 over Q1.

As I said again, that fourth line, one of the two potlines that was continuously producing, we took that down around the same time. So that went the other way, of course, Q2 over Q1. You were missing those tons. And then again, lastly, that last line that's yet to be rebuilt last year continues to lose cells on a predicted basis slowly. So obviously, that will

continue to drag down production at Hawesville, as planned, quarter-over-quarter yet this year.

Sebree is down very slightly on a per day basis. That's been corrected.

That was entirely due to alumina quality supply issues that we experienced in the first and more so in the second quarter. Hawesville shares that same supplier, and we believe now that supplier has now resolved that issue.

The alumina we're receiving now is back on good spec.

As you can see, Mt. Holly and Grundartangi's stable and flat production.

Production efficiencies and metrics across the plants was good; Sebree up just slightly, gain, that's due to the alumina quality problems. The other plants, nice and stable.

Controllable costs in very good shape. Hawesville, as you see up there, that was solely due to a large nonrecurring engineering project relating to the high-voltage electrical system, obviously. And at the other plants, controllable cost is flat to down sequentially. So again, very pleased with the operations performance during the quarter.

And with that, I will hand you over back to Craig.

C. Conti

Okay. Let's turn to slide 6, and I'll take you through the high-level results for the second quarter. On a consolidated basis, global shipments were down 1% quarter-over-quarter, largely driven by timing of deliveries. Realized prices were down 3% as a result of lower lagged LME prices.

Looking at operating results, adjusted EBITDA was \$12 million this quarter, and we had an adjusted net loss of \$16 million or \$0.17 per share. In Q2, the primary adjusting items were \$2.8 million related to the Sebree equipment failure and \$4.3 million related to the sale of our stake in BHH. Adjusting items this quarter also include a \$9 million charge for net realizable value of inventory adjustments and a \$6.2 million unrealized gain on derivatives, both of which were primarily driven by lower LME prices versus prior quarter.

Let me give you a little detail on the Sebree and BHH adjustments. As a reminder, we expect to fully recover all associated losses from the Q2 2018 Sebree line outage from our insurance policies net of our \$7 million deductible. As we mentioned last quarter, we will continue to call out the associated P&L impacts and cash receipts as they occur. In Q2, we received \$2.8 million worth of proceeds on our insurance claim, bringing

our total recovery to date to \$15.2 million. We expect to receive the balance of the claim proceeds in the coming months.

As Mike mentioned earlier, we reached an agreement to sell our 40% stake in an anode manufacturing facility, BHH, located in Guangxi province in China. During Q2, we received the first installment payment of \$10 million against our \$20 million sales price. And, we will receive a similar installment payment during the fourth quarter of this year for the balance. The \$4.3 million Q2 item is a one-time, non-cash charge to adjust the carrying value of the BHH investment to the agreed sales price.

Our liquidity remains strong with \$202 million of funds available via a mix of cash on hand and revolving credit facilities. During Q2, our cash balance increased by \$4 million. I'll give you some more detail on the cash rate shortly.

Availability under our revolving credit facilities remains robust at \$177 million. While we did have an outstanding balance at the close of Q2, our credit facility was fully repaid during the month of July and remains undrawn at present.

Let's go to slide 7, and I can walk you through our quarter-to-quarter bridge of adjusted EBITDA. The \$56 million increase versus Q1 adjusted EBITDA of negative \$44 million was largely driven by lower realized alumina prices, tempered by lower LME prices, as we forecast on our last call. On a realized basis, LME was down \$55 per ton, the US Midwest Premium was down \$8 per ton, and the European duty paid premium was up \$8 per ton, which in sum drove \$12 million of decreased EBITDA during the quarter. The Q2 realized alumina price of \$384 per ton was down \$128 per ton versus Q1, which resulted in about \$50 million of increased EBITDA during the quarter. Power prices, particularly in the US, were a benefit to sequential EBITDA of \$5 million versus Q1.

Looking ahead to Q3 specifically, the lagged LME is down about \$80 per ton and the lagged US Midwest Premium is down \$11 per ton, while the European delivery premiums are up \$15 per ton. We expect our realized alumina costs to be largely flat with Q2 with a realized value of approximately \$385 per ton. These items translate to a net decrease of approximately \$15 million in EBITDA from Q2 levels.

Let's turn to slide 8, and we'll take a quick look at cash flow. We started the quarter with \$22 million in cash and ended June with \$26 million.

During the quarter, we had \$11 million of capex spending, \$2 million of which was related to the ongoing Hawesville restart. We made our normal semiannual interest payment on our outstanding bonds of \$10 million, and we received \$13 million in proceeds during the quarter for the Sebree insurance claim and BHH sale, as mentioned earlier. Net borrowings were an inflow, up \$10 million, while an increase in working capital, largely driven by inventory timing, was an outflow of \$10 million during Q2.

To close out today's presentation, we'd like to have a short discussion on alumina and how its pricing impacts our business. As we have discussed in the past, the historical relationship of alumina to the LME price has averaged about 15% to 17%. Two unprecedented events in early 2018, the Alunorte curtailment and the Rusal sanctions, drove alumina to a historic high of \$700 per ton or about 32% of the LME price.

On May 20th of this year, the restart of the Alunorte refinery was announced and the price of alumina began to fall precipitously as we have been forecasting for some time now. The price has continued to fall in recent weeks as cargoes from the restart facility have begun to physically arrive in the marketplace. Fast forwarding to today, the spot price is \$303 per ton or about 17% of the LME spot price, which is roughly in line with

its historical average. It's important to know that the benefit of this reduction in alumina price will begin to favorably impact cash in the third quarter, however, due to the lag in pricing and usage, will not materially impact reported earnings until the fourth quarter of 2019 and beyond.

Finally, on page 9, we wanted to illustrate how the current spot price for alumina could impact our business. As we pointed out earlier, our Q2 adjusted EBITDA was \$12 million with a realized alumina price of \$384 per ton. Adjusting for the spot alumina price of \$303 per ton, with all else remaining constant, would increase EBITDA by \$29 million for a total of \$41 million. Please remember, this is an illustrative example using Q2 as a starting point. In short, recent spot pricing will benefit our P&L materially in the fourth quarter due to the lag nature of alumina pricing and consumption.

This concludes our prepared remarks. Thank you for your time and attention. I'd like to turn the call back over to Anna to begin the question-and-answer session. Anna?

Moderator

[Operator instructions]. There are no questions in queue, please continue.

I'm sorry. Please go ahead. I apologize.

We do have a question from Lucas Pipes with B. Riley FBR. Please go ahead.

L. Pipes

Hi, good afternoon, everyone, and thank you so much for taking my question. It just took me a moment there to hit star one, I apologize.

I wanted to follow up on that last point, where you kind of ran through the math with the changes in the alumina price. I was curious kind of if you were to think about the business on a mark-to-market basis. Obviously, it's been pretty volatile. So if you could maybe walk us through on a mark-to-market where you would see EBITDA, and then also translate that into free cash flow, not just right now, but maybe also for 2020. I would very much appreciate your perspective on that. Thank you.

M. Bless

Sure, Lucas, it's Mike. I mean, I assume when you mean mark-to-market, you simply mean to take the current results or I'm going to use the results that we just reported and run through current LME and alumina pricing. Is that where you're kind of heading with that question?

L. Pipes

Yes. That would be helpful.

M. Bless Sure. Okay. Let me give you that math, and it's important to note, again, with apologies for all the caveats.

What I'll do here is I'll give you what we just reported. You could run the same math. All you do is take the sensitivities that we've given you every quarter and update it, so they're in the back of the deck there, and just apply them to the quarter that we just reported and pick whatever pair of alumina and LME pricing you want.

If you wanted to use around the current price, what you would get from that, again, we just reported \$12 million or \$48 million on an annualized basis, if you were to just take Q2 and annualize it. Pretty simple math, 12 times 4. If you would "mark that to the market" in around \$1,760 metal and \$303 alumina, I'm interpolating now. Again, you can run this math yourself. You'd get a little bit somewhere between \$90 million and \$100 million of annualized EBITDA.

L. Pipes Got it. That's helpful. And then when you think about EBITDA to free cash flow conversion, could you give us an update on that, both as it relates to back half of this year and then also for 2020?

C. Conti Sure. I think if you look back to what we covered, Lucas, in February, you're going to see pretty much the same thing. We're going to have our normalized interest payment in the back half of this year. Our sustaining capex looks to be on plan for what we said. I would put that at about \$15 million for this year.

M. Bless Full year.

C. Conti So, \$15 million for a full year and \$15 million to \$20 million on an adjusted go forward. The swing continues to be the Hawesville restart. And if we look at the back half of this year, this number does move, as you could appreciate with the complexity of the project. It looks to be about \$40 million of spend in the back half of this year.

I wouldn't bring that yet forward to 2020; I'd probably want to do some more work. But those are the big items that will get you there.

M. Bless As Craig said, that's consistent with, A, Lucas, as you correctly pointed out, the estimates we gave you back in February; and then, B, updated by what we told you in April, when we told you we had made a decision to

rebuild the line that we're currently rebuilding, and the \$40 million cost of that rebuild process plus the associated capital projects in the anode rodding shop.

L. Pipes

Very helpful. Thank you for that color. And then my second question, kind of bigger picture on both LME aluminum and then alumina, can you share with us your thoughts on the pricing outlook for those two very important factors for your business? I would be curious what you're seeing in the market, what you're hearing, any supply response. One of your peers earlier this earnings season commented on the decline in the cost curve. I would appreciate your thoughts on both the LME and alumina as you look out and as you speak to your customers and suppliers. Thank you.

M. Bless

Sure. Sure. So alumina is the much easier one, as you would expect. It's a more tangible commodity at this point to count because you're really just counting—you're counting cargoes, you're counting availability.

And so as we said, we think the current prices is, in the current metal price environment, getting pretty close to fair value. It's been hovering around the \$300 level. It was a little bit below. It ticked up a couple of bucks. I

think it was last week, we think that was just having to do with some freight rates, but nothing fundamental in alumina, partly supply.

So we think that is, as we said, it's kind of found its level, but has some risk to the downside as more actual physical supply is brought on—new physical supply is brought online in the balance of the year. So that's alumina.

On metal, Lucas, I'm going to largely take a pass on that. I understand that I think the comment as it relates to cost pull, if you will, where it goes without saying, decreasing alumina prices lowers the global cost curve. That goes without saying.

The big issue there, of course, and this is why I'm going to take a pass, because we don't have a view on these kinds of real big global macro issues, is just the global economic outlook on the one hand and moves in monetary policy by the US, it goes without saying, the ECB and other monetary authorities. And that's one where our view, not wishing to be self-deprecating here, is no better than anyone else's on this telephone.

L. Pipes Got it. Okay. Well, very much appreciate your perspective and continued best of luck.

Moderator Our next question comes from Paretosh Misra from Berenberg. Please go ahead.

P. Misra Great. Thank you. Thank you for taking my question. So first one outside alumina and perhaps a couple of other variables, is your cost structure broadly in line with the expectations that you laid out in your February guidance for the second half of this year?

C. Conti A real short answer to that one. The short answer is yes there.

P. Misra Okay. Great. And then second, on the alumina side, how exactly are you buying alumina? If I remember correctly, it's sort of a blend of LME linked and API and maybe even from fixed-price contract for this year. So first of all, is that correct? And does it extend to—is it a similar mix next year also?

M. Bless This year is largely API, which you may be remembering as we did sign some contracts starting in 2020. So, we'll have more both LME

referenced and some fixed prices in there as well. But it's largely API-related this year.

Shelly, do you want to?

S. Harrison Yes. So it's between 10% to 20% as far as LME and the rest API.

M. Bless There you go. Thanks, Shelly.

P. Misra Got it. And just lastly, maybe a big picture one, on Midwest Premium, just curious how you're thinking about it for the second half of this year particularly on the—like what Section 232 duties are baked into that number, so how that plays out over the next six, nine months.

M. Bless Yes. Thank you. We think that we're very confident. The whole duty is baked into that number.

Perhaps you might be referring to, with apologies if this wasn't where you were intending to head, the recent small decrease in it, which we believe is almost wholly due to simply the fall in the LME price. As you know, it's a circular reference, it's the duty is charged on the LME plus the Midwest

so you have to calculate on the LME price itself. And so you can explain—and I mean, you don't have to explain, the fall of—90% plus of the fall is explained simply by the fall in the LME.

And so, we think it's well supported. There hasn't been a lot of transactional activity. If you look at the folks who actually publish that index, publish the Midwest Premium, it's been pretty quiet recently. So it's kind of strange in the certain respect it came down a little bit, but it really is based on the LME.

P. Misra Appreciate that. Thanks, guys.

Moderator Our next question comes from John Tumazos from John Tumazos Very. Please go ahead.

J. Tumazos Oh, thank you. Pareto asked my question about the Midwest Premium. Are you pleased that the Midwest Premium did not contract at all with Canada being exempted from the 232?

M. Bless Sure, John. Yes, of course, we're pleased. But I might say, answer, we're not surprised because as we said, we really do think the remedy—the deal

that was cut with the Canadians and Mexicans is an effective one. It maintains the regime. And if you read what sort of trades experts and others have said, that's the consistent opinion. And so, we weren't expecting it to fall just because we think they did a good deal.

J. Tumazos Thank you.

Moderator Our next question comes from David Gagliano from BMO. Please go ahead.

D. Gagliano Hi. Thanks for taking my question. One of the areas that we've—yes, I don't think it's been touched on, is the value-add premium. I remember way back when that was something that was talked about quite a bit at one point.

And I'm wondering if you can remind us again how much of your volumes are kind of exposed to higher-end premiums and what you're seeing there. We are hearing of weakness in value-add premiums. I just want to hear what you're seeing.

M. Bless

Sure. So if you go back, again, I'll send you back to the data that we put out in Feb., and that has total value-added tons. Now I'd caution you that some of those ton, not all of those tons are VAP as they would—sorry, value-added tons as they would garner, say, like a billet premium that you may be thinking of. Some of those are molten and some of those are high purity. So, it's not all subject to where I think you may be heading, which is probably billet premiums.

Obviously, you asked the question at an interesting time because the meetings—the commercial season it's kind of in the first or second inning here. And it'll be kind of in the sixth and seventh inning in the next 45 days or so. So we'll see what 2020 contracts look like.

In answer to your question and to echo your comments, the spot business over the last, call it, three to four months—and there is, as you know, in billets, there isn't a lot of spot business, certainly not in most of the vast majority of the markets in which we play, which are the high-premium 3,000, 2,000, 1,000 series markets. But in sort of the standard commodity grade, 6,000 series billets, it has been soft a little bit on the spot business, David, over the last couple of months.

But, you have to wait to see where the 2020 contracts shake out before you kind of have a real opinion on it. We'll answer the question in October. We'll have a much more informed view because we'll have been through all those negotiations.

D. Gagliano All right. And then just as a sort of the benchmark, I guess, can you just tell us what the—is there a way to give us just what an average billet premium is flowing through your results right now?

M. Bless No. No, we haven't, David, we haven't gone on that level. Because, again, most of our billet premium—and in fact, I was going to say we do very little. We do very, very little spot business.

Just because the US is so short and so much of our product is bespoke, is high-value and proprietary alloys that customers contract for on an annual basis, we don't see a lot of the vagaries of the volatility of change of that spot premium. In terms of where the market is, I wouldn't even want to get in trouble with our license for quoting it, the attorneys, although, I guess, we don't have one in the room. Yes, as we do, Jesse is here, will frown.

Platts [ph] and MD [ph] published them, so you can get a sense of where they are and where they've come over the last couple of months. And you'll see those data will echo the qualitative comments I just made.

D. Gagliano Okay. Great. Thanks very much.

Moderator [Operator instructions]. There are no further questions in queue. Please continue.

M. Bless Okay. Very good. Again, thanks, everybody, for joining us. We look forward to talking to you after what I'm sure will be an interesting next couple of months. Take care.

Moderator Ladies and gentlemen, that does conclude our conference for today.
Thank you for your participation and you may now disconnect.