

 **METALS & MINING**

19 January 2023

Constructive outlook despite uncertainty: Alcoa

- **Alcoa's Q4CY22 EBITDA miss vs. consensus highlights above-expected raw material cost pressure**
- **Management constructive on aluminium margin improvement in CY23 as demand picks up in a balanced market**
- **Read-across suggests pressure on margins for Indian players in H2FY23 but recovery from FY24**

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Alcoa reports a weak Q4: Alcoa's Q4CY22 adj. EBITDA of US\$ 29mn nosedived 86% QoQ, coming in 73% below consensus. As the decline in realisations was a known factor, the underperformance stemmed primarily from high raw material costs. While prices of pitch/coke used for making anodes in aluminum smelters rose 70%/30% YoY, caustic soda used in alumina refining was up 39% YoY. Alcoa sees signs of costs softening from early-CY23 and is also seeing a return of pricing power.

Near-term demand outlook positive: Alcoa remains positive on aluminium demand improvement in CY23, citing loosened Covid restrictions and stimulus measures in China, continuing demand strength in the US, and some pullback in uncertainty in Europe with the easing of power and natural gas costs.

Market to remain in balance and support margin recovery: The US aluminium major sees a limited (1mt) rise in China's capacity under the swap policy in CY23 and believes the industry remains intent on adhering to the self-imposed 45mt cap. Management highlighted the 2.5mt of production curtailments in China and anticipates further cuts in Europe as the operating environment remains difficult. Per Alcoa, 15-25% of European smelters were cash-negative at Dec'22 average prices. With the aluminium market already in a small deficit in China and the rest of the world in CY22, and record-low inventory (49 days vs. the 10Y average of 70), the physical market balance is tight.

Upbeat long-term view: Alcoa is positive on long-term demand fundamentals, pointing to strong offtake in transportation and packaging. The global EV market has clocked 7x growth over 2016-23 with China ramping up EV capacity to 6.9mn vehicles in CY22 and further to 9.0mn in CY23. Per management, packaging demand (aluminium cans) has also posted strong ~40% demand growth over 2016-23.

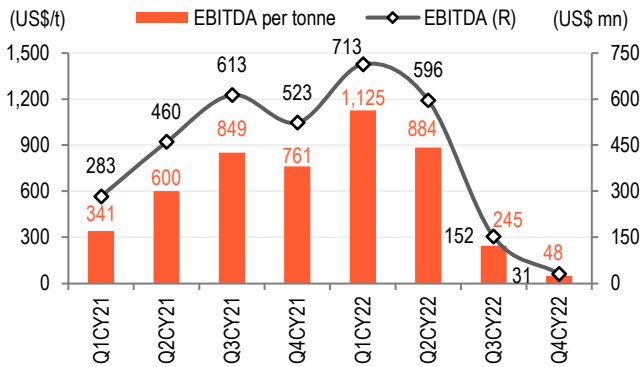
Read-across for Indian aluminium players: Alcoa's results point to weaker Q3FY23 margins for domestic aluminium players and the possibility of continued cost pressure in Q4 from expensive raw material inventory. However, margins could look up in FY24 aided by demand recovery and pullback in raw material costs.



Alcoa: Q4CY22 earnings highlights

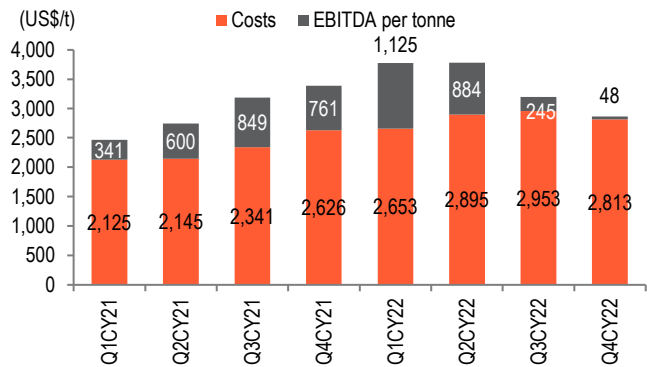
Alcoa reported Q4CY22 adj. EBITDA of US\$ 29mn, down 86% QoQ and 73% below consensus. The miss stemmed primarily from high raw material costs, with prices of pitch/coke soaring 70%/30% YoY and that of caustic soda up 39%. Alcoa expects costs to soften from early-CY23, aiding a return of pricing power.

Fig 1 – Aluminium EBITDA/t nosedived QoQ...



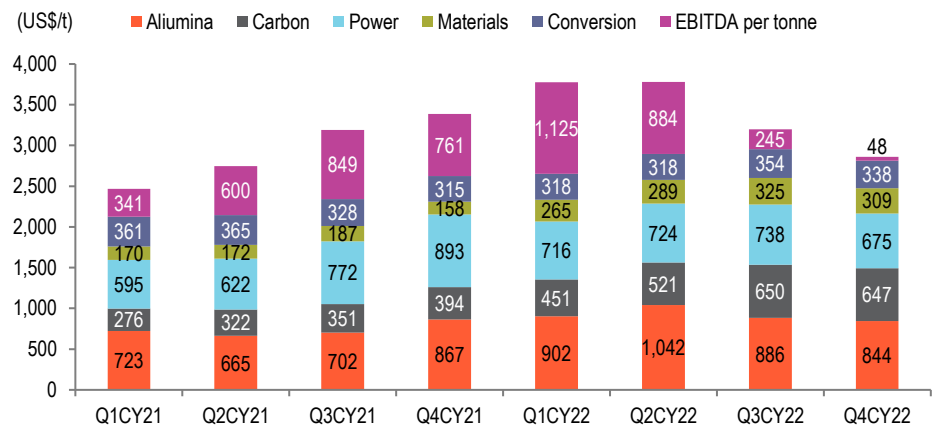
Source: Company, BOBCAPS Research

Fig 2 – ...due to lower realisations and higher raw material costs



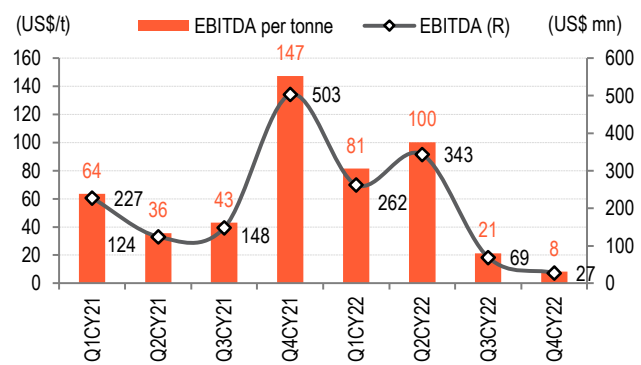
Source: Company, BOBCAPS Research

Fig 3 – Alcoa’s aluminium cost and profit breakup



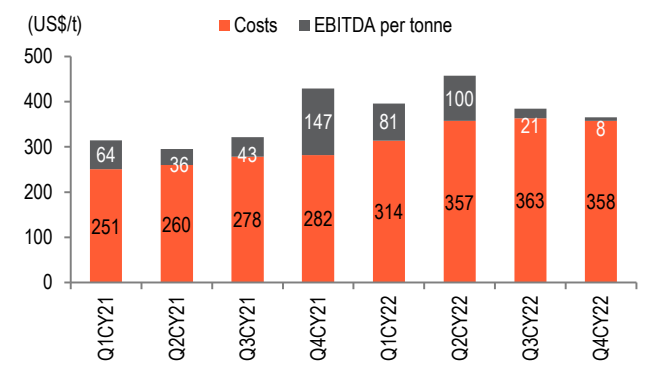
Source: Company, BOBCAPS Research

Fig 4 – Alcoa’s alumina EBITDA also plummeted...



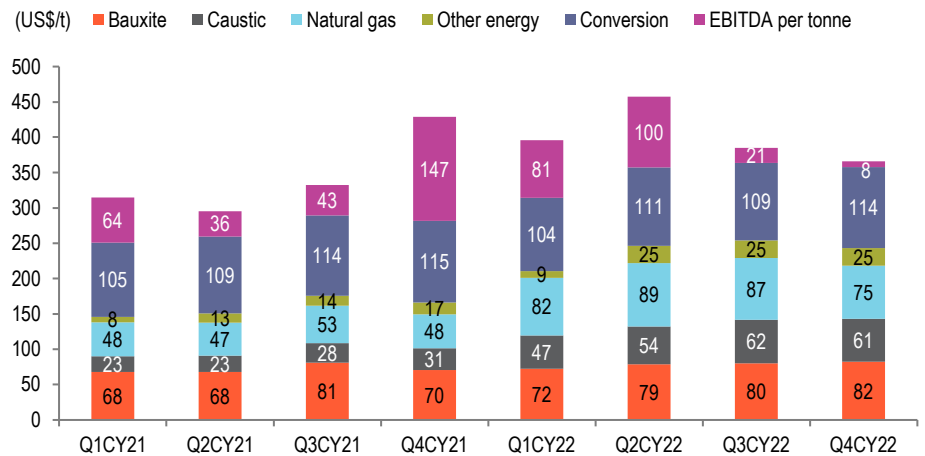
Source: Company, BOBCAPS Research

Fig 5 – ...driven by lower realisations and higher raw material and production costs



Source: Company, BOBCAPS Research

Fig 6 – Alcoa’s alumina cost breakup



Source: Company, BOBCAPS Research

Progress on zero-carbon initiatives

Alcoa’s low-carbon aluminium, Ecolum, has registered 4x volume growth in CY22, driven mostly by the European market, and has also started earning increased margins on deliveries. The company is also working on several breakthrough technologies as part of its zero-carbon initiatives:

- **Elysis technology for smelters:** Alcoa plans to (a) demonstrate commercial-sized 450kA cells for use in a carbon-free smelting process in CY23, (b) make a commercial package available for installation by end-CY24, and (c) operate its first commercial capacity in CY26.
- **Refinery of the future:** To decarbonise the alumina refining process, the company is developing mechanical vapour recompression (MVR) and electric calcination processes. Alcoa plans to pilot the MVR process with funding support from the Australian Renewable Energy Agency.
- **Astraea:** For recycling of post-consumer scrap, the company is planning a pilot demonstration of its ‘Astraea’ technology to convert scrap into high purity aluminium.
- **Green energy:** Alcoa has shifted to renewable sources for a bulk of the power requirements of its aluminium smelters.

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Note: Recommendation structure changed with effect from 21 June 2021

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