METALS & MINING

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Aluminium market thinly balanced: Alcoa

- **Alcoa's Q1CY23 EPS narrowly missed consensus; aluminium posted higher sequential improvement than alumina**
- **Aluminium market still thinly balanced even after cuts in Yunnan; demand pick-up in China, further Yunnan cuts and restarts key to watch**
- **Read-across suggests sequential improvement in aluminium margin for Indian players in Q4FY23; price volatility to increase**

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Sequential improvement in EBITDA: Alcoa (AA US, Not Rated) posted a Q1CY23 adj. EPS loss of US$ 0.21 vs. Zacks consensus estimate of US$ 0.05. More importantly, however, aluminium segment EBITDA soared ~US$ 258/t QoQ with a US$ 159/t improvement in realisation and a US$ 98/t decrease in costs. The alumina segment posted a softer US$ 19/t QoQ increase in EBITDA to US$ 35/t.

Near-term demand outlook mixed: AA indicated that improvement in automotive production is supporting flat products, but challenges in the building and construction segment persist given high interest rates. The company also noted improvement in premia. With global aluminium stocks at historical lows of 48 days, price recovery could be faster when demand normalises.

Aluminium market thinly balanced: Management anticipates only a small supply deficit in China even after a net 700kt production cut in Q1, as this will likely be offset by a slight surplus in rest of world (ROW) markets. Outside China, there was a net 20kt capacity cut in Q1. The risk of further cuts in Yunnan vs. restarts in Europe will determine market balance. Lower power cost has not yet resulted in restarts owing to slim margins for smelters. Also, the risk of LME dislocation has increased with Russian metal accounting for 53% of LME stocks (5% prior to the Ukraine war). Per AA, the alumina market is also balanced with a small deficit in China offset by a slight surplus in ROW.

Raw material deflation finally underway: Market indices of all three key raw materials – caustic soda for alumina (-17% from peak), and calcined petroleum coke (-16%) and coal tar pitch (-7%) for aluminium – have come off peaks. Given AA's inventory of 3-6 months, this could take 1-2 quarters to feed through the cost base.

Read-across for Indian aluminium players: AA's results support sequential improvement in Indian aluminium margins in Q4FY23 with higher realisation and lower energy costs. Margins for net long alumina sales may not improve yet though. With a thin balance market, price volatility could rise near term. Upside risks include stronger China demand and further cuts in Yunnan. Downside risks include slower demand recovery in China & the western world and the restart of European capacity.

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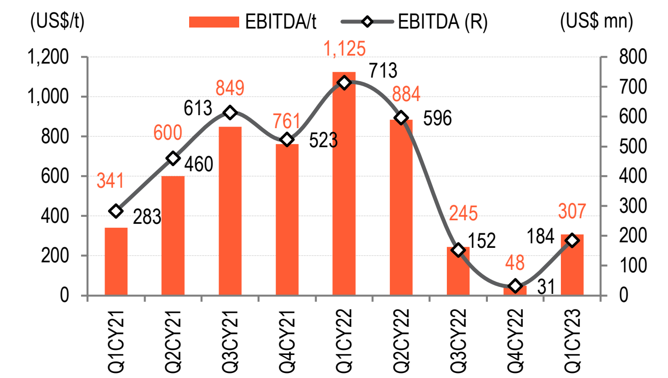
Alcoa: Q1CY23 earnings highlights

Marginal miss but sequential improvement

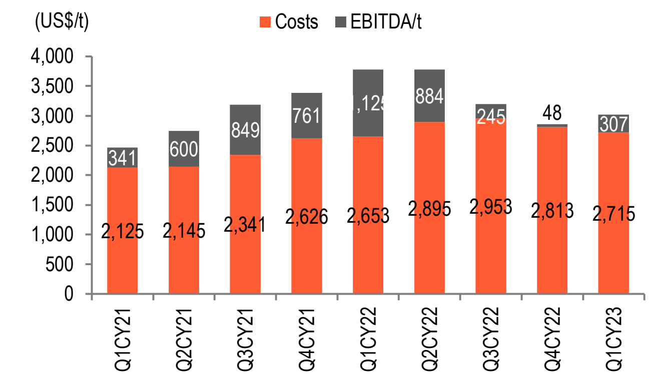
- AA's adj. EPS loss at US$ 0.21 was a slight miss vs. Zacks consensus of US$ 0.05 for Q1CY23.
- Sequentially, EBITDA improved from US$ 29mn in Q4CY22 to US$ 240mn in Q1CY23 as AA benefitted from an increase in realisations and a decline in raw material and energy costs. This was partially offset by higher production costs at two locations – the Alumar (Brazil) refinery and Portland (US) smelter.
- Aluminium segment EBITDA/t improved sharply from a low base of US$ 48/t in Q4 to US$ 307/t in Q1 and is now nearly half of CY22 levels. AA benefitted from a US$ 159/t improvement in realisation and a US$ 98/t decrease in costs.
- Alumina segment EBITDA/t doubled from a low base to US$ 35/t but was still ~75% below CY22 levels. The segment benefitted from stronger API (Alumina Price Index) pricing and a better product mix but was still burdened by high raw material costs and elevated costs of production at the Alumar refinery.

Fig 1 – Aluminium EBITDA/t improved sequentially…



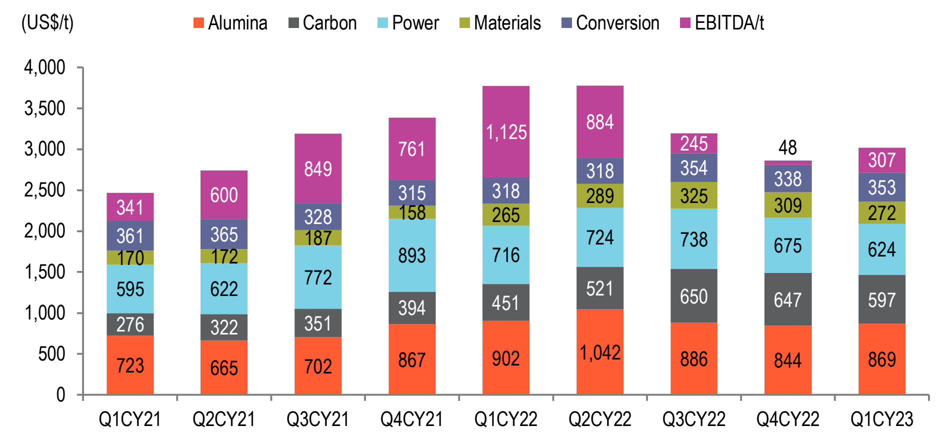
Source: Company, BOBCAPS Research

Fig 2 – …with higher realisations and lower raw material costs



Source: Company, BOBCAPS Research

Fig 3 – Aluminium cost and profit breakup



Source: Company, BOBCAPS Research

Fig 4 – AA's alumina EBITDA also improved from a low base but is still under pressure...

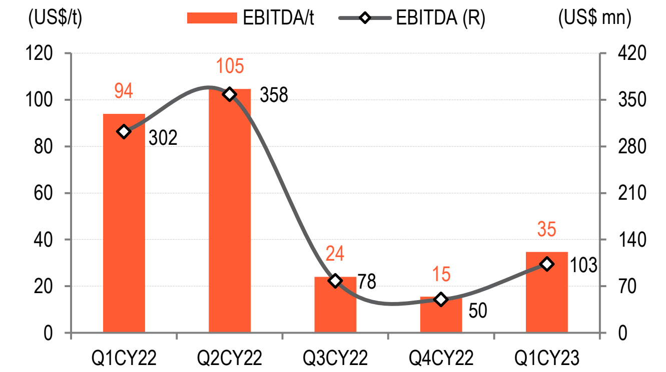


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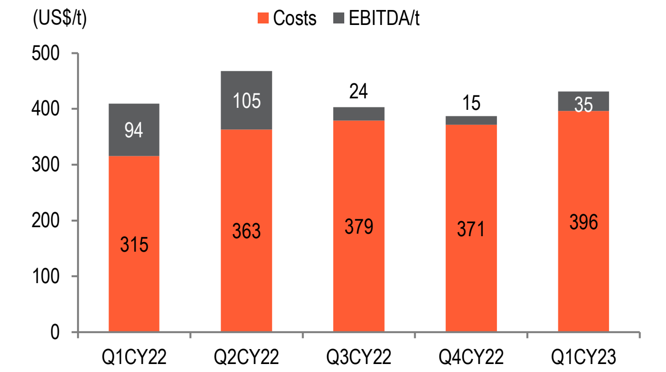
Fig 5 – …with higher raw material and production costs



Source: Company, BOBCAPS Research

Key operational developments

- AA's alumina sale volumes declined 9% QoQ in Q1, the result of a previously announced curtailment at its Kwinana refinery in Australia (due to delayed mining approvals for bauxite) and a short-term disruption at its Alumar refinery in Brazil. However, the company does not anticipate any changes to its annual alumina guidance.
- Smelter restarts for the company have been slower than guidance. The Alumar smelter has faced logistical challenges to arrange the right quality of material and has reached only 60% utilisation. Similarly, the San Ciprian smelter may also see a slow ramp-up over CY24-CY25 with the wind power plant facing delays in securing permits.
- AA had announced closure of the already shut-in Intalco smelter in the US in Mar'23.
- With the availability of reasonably priced power contracts, the Lista smelter in Norway has turned breakeven from a US$ 45mn loss in Q3CY22.
- AA flagged extended approval procedures for securing bauxite mining permits in Australia which is increasing mine development timelines.

Long-term positive outlook intact

- The International Aluminum Institute is forecasting an up to 80% increase in global aluminum demand by 2050 from a baseline of 2018. This would require the development of new primary and secondary capacity.
- Per management, long-term demand growth will be supported by the use of aluminium in electric vehicles, renewable energy and numerous other aluminum-intensive products that can help in decarbonisation goals.
- As copper price goes up, aluminium will benefit from substitution demand.
- AA expects longer term primary aluminium supply to be constrained given the limited number of new projects underway in Southeast Asia and the Middle East.

Green aluminium finding its feet

- AA's *Sustana* family of low-carbon products comprises *EcoSource* alumina, *EcoLum* aluminium, and *EcoDura* aluminium with recycled content.
- Management is guiding for a 30% YoY increase in sales of EcoLum (one-third carbon emission intensity) in CY23 after sales doubled in CY22 from a low base. The product still forms only a small proportion of overall sales.
- Low-carbon alumina brand EcoSource has also been extended to non-metallurgical grades on top of existing smelter grades.

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Note: Recommendation structure changed with effect from 21 June 2021

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