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Aluminium: Read-across from Alcoa results

- **Alcoa's Jan-Mar quarter EBITDA improved 36% QoQ in aluminium but declined 48% in alumina; guiding for a stronger Apr-Jun quarter**
- **Aluminium price supported near-term by supply disruptions, low inventory and high transportation cost despite slower demand growth outlook**
- **Alumina price easing with improved supply and a softer demand outlook following smelter cuts**

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In-line aluminium profits but alumina a miss: Alcoa's (AA US, Not Rated) Q1CY22 EBITDA growth of 19% QoQ was broadly in line with Bloomberg consensus estimates for the company (+3% vs. consensus) and for its aluminium segment (-2%), though it reported a sharp miss for its alumina segment (-19%). EBITDA per tonne improved by US$ 363/t QoQ (+48%) in aluminium but declined by US$ 66/t (-45%) in alumina. The aluminium segment benefitted as higher realisations and lower alumina prices offset the rise in other raw material cost. The alumina segment declined due to weaker realisations and higher input costs. Alcoa's working capital increased from 50 days (Sep'21) to 68 days (Mar'22) on higher prices.

Guides for a strong Apr-Jun'22: Management has guided for a QoQ increase in margins with higher prices to offset the impact of raw material and energy inflation.

Aluminium to see near-term support: Supply disruptions, low inventory levels and high transportation cost should support aluminium price near term. While Alcoa guides for lower demand growth of 2% for CY22 (down from 2-3%), it sees even higher supply disruptions, keeping the market tight. Russian supply faces the challenges of securing adequate alumina and difficulty in selling into Western markets. European supply has seen cuts in January/February due to higher energy prices. While Chinese aluminium production is increasing with smelter restarts, Alcoa believes that overall discipline remains intact.

Alumina price eased on better supply: Alumina demand has fallen due to global smelter aluminium cuts. Prices have eased somewhat with the restart of Chinese refineries and improved supply outside China as Australia redirects supply away from Russian markets (export ban), offsetting disruptions at Ukrainian refineries.

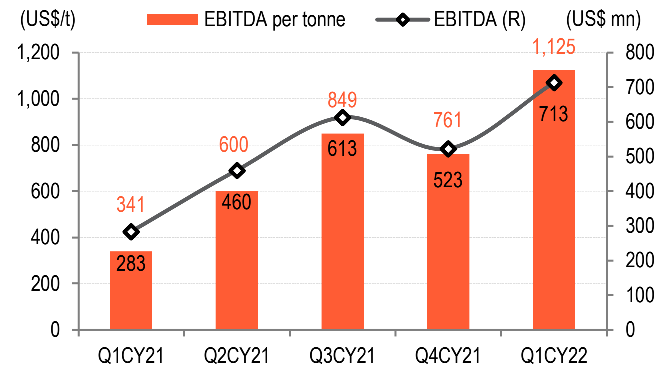
Near-term read-across for domestic players: Though the Indian industry will benefit from higher aluminium realisations, the benefit will be partly offset by higher coal cost due to exposure to e-auctions and imports. While players with long alumina positions (such as NALCO) will continue to benefit from above-average prices, alumina segment profit will likely ease QoQ owing to lower realisations and higher raw material costs.

Other takeaways

Aluminium EBITDA increased QoQ

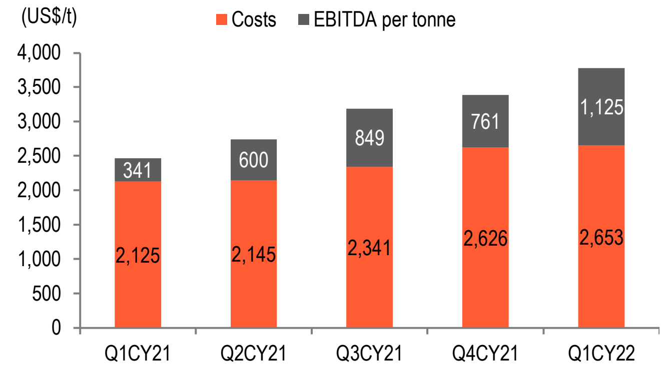
Alcoa's aluminium EBITDA grew 36% QoQ with higher realisations and lower alumina costs offsetting the rise in other raw material costs. Alumina segment EBITDA declined 48% QoQ with fewer shipments, decline in realisations and increase in cost of raw material (such as caustic soda).

Fig 1 – Aluminium EBITDA improved QoQ…



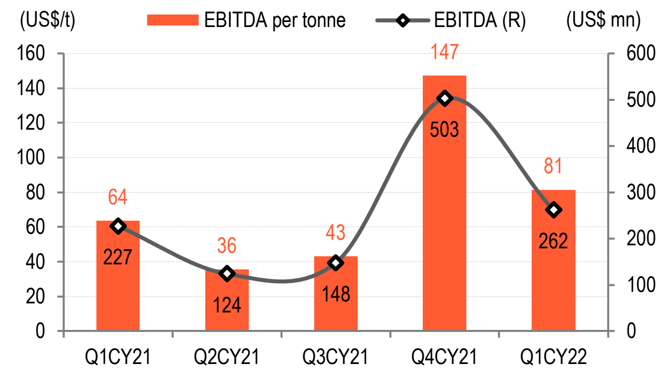
Source: Company, BOBCAPS Research

Fig 2 – …as higher realisations and lower alumina cost offset rise in other RM costs



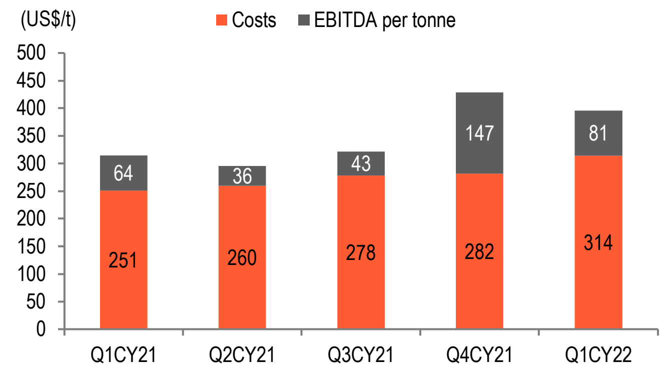
Source: Company, BOBCAPS Research | Note: Other raw material costs have increased due to increase in cost of petroleum coke and coal tar pitch

Fig 3 – Alumina EBITDA declined QoQ...



Source: Company, BOBCAPS Research

Fig 4 – ...with easing of alumina prices and increase in raw material cost



Source: Company, BOBCAPS Research

Alcoa stock down 4.6% post-market despite in-line EBITDA

We believe the stock weakness was partly driven by company-specific factors (such as lower sale volumes for aluminium, alumina and bauxite). Also, management's softer aluminium demand outlook for CY22 (2% growth from 2-3%) and Alcoa's weaker alumina profitability due to raw material inflation also weighed on the stock.

Portfolio developments

- Alumar refinery (2mtpa) restart has faced a setback of around a month, but Alcoa remains confident of achieving full operations by end-CY22.
- Of its portfolio of 3.0mt/13.8mt of smelting/refining capacity, the company is still reviewing 0.5mtpa/2.0mt for operational improvements, sale or closure. While these capacities are currently supported by higher price environments, Alcoa is reviewing them for long-term sustainability.

Progressing on zero-carbon technology initiatives

- To decarbonise smelters, Alcoa is targeting the first full-scale commercial application of its Elysis smelter technology within two years and aims to prove the efficacy over the next 5-10 years. The company believes that the Elysis technology will have 15% lower C1 operating costs than current smelting technology as well as the advantage of zero carbon costs.
- To decarbonise alumina refining, Alcoa has secured funding for two key initiatives – electric calcination and mechanical vapour recompression. Both technologies aim to use renewable power by displacing fossil fuel.

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