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Aluminium: Read-across from Alcoa results

Kirtan Mehta, CFA
research@bobcaps.in

- **Alcoa's aluminium commentary sets a positive tone; management continues to see market in deficit in CY22**
- **With aluminium price already dipping in the cost curve and costs starting to peak out, ground being set for margins to bottom out**
- **Miss on Q2CY22 aluminium EBITDA indicates above-expected costs, while beat on alumina suggests possibility of better realisations**

Aluminium market commentary positive: Despite economic uncertainty, Alcoa still expects positive demand growth and global deficit in the aluminium market in CY22. The company continues to have a full order book and is seeing strong premiums with healthy demand for value-added products. Its stock was up 3% in post-market trades, reflecting the positive commentary.

Aluminium price has already dipped in cost curve: Alcoa highlighted the support to aluminium price from the cost curve. While 10-20% of global smelters are underwater at the June-price level, half of the Chinese smelters are lossmaking at July prices.

Near-term prices volatile: While the impact of China stimulus and near-term economic growth are key demand uncertainties, exports from Russia and further energy-driven curtailments hold the key on the supply-side. In terms of supply, Russian aluminium production has continued to surpass expectations, indicating that the country is managing adequate imports of alumina.

Q2 aluminium miss vs. alumina beat: Alcoa's adj. EBITDA fell 15% QoQ primarily on lower metal prices in late-Q2CY22 and higher costs for raw materials, energy and production. While company EBITDA was in line, aluminium EBITDA missed consensus by 6% on higher costs whereas alumina was 8% ahead on better realisations.

Q3 guided to see further decline in EBITDA: Alcoa guides for a further sequential decline in EBITDA as higher costs of energy and raw materials in the aluminium and alumina segments will be only partially offset by an increase in shipments. Indian smelters may face a higher decline than Alcoa owing to higher linkages to coal.

Cost peak-out could lead to margin bottoming out: Management sees signs of costs peaking out, with a reduction in cost of alumina from Q3, caustic soda over Q2-Q3, and petroleum coke and pitch over Q3-Q4.

Structural story intact: Alcoa demonstrated its confidence in the cycle by announcing another US$ 500mn share buyback on top of US$ 350mn in H1CY22.

Other result takeaways

EBITDA marginally ahead of consensus

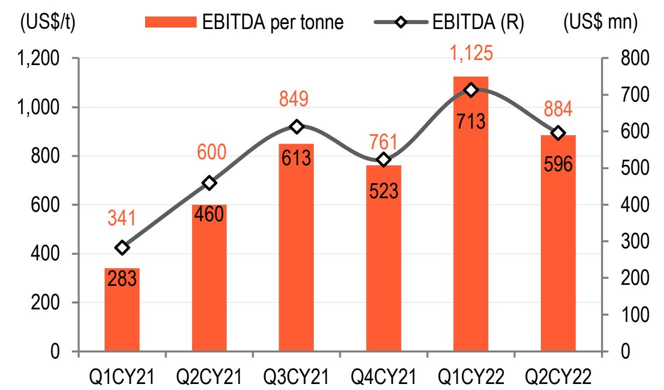
Alcoa's Q2CY22 adj. EBITDA at US$ 913mn was marginally ahead of consensus estimates of US$ 909mn. While aluminium EBITDA at US$ 596mn was 6% below consensus, alumina at US$ 343mn was 8% ahead. Overall, Q2 adj. EBITDA was down 15% sequentially primarily owing to lower metal prices in late-Q2 and higher costs for raw materials, energy and production.

Aluminium EBITDA underperforms

While Alcoa's aluminium EBITDA at US$ 596mn was 6% short of consensus, EBITDA/t at US$ 884 was 12% short. Segment EBITDA declined 16% QoQ as a 21% drop in unit profitability was only partially offset by a 6% rise in shipments. Aluminium realisation at US$ 3,864/t was flat QoQ with stronger regional premiums despite 7% lower metal prices. The decline in unit profitability was driven by a 9% QoQ rise in unit cost to US$ 2,895/t.

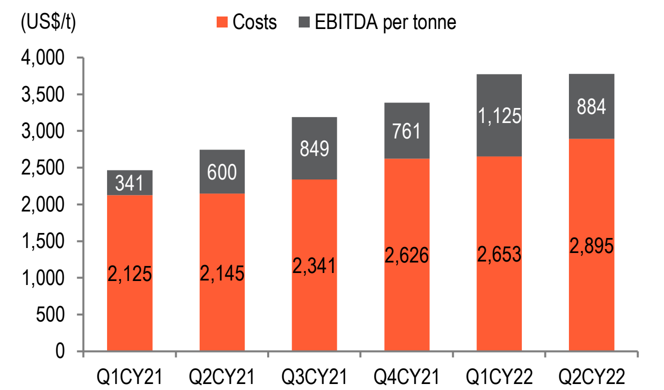
Alcoa maintains its CY22 aluminium output guidance at 2.5-2.6mt despite production curtailments and delayed restarts. In particular, ramp-up at the Alumar smelter in Brazil to 268ktpa is now delayed by one quarter to Q1CY23 (29ktpa energised till Q2). Further, the company has announced a 54kt curtailment at Warrick smelter in the US due to a shortage of workers.

Fig 1 – Aluminium EBITDA/t at US$ 884 was 12% below consensus…



Source: Company, BOBCAPS Research

Fig 2 – …implying a higher rise in costs



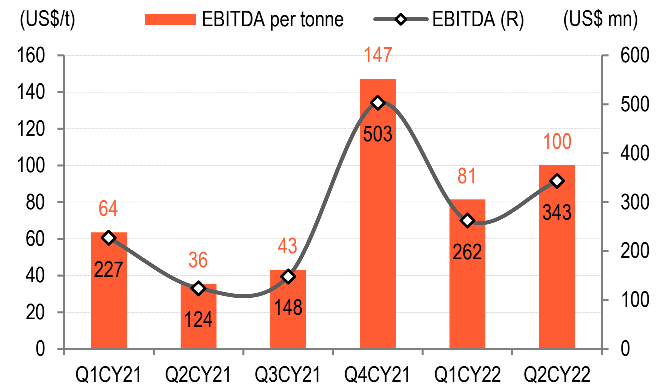
Source: Company, BOBCAPS Research

Alumina EBITDA above expectations

Alumina EBITDA at US$ 343mn was 8% ahead of consensus with unit profitability 9% ahead at US$ 100/t. Segment EBITDA increased 31% QoQ as an 18% rise in third-party realisations offset a 14% increase in cost of production.

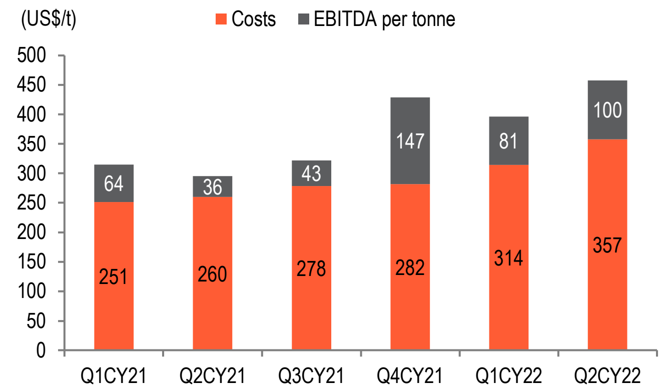
For Q3, management guidance implies an 8% QoQ (US$ 30mn) decline in EBITDA as sequential improvement in shipments offsets only a part of cost pressures. The company has cut its CY22 shipment guidance by 0.6mt to 13.6-13.8mt factoring in H1 weakness. It is also reducing 0.2mt of refinery production in Spain as it aims to lower 15% of the refining throughput at its 1.5mt Spanish refinery after a surge in natural gas cost from US$ 45/t in early CY21 to US$ 215/t in Q2.

Fig 3 – Alumina EBITDA/t at US$100/t was 9% above consensus...



Source: Company, BOBCAPS Research

Fig 4 – ...as higher alumina realisations offset increase in raw material cost



Source: Company, BOBCAPS Research

Portfolio developments

- Alcoa highlighted that its smelting portfolio has turned quite resilient to downturns as it has successfully linked 65% of its energy contracts with aluminium prices.
- On return-seeking growth investments, the company is focusing only on smaller projects to improve returns at existing sites. This quarter, it approved 14kt of smelter capacity addition at the 200kt Mosjoen smelter in Norway and additional casting capability at its smelter in Quebec, Canada, to produce standard ingots besides larger T-bar ingots.

Progress on zero-carbon initiatives to pose challenges for Indian smelters in medium term

- Aloca has been successful in reducing total scope 1 and 2 greenhouse gas emission intensity by 11% YoY in CY22 and by 23% from the CY15 baseline.
- Renewables sources contributed 81% of the electricity consumed by the company's smelters in CY21.
- Aloca sees growing demand for low-carbon aluminium at a premium in North America and European markets.
- The company is working on four breakthrough technologies for decarbonising. For smelters, it plans to demonstrate commercial-sized 450kA cells in CY23. For its refinery of the future, Alcoa has received funding from the Australian government for an electric calcination pilot. In post-consumer recycling, it is planning a pilot demonstration of 'Astraea' technology to convert scrap into high purity aluminium.

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Note: Recommendation structure changed with effect from 21 June 2021

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