

# **METALS & MINING**

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## Medium-term aluminium outlook strong, near-term soft: Alcoa

- Only a third of AA's 42% QoQ EBITDA decline in Q2CY23 attributable to market factors relevant to Indian companies
- Kirtan Mehta, CFA | Yash Thakur research@bobcaps.in
- Global aluminium market softened slightly in Q2 but remains in balance as weakness in supply offset slowing demand
- Indian players exposed to price decline during Q1FY24 but could see partial offset from lower coal cost

AA's Q2CY23 headline slump overstates the impact on markets: Alcoa (AA US, Not Rated) posted a US\$ 103mn drop in Q2CY23 adj. EBITDA (-42% QoQ). However, only a third of the decline (US\$ 35mn) was driven by factors relevant to Indian players. In this context, the impact of lower aluminium metal prices (US\$ 70mn) was partially offset by higher alumina API prices (US\$ 20mn) and lower raw material costs (US\$ 24mn). The remaining two-thirds of the decline stemmed from factors specific to AA such as lower bauxite grade at its Australian mines along with an unfavourable change in volume and price mix.

Aluminium markets have softened slightly: Demand for aluminium has weakened further in Europe and North America, but this was largely offset by softer supply, keeping aluminum markets balanced, per AA. Sluggish sales of billets and slabs reflect additional weakness in the construction and packaging segments. China's real estate downturn continues to have an impact on construction-led aluminium demand. Against this, the automotive and electrical grid markets are registering strong growth both in and outside China. On the supply front, some Yunnan supply is looking to return, but restarts outside China look challenging due to the high energy costs.

Raw material deflation to aid margins: Market indices of two key raw materials – caustic soda (-44% YoY) for alumina and calcined petroleum coke (-30% YoY) for aluminium – have finally corrected meaningfully in Q2, though coal tar pitch remains high. This improvement will start to percolate to the cost base from Q3CY23, a lag of 1-2 quarters as AA carries inventory of 3-6 months for these raw materials.

**AA** has a cautious stance for **FY24**: This is reflected in (a) a US\$ 60mn reduction in CY23 capex guidance by not refilling delayed project spends, and (b) sticking to dividend payouts rather than buybacks at this point in the cycle.

**Read-across for Indian players:** Indian aluminium players are also exposed to the aluminium price decline in the April-June quarter but could see a partial offset from reduction in coal cost. Hindalco's guidance on its last call, however, was for flat cost QoQ in view of entry into the monsoon quarter.





# Alcoa: Q2CY23 earnings highlights

## AA's headline EBITDA decline overstates impact of fall in metal prices

- Sequentially, AA's EBITDA declined from US\$ 240mn in Q1CY23 to US\$ 137mn in Q2CY23. While a third of this decline was attributable to lower market prices of aluminium partially offset by fall in raw materials, the balance stemmed from factors specific to AA that have no relevance as a read-across for Indian players.
- Aluminium segment EBITDA/t declined sharply by US\$ 130/t QoQ to US\$ 177/t driven largely by a US\$ 145/t drop in realisation and only partially countered by a US\$ 15/t decrease in costs.
- Alumina segment EBITDA/t was 90% below CY22 levels at US\$ 11/t, mainly due to higher bauxite cost for AA in Australia as delayed mine approval led to use of lower grade material. The segment benefitted from stronger API (Alumina Price Index) pricing and some reduction in raw material costs. More reduction is guided to follow in Q3.

Fig 1 - Aluminum EBITDA/t falls sequentially ...

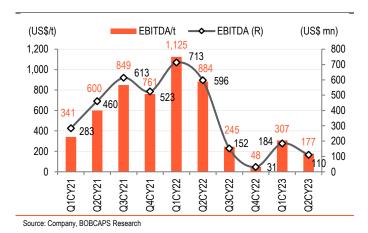
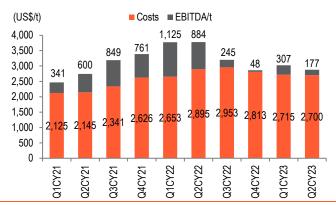
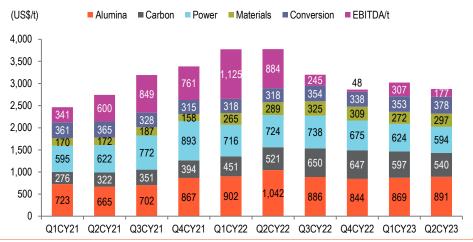


Fig 2 – ... as lower realisations is offset marginal cost decline



Source: Company, BOBCAPS Research

Fig 3 - Aluminium cost and profit breakup



Source: Company, BOBCAPS Research



Fig 4 – AA's alumina EBITDA declined ...

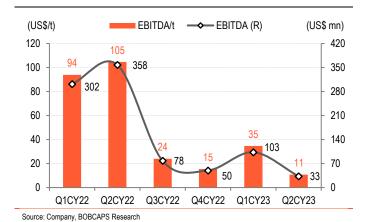
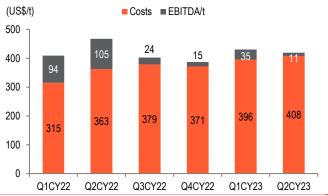


Fig 5 – ...as higher production costs offset benefit of higher API and lower raw materials



Source: Company, BOBCAPS Research

# Commentary on global markets

- The medium-term outlook for aluminium markets is positive as the return of supply could lag behind the return of demand. China's supply resumption faces questions over stability of hydroelectricity in the Yunnan and Sichuan provinces. Outside China, competitive renewable electricity contracts are not available for restarts at the current high energy prices.
- The long-term outlook for aluminium is strong with demand growth supported by (i) the use of aluminium as an energy transition metal, (ii) the capacity cap (of 45mt) restricting supply growth in China, and (iii) the availability of competitive renewable energy restricting new supply additions outside China.
- LME price discovery faces the risk of dislocation from physical contract prices. Aluminum metal of Russian origin now constitute as much as 80% of London Metal Exchange (LME) stocks. With these stocks self-sanctioned by several buyers, there is a risk that the LME may not represent a fair price of physical contracts excluding Russian metal. Of the balance 20% stocks in the LME, aluminium metal of Indian origin also have a large share.

## Sustainability initiatives

- Low-carbon aluminium is gaining traction in Europe and AA expects the sale of its EcoLum brand to reach 40% of its value-add production in the region. This product is also starting to find use in North America from European buyers operating there.
- Low-carbon aluminium is deriving a premium of US\$ 25-50/t at this stage.
- AA is moving forward on three projects for the production of low-carbon metal, viz. ELYSIS technology for smelters, its 'Refinery of the Future' initiative, and the ASTRAEA scrap purification process.
- The company is currently working to ramp up ELYSIS technology to commercial scale, including the development of larger smelting cells that would operate at 450kA at the end of an existing pot line in Quebec.
- AA currently offers low-carbon aluminium under the EcoLum brand, recycled content under the EcoDura brand, and low-carbon alumina under EcoSource.



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