Alcoa - The New Bauxite-Alumina Powerhouse

On 1 November, Alcoa split into two companies - Alcoa Corporation (upstream) and Arconic (downstream). This is the aluminium industry's largest demerger in many years and has a substantial impact on the markets for aluminium, raw materials and finished products.

CRU sees the new Alcoa Corporation (post-split Alcoa) as a strong commodity producer with adequate profitability at low commodity prices and substantial upside as commodity prices rebound over the next 5 years. There are also some growth opportunities. The key strategy is cost reduction and movement down the industry cost curves.

By contrast, CRU sees Arconic as a company exposed to expanding markets and propelled by technology and innovation. CRU forecasts major growth in 2017-2020, and beyond, in aerospace and aluminum penetration of autos.

The crown jewel of the new Alcoa Corporation, will be as the dominant producer of bauxite and alumina in the world. Alcoa is both the world's largest bauxite miner and largest alumina refiner. More importantly, an examination of segment profitability shows that Alcoa is largely a bauxite and alumina producer, accounting for a combined 62% of EBITDA and 73% of total segment profits on a pro-forma basis for 2015.

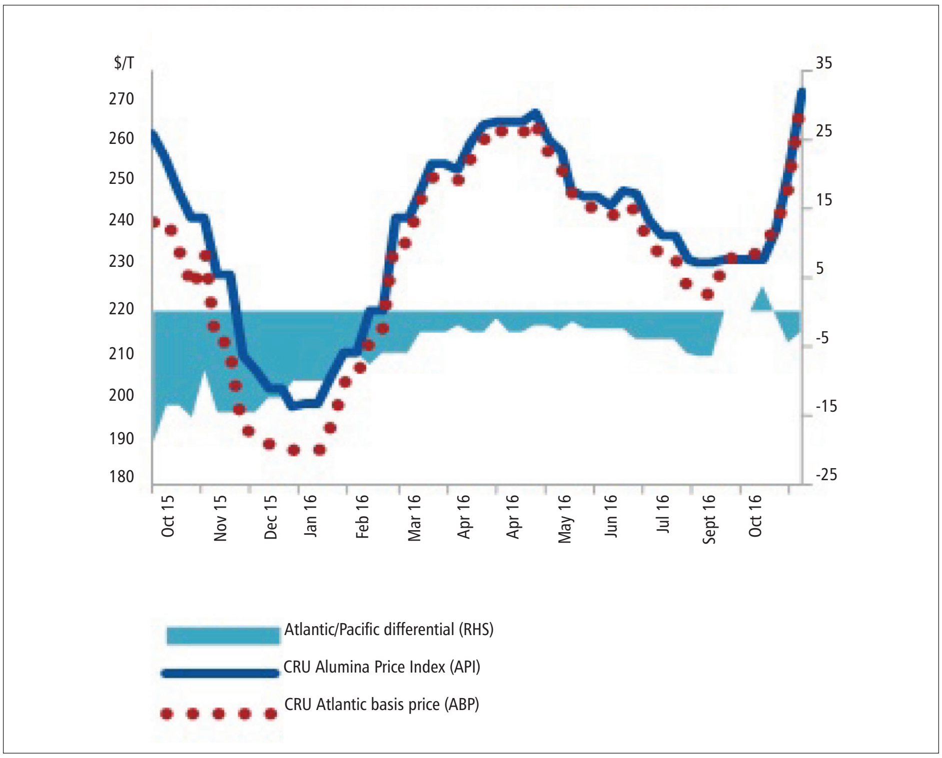
Raw materials: future belongs to low cost producers

Alcoa Corporation produced 45.3 million dry metric tonnes (dmt) of bauxite in 2015, enjoying a dominant first-quartile cost curve position. In addition to its low cost position in the industry, Alcoa has significant growth opportunities for third-party sales of bauxite from both Brazil and Western Australia. According to CRU, China will require massive imports of bauxite over the next 5 years, and using CRU's Bauxite Price Index for gibbsitic ore (BPI-G, China CIF) the competitive viability of Alcoa's bauxite export options can be assessed. In 2015, pro-forma EBITDA was $455 million while after-tax operating income (ATOI) was $258 million.

Alcoa is also the world's largest alumina producer, with a highly competitive first-quartile cost curve position (management places itself at the 17% mark on average). Higher margins have been achieved by shifting pricing away from the historical LME-based formula to index or spot pricing.

CRU projects an alumina price increase of over 33% over the next 4 years. Furthermore, Alcoa has also steadily increased its system-wide capacity over the past decade through a combination of operational improvements and incremental capacity projects, effectively adding capacity equivalent to a new refinery. This incremental capacity helps cost reduction through better fixed cost absorption on top of any operational improvements.

CRU projects a small deficit in the alumina market for both 2016 and 2017. This will be driven partly by smelter restarts and expansions in China. Projected deficits imply higher alumina prices as well. In 2015, Alcoa's alumina segment had revenue of $5.0 billion, third party sales of $3.3 billion, EBITDA of $910 million, and ATOI of $476 million. ■



CRU's API reaches 52 week high. Data: CRU bauxite and alumina monitor

Lloyd is a Senior Analyst in CRU's Aluminium team and is based in Pittsburgh. Prior to joining CRU, he held the position of Corporate Economist at Reynolds Metals Company for almost 20 years, as well as the position of Chairman of the Aluminum Association Statistics and Market Research Committee, before embarking on a career in the financial sector as a senior equity analyst in the aluminium and speciality metals space. This included positions at BB&T Capital Markets and Davenport & Company, LLC. Most recently he was at Northcoast Research covering aluminium, steel and speciality metals.

For more information on CRU's competitive analysis and outlook for the new Alcoa and Arconic companies, please contact sameer.virani@crugroup.com