Final Transcript

CENTURY ALUMINUM COMPANY: 2nd Quarter 2013 Earnings

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SPEAKERS

Peter Trpkovski - Investor Relations Manager
Mike Bless - President and Chief Executive Officer
Rick Dillon - Executive Vice President and Chief Financial Officer
Shelly Harrison - Senior Vice President, Finance and Treasurer

ANALYSTS

Jorge Beristain - Deutsche Bank
David Gagliano - BMO Capital Markets
John Tumazos - John Tumazos Very Independent Research

PRESENTATION

Moderator Ladies and gentlemen, thank you for standing by. Welcome to the Second Quarter 2016 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session; instructions will be given at that time. (Operator instructions.) As a reminder, this conference is being recorded.

I would now like to turn the conference over to our host, Mr. Peter Trpkovski. Please go ahead.

P. Trpkovski Thanks very much, Ernie. And good afternoon, everyone, and welcome to the conference call. Today's presentation is available on our website, www.centuryaluminum.com. We use our website as a means of disclosing material information about the company complying with Regulation FD.

I would like to remind you that today's discussion will contain forward-looking statements related to future events and expectations, including our expected future financial performance, results of operations and financial condition. These forward-looking statements involve important known and unknown risks and uncertainties, which could cause our actual results to differ materially from those expressed in our forward-looking statements. Please review the forward-looking statements disclosure in today's slides and press release for a full discussion of these risks and uncertainties.

In addition, we have included some non-GAAP financial measures in our discussion. Reconciliations to the most comparable GAAP financial measures can be found in the appendix to today's presentation and on our website.

And now, I'd like to introduce Mike Bless, Century's President and Chief Executive Officer.

M. Bless Thanks very much, Pete, and thanks to all of you for joining us this afternoon. If we could please turn to Slide 4 on your deck, I'll give you a quick summary of what we've been working on here over the last couple of months. First, during this period, we see market conditions and trends that have remained reasonably consistent. Shelly is going to give you an overview of the industry in just a moment. I'd like to just make a couple of comments to put my comment about the business into context.

Demand as we've seen in most major markets has remained generally stable, we've seen no major changes since we last spoke with you in April. The short-term spending by the Chinese government that's been aimed, as you've read, at simulating their general economic conditions, is coming to an end for sure. At the same time, we're seeing potential tiring in some end markets in developed regions. We think these could be just seasonal in nature, but obviously we are watching them very closely for any more structural trends.

On the supply side, production in China remained relatively stable during the first part of the year. This is exactly as was expected. That having been said, production has increased in each of the last several months and the market is still anticipating a significant build during the second half. This is from a combination of restarts and the addition of new capacity.

Bottom line, the first half of this year saw the largest deficit in the primary aluminum business that we've seen in some time. But this is expected to reverse significantly due to the coming production increases in China; we're expecting to see that over the coming months. Again, Shelly will give you some more detail on the market fundamentals and I'll also address the trade picture in just a few moments.

We had a very good quarter in the operations. As you'll recall, we took significant restructuring actions in our US operations in the back half of last year. Since then, we've been consistently on track with the cost structure, the financial performance and the cash flow targets we set for each of the facilities. All the plants have achieved their objectives and I'll discuss this in more detail in just a few minutes.

It goes without saying no one here is satisfied about the absolute level of profitability of the business at this time, but we're confident we can operate this company successfully in the current environment, can run the plants very tightly while maintaining the necessary investments in their future viability. At the same time, we've achieved the operational stability that's enabled us to produce a portfolio of value-added products that are required by our customers. And as Rick will detail, we've maintained a conservative balance sheet and very good liquidity.

Moving on, as you saw us announce a couple of weeks ago, we've now committed to a new purchase of competitive market power for our plant at Mt. Holly. This has a term of September 2016 through December 2017, so obviously it will pick up as soon as the current contract expires at the end of August. It's similar to the contract now in place and that is for 75% of the plant's power requirements. We do have the right to terminate it with 60 days' notice if we find ourselves needing to curtail the plant's operations. And as you know, this is the same right that we have in the contract for the remaining 25%.

Regrettably we've been unable to produce any changes in the current structure. That structure, as you know, requires us to purchase 25% of our power at Mt. Holly from the in-state power company. We remain absolutely convinced the facts support the various proposals that we made in South Carolina. Those would leave the local power company in the same or better position than if the plant were to shut, and those would have no other customer harm in any way. For some reason thus far, the facts have been unable to prevail. Requirement hasn't change one bit. We must achieve a different structure or the plant simply can't be viable over the longer term.

We think the path of least resistance here as for Mt. Holly to be allowed to buy 100% percent of its power from the free market, but we've made a range of other proposals and put forth a range of other options and we remain committed to work creatively to find a solution. We've talked to you about this before, but let me just remind you of the economics here, so you can get a sense of where we are. And you'll get a sense that it's only due to the competitive nature of these power markets that's allowed us to continue to operate Mt. Holly. This is despite the requirement that we have to pay two transmission fees to get the power all the way to the plant.

One fee is paid to an out-of-state transmission company to get the power from its source to the South Carolina state border and then of course the other fee is paid to the in-state power company to get the power from the state border all the way to the plant.

Even with this duplicative fee, if we were buying 100% of the power from the market what we're trying to achieve, the fully delivered cost of that power at the plant would put us at above the median on the global power cost curve for smelters, of course. The delivery cost of the in-state power as we've talked about before is double the delivery cost of the competitive market power literally 2x. And thus when you put those two together, 75% of the power coming from out-of-state from the competitive market and the 25% coming from in-state, the weighted average costs that we are bearing today puts the plant at the 78 percentile on the global power cost curve.

For this reason, we're forced to run the plant in a manner which is simply not sustainable for the long term. And so now it's easy for you to understand why this isn't a long-term solution, we need to change it. We'll continue to run Mt. Holly safely and efficiently, continue to produce their products that are in high demand by our customers in the US. Employees at this plant have done a tremendous job.

The quality of this workforce is a reminder every day of why this plant has always been considered one of the finest in North America, of course other than the power price. We are absolutely determined to find a way to achieve a power structure that works for the plant and that would also enable us to restart that second pot line and rehire the 300 folks with whom we very regrettably had to part company last December.

Lastly, the fair trade efforts on which we've been working for the better part of the year, we believe are reaching a decision point. We continue to be very confident. The facts and circumstances support a textbook illegal subsidies case in front of the WTO. As we've discussed before, the primary aluminum industry in China is massively subsidized both directly and indirectly in many different forms. It receives huge financial support ultimately from state-owned financial institutions, subsidies on power tariffs, free and subsidized land, and countless other measures.

The material damage of course to the US industry is evident. As you know, there is only a handful of smelters remaining in this country. Metal continues to pour into the US markets due to the huge amount of production in China, which without the illegal subsidization wouldn't be viable. So the situation is very clear and we and all the mainstream experts that have looked at the situation believe strongly that the facts are in arguable. The time is now acute, if no action is taken, we could easily find ourselves in a situation where it's too late in a very short period of time.

And with that, I'll ask Shelly to provide some more comments on the industry environment. Shelly?

S. Harrison Thank you, Mike. If we can move along to Slide 5 please, I'll provide some comments here on the industry environment. The cash LME price averaged $1,571 per ton in Q2. This reflects a 3.6% increase over Q1. Prices have been fairly volatile recently with spot reaching a high of $1,670 in this July, but then falling to the current price right around $1,600 per ton.

Regional premiums continue to show weakness in Q2. Premiums fell by about 10% quarter-over-quarter both in the US and in Europe. Today, the Midwest premium is $0.0675 per pound and the European duty paid premium is $118 per ton. For the first six months of 2016, the global aluminum market recorded a deficit of 0.5 million ton. This is the largest first half deficit in well over a decade.

But concerns about the increasing Chinese supply is building demand in the second half, continue to be an overhang on the aluminum market. Global primary production was up by just 1.5% in the second quarter. Although the back half of the year is expected to see much higher supply growth with new smelter projects and delayed restarts coming back online in China.

Global aluminum demand grew to a rate of 5.2% in Q2 as compared to the year-ago period. We saw healthy Chinese consumption growth in the second quarter driven by government stimulus spending. Chinese demand is expected to soften in the second half as government support begins to ease. Most industry experts continue to expect the global aluminum market to be reasonably well balanced in 2016 with a large surplus in China, resulting in significant exports to the Western World.

Okay, just a couple of quick comments on the alumina market before I hand it back over to Mike. Alumina prices peaked at about $260 per ton around the time of our Q1 call and then declined to their current level of $235 on the back of Chinese refinery restarts and declining LME prices from when we last spoke in April.

And with that I'll hand it back to Mike.

M. Bless Thanks, Shelly. And if we can turn to slide 6 please. Just a couple of comments on the operations. I'm starting from the top. We had a mixed quarter in safety over the last couple of months. It's important to remember that all our plants continued to perform significantly better than industry norms, but as you see we did lose a little bit of momentum in the couple of key places.

First and foremost the Kentucky plants continued their excellent performance this year and we're extraordinarily proud of the commitment of the folks there and the results that they are producing. Grundartangi also continues to perform at a high level in safety; it's only one more incident that we recorded in Q2 over Q1. Mt. Holly did see far too high a number of incidences in May and June versus their history and versus our expectations. Most of these were careless and they're evidence to me of the stress of our people in this uncertain situation.

We remain committed to an environment of zero serious injuries in this company and thus we're continuing to invest in this most important area. For example, we recently brought on board a very talented individual with a long history in the primary aluminum business and he is now leading our US efforts.

Moving down the page to production, as you can see generally good progress here across the board. As we discussed with you in April, Hawesville had been working to reach a full pod count after we took the three pot lines down in the latter half of last year. That situation has been aggressively managed and as you can see the result here has been quite good.

Same is true with Mt. Holly as we told you about in April when we took that pot line down at the end of last year. We did see some instability in the first couple months of this new year and as you can see that's also been corrected. So excellent work there.

Moving down to KPIs or production metrics, again as you can see very good across the operations. As I said Hawesville especially has come back nicely and is showing excellent improvements. Effectively all cells are now operating online at Hawesville and that course is in the two pot lines that are running.

The efficiency metrics have improved and the pot rooms have reached a very high level of stability and this is important. And that is enabling us to produce high purity metal at a very strong rate.

Lastly on the cost side, as you can see performance generally good, with Grundartangi, Hawesville, and Mt. Holly all flat to lower Q2 over Q1. That increase that you see there at Sebree is primarily due to a higher power price Q2, versus Q1 as we started to see some higher market power prices in June, due to the hot weather. That trend has continued a little bit in July, it's coming off a little bit now. So it's getting a little bit better, but we're watching it very carefully.

Hawesville of course faced the same issue in the second quarter on hotter temperatures, but was able to offset that increase via improvement in other areas. Again, we are really pleased with the performance of the operations and really proud of our folks. What they're doing is allowing us to preserve the value of these plants during these tough conditions.

And with that I'll turn it over to Rick.

R. Dillon Thanks, Mike. If you turn to slide 7 of the presentation, I will provide some details on our financial performance for the second quarter. Our net sales were up almost 3% from the first quarter reflecting favorable market conditions. On a two-month lag basis, the average cash LME price was up over 4% in the second quarter.

However the Midwest premium decreased 5%, resulting at a Midwest transaction price increase of approximately 3% quarter-over-quarter. Our realized prices in the US were up almost 3%, reflecting that increase in the Midwest transaction price. It's important to note here that the average two-month lag LME price for the second quarter was approximately $1,544 per ton.

Shelly spoke earlier of the recent volatility in the LME prices and the favorable spot pricing we have seen in July. The average two-month lagged LME price to date for the third quarter is almost $1600 per ton. As a result, we should realize more net favorable pricing in Q3. For Iceland, the all in two-month lag LME and European duty paid premium increased approximately 2% in the second quarter, consistent with our realized price increase.

On a consolidated basis, global shipments were up 2% in the second quarter of 2016 and while production levels were essentially flat quarter-over-quarter. Turning our attention to operating profit, we reported an adjusted EBITDA this quarter of $21 million, an increase of $19 million, compared to the $2 million of adjusted EBITDA reported for the first quarter.

Just a few things to call out here. Lower raw material costs increased EBITDA by approximately $16 million during the quarter led by a significant decline in the realized cost of alumina in the second quarter. As a reminder, there is a one to two month lag on alumina cost realization depending on timing of shipments and inventory levels. Higher all-in pricing net of the impact of a rising LME on Iceland power increased EBITDA by approximately $7 million from the first quarter of 2016.

Power costs at our Kentucky operations increased by $3 million from the first quarter. However these costs still remain at historically low levels.

The increase is driven by hot temperatures and more seasonal in nature as Mike noted. Just a reminder, every dollar per megawatt hour impacts EBITDA from our Kentucky operations by approximately $5 million per year, assuming our current configuration, Hawesville at 40% and Sebree at 100% capacity.

Power costs at Mt. Holly were favorable to the first quarter by over $1 million. As we discussed last quarter, our first quarter costs included the impact of purchasing 100% of our Mt. Holly's power requirements from the local power company generation in the month of January, as we transitioned to our new arrangement. In the second quarter, we had 75% market and 25% local power company generation mix for the entire quarter, which resulted in lower costs on favorable natural gas prices.

Collectively, all of these items resulted in an adjusted loss per share of $0.05, an increase of $0.18 when compared to the $0.23 adjusted loss per share reported in the first quarter.

Moving on to liquidity, there were no outstanding borrowings under our revolver other than the letters of credit. We ended the quarter with $129 million in cash and $89 million of availability under our revolving credit facilities.

Our facilities are secured by both accounts receivables and inventories and availability under revolver will fluctuate as our working capital levels move during the year.

Please turn to slide 8 and we'll take a look at cash during the quarter. Cash increased during the quarter by $3 million as the $21 million in adjusted EBITDA was more than enough to cover CapEx, taxes and interest during the quarter. Capital expenditures were $4 million during the quarter, which brings our year-to-date capital spending to $8 million. We continue to expect spending for the year to be between $20 million to $25 million as we indicated in our 2016 items, which means back half spending is expected to be heavier than the front half. We made estimated tax payments of $4 million in the quarter and we also made our semi-annual interest payment of approximately $10 million. Working capital increased slightly during the quarter driven primarily by increased alumina inventory in Iceland as the toll of the last of our tolling contracts expired.

Now let's revisit our consolidated cash breakeven point. When we last spoke we gave you our estimated consolidated breakeven point of $1550 per ton. As an update, our current estimate for the consolidated breakeven increased by $20 to approximately $1570 per ton. This increase corresponds to the decrease of about $20 per ton in regional premiums.

As a reminder, the consolidated breakeven assumes the benefit of premiums we received above the LME price. So, when these premiums go down, our LME equivalent breakeven price goes up. The recent decrease in alumina costs were offset by increases in power costs we discussed earlier.

As we have noted before, the consolidated cash breakeven point is the LME equivalent number and represents cash flow after maintenance, capital expenditures, cash taxes, interest expense, SG&A and pension contributions, pretty much everything excluding any discretional capital spending.

So, with that I'll turn the call back over to Mike.

M. Bless Thanks Rick, and I think Pete we can move pretty quickly to questions. Please be assured we're going to be focused hard here over the coming months as we always are on operational execution and product quality. Our folks know very well that there's absolutely no room for self-inflicted wounds or anything like that in these difficult market conditions.

From a strategic perspective we've got sort of two major issues here on the docket over the next couple of months. The first, again is to pursue a structure that will work for Mt. Holly long-term and importantly will allow us to restart that second pot line, and second we need to get to the finish line finally or I suppose push the ball over the finish line on the fair trade efforts.

And with that Pete, I think we can move to questions.

P. Trpkovski Thanks, Mike. Ernie, at this time please kick-off the Q&A session.

Moderator (Operator instructions.) And we'll go to the line of Jorge Beristain with Deutsche Bank. Please go ahead your line is open.

J. Beristain Hi, guys. I just wanted to ask, Mike, maybe about the, well two things, your efforts you're seeing in terms of fair trade pushing it over the finish line, and you did mention in your comments you were very close there. Could you just talk exactly what you mean and obviously we've seen the benefits play out in steel, so I'm just trying to wonder for we could expect something similar in terms of tariff protection?

M. Bless Yes. Sure, Jorge. So over the last couple of months, there is one thing that surprised me given my dearth of experience in this kind of thing, it's just the amount of data that's required. It's an enormously analytic process and there is just literally reams and reams of data, most of which or much of which had to be translated from Mandarin. So it's just that the last efforts here really have been producing those data that are required because of course if a case is brought, the case needs to be a strong one and so it's nothing more complex than that. As I said, we are optimistic that we are close here but it's not in our hands ultimately that goes without saying.

In terms of tariffs brought, just to kind of touch on that. The first step here is just that the government, the administration, would bring the case and that just sets in motion a process that can take some time. And so any remedies whether tariffs, quotas, combinations thereof, other things, would be sometime and coming but the world would know that the case has been brought, that would be obviously very public upon inception.

J. Beristain — Got it. So it sounds like this is still a ways off then in terms of any time, tariffs sound like they might be more of a 2018 type of outcome.

M. Bless — I think any tangible thing, the remedies in the jargon of the practice, Jorge. I think that's whether 2018 is right or not, it's not in the next quarter two or three like that. But our view again is, as we said before is, we think the bringing of the case is an extraordinarily important milestone because that signifies to all market participants that the government believes that there is a strong case to be brought and that it's—because if you look at the history, cases aren't brought that don't proceed and ultimately win. And so we think it's a very important signal that the case itself is brought even as you say correctly if a tangible, you didn't use that word but I will, a tangible remedy is sometime away.

J. Beristain — Okay. And then just on the recent news that Glencore was pulling out of its marketing of Sebree product. Can you just expand on that? Should we read anything into that? Is there going to be an incremental cost for you guys to market your own product and then does that have any impact on your alumina relationship with Glencore?

M. Bless I think the easy answer to that question is you ought to be careful what rumors and innuendo and what scuttlebutt you listen to.

J. Beristain Okay. I'll have to stop reading *American Metals Market* then.

M. Bless We were scratching our heads to be quite honest.

J. Beristain Okay. And then I thought I had another question but I guess I'll just get back in queue. Thanks.

Moderator Thank you. Next we go to the line of David Gagliano with BMO Capital Markets. Please go ahead. Your line is open.

D. Gagliano Hi, just a follow-up on Jorge's question, on the trade side. Are you working in conjunction with other aluminum producers in bringing this case or is this on your own?

M. Bless It wouldn't be, David, technically we wouldn't bring it, the government brings it and so the government is talking to lots of different industry participants about the case. As you know, our consortium itself—the China Trade Task Force, there is only a few members of that, it's ourselves, Brazeway which is a major billet producer in the US and of course the United Steelworkers. We believe that there will be other members announced quite soon in the next couple of weeks, but in terms of the case itself it's the government that brings it and we are well aware that the government is talking to lots of different industry participants.

D. Gagliano Just on the Mt. Holly side, I was wondering if you could drill down similar line of question there, what are really specifically the next steps that we should be looking for or milestones things like that for decisions regarding Mt. Holly?

M. Bless From a decision standpoint, David, I'll answer the question I think maybe you're asking, from a decision standpoint, we procure this power. So we own it through the end of 2017, it's market based, same kind of pricing in terms as the contract that's expiring, and we intend to run Mt. Holly. We're happy about that, and we're entering the commercial season here that will be starting in earnest at the end of the summer into the fall, with full confidence. We are confident our customers will have full confidence that Mt. Holly is going to run, it's going to be a major billet supplier as it has been for years and years and years.

So there is really no decision to be made for the next year and a half sitting here today. The issue is a longer term issue and barring any precipitous or draconian fall in the market, of course and that's why we needed to negotiate 60 day out just to mitigate that kind of risk. But barring that, the issue that needs to be solved is a longer term issue, and it's because number one, at some point in time we're not going to run the plant on the basis we're running it today just from an operational sustainability standpoint, cost structure standpoint.

And two is, at some point in time, I don't have to tell you, you've been following commodities long enough, if you are at the 78 percentile on your major cost, you're going to get pushed off there at some point in time. I don't have to tell you, that's how the market works.

D. Gagliano Okay. So but you're still—it's the other 25% of the power I'm trying to?

M. Bless That's it. Okay, sorry, I said I was going to answer question I thought you were asking and then I proceeded to not.

D. Gagliano No, no, that's fine.

M. Bless I apologize. So in the next couple of months, I think you should not expect to see anything there, although we'll be having a lot of private discussions and strategizing discussions with people involved in the situation, including we hope with the power company itself because their portfolio is always changing, the situation is changing.

So we intend to engage in a constructive dialog with them. They've always been willing to engage in a constructive dialog. We always haven't seen eye to eye about what the results ought to be but they've always been more, more than willing to meet and talk and listen to ideas and all that kind of stuff. And so that will be the next couple of months.

Then, going into next year, another legislative session, who knows where it may be but I wouldn't look for anything tangible coming out of us on that 25% as you say over the next say quarter, at least the next quarter.

D. Gagliano — Okay. And then just really quickly last question, I just missed it, what was the updated cash flow breakeven number again, LME number?

R. Dillon — It’s $1570.

Moderator — (Operator instructions.) We’ll go to the line of John Tumazos. Would you please state your company please?

John Tumazos — John Tumazos Very Independent Research. Hi, Mike. What is your best judgment as to the increase in Chinese output second half of this year compared to first half?

M. Bless — Yes, that’s a good question. It’s interesting. You look at the range of results there which was pretty tight. I was just looking at this the other day, that was pretty tight three or four months ago, the dispersion of those results has really widened out. I guess that’s not a great surprise. It’s going to be, Shelly, at least in the high single digits if not higher year-over-year, maybe higher than that.

S. Harrison — Right. We’ve got a bunch of restarts that people have been anticipating and they’ve been slower than expected coming back on line but the expectation is that you'll see those restarts in the second half as well the significant amount coming online from new projects.

M. Bless So I mean, John, it could be as high as some of the estimates that I'd seen. I wouldn't say this is the most outlier but maybe towards the outlier of the spectrum have talked about full year of production growth average of course in that high single digit. So in order to get there, you'd have to be in the high double digits percent for the second half. So we'll see, it seems to be changing every day as the market has a better opinion on whether a particular plan. I think most of the variability and the expectation show is on the restarts more than the new capacity.

S. Harrison That's right.

M. Bless But it's coming. It's going to be a wave. The only question is whether it's a huge wave or huge wave times two.

Moderator Thank you. We do have a follow-up question from the line of Jorge Beristain with Deutsche Bank. Please go ahead. Your line is open.

J. Beristain Hi, guys, just wanted to drill down on what was happening with Sebree. You had flattish volume quarter-on-quarter, but you saw a 7% jump in the unit cost. So what's behind that and should we expect things to normalize going forward?

M. Bless Sure, Jorge. The volume wasn't a big surprise, as you know, Sebree is producing at capacity, in fact a little nicely above its rated capacity. So we have all three lines chugging away, we wouldn't in a normal quarter expect much. There was actually—we don't talk about this, actually that is on a per day basis, we give that right, Pete, so that's adjusted per day so that's a clean estimate.

On the power, as I said, Jorge, specifically of that amount, 5 of those percentage points of that increase was just an increase in the power cost, the power price and that was due as you know as the June heating up and thus the MISO prices starting to increase.

To answer your question, regrettably over the first couple of weeks of July as we all know in the Northeast, those of us who are in the Midwest or the Northeast, it's been hot, I guess it's been hot over most of the country and those prices have stayed at those levels. Now, we've started to see it nicely dissipate, come back down over the last couple of days where we hope to put some more data points behind that over the next couple of days.

But as Rick said, you could see reasonably higher power cost Q3 over Q2 in the Kentucky plants. And all you have to do there, Jorge, you can see it on your Bloomberg screen, look at Indiana Hub, MISO prices at the Indiana Hub and we pay generally a little bit less than that. We have generally at both plants a positive basis, so a positive differential.

P. Trpkovski Negative.

M. Bless Negative. Pardon me. Thank you, Pete. So we are paying less than that negative basis, but it's within let's say, $1 megawatt hour. At Mt. Holly on the other hand, you want to watch natural gas prices, Henry Hub Natural Gas prices because our power floats based on that price.

Moderator Thank you. And there are no further questions in queue at this time, please continue.

M. Bless — We thank you all for participating this afternoon. And we appreciate your interest and we look forward to talking with you in a couple of months' time, if not before. Take care.

Moderator — Thank you. That does conclude our conference for today. Thanks again for your participation and for using AT&T Executive TeleConference Services. You may now disconnect.