Final Transcript

CENTURY ALUMINUM COMPANY: 3rd Quarter 2015 Earnings

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SPEAKERS

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

ANALYSTS

David Gagliano – BMO Capital Markets
Michael Gambardella – JPMorgan
Jeremy Kliewer – Deutsche Bank
John Tumazos – Very Independent Research
Paul Massoud – Stifel

PRESENTATION

Moderator: Ladies and gentlemen, thank you for standing by, and welcome to the Third Quarter 2015 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.) Also as a reminder today's teleconference is being recorded.

At this time I will turn the conference call over to your host, Mr. Peter Trpkovski. Please go ahead, sir.

P. Trpkovski Thank you, Tony. Good afternoon, everyone, and welcome to the conference call. Today's presentation is available on our website at www.centuryaluminum.com. We use our website as a means of disclosing material information about the company and for complying with Regulation FD.

I would also 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.

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

M. Bless Thanks, Pete, and thanks to all of you for joining us as usual this afternoon. If you could move to Slide 4 please, we'll get right to it. Shelly in just a couple minutes is going to give you a full update on the market environment obviously a critical issue for this call and otherwise, but just to put the comments I'll make here in context. Let me just make a couple quick observations.

The trends that we talked to you about back in July on the same call have continued, if anything they've become more pronounced as you know. Dynamics in the market outside of China continue to be favorable for this sector. Demand development continues to look good and still we're seeing no new capacity coming on ex-China and we firmly believe this won't change.

The net result currently is a deficit outside of China of about a million tons per year. Of course all this and more is wiped out with the metal that's currently coming out of China.

The issues with regard in China have not abated. Domestic demand is weak. We share the point of view about which you’ve read that it’s actually meaningfully weaker than it’s been publicly reported. Capacity is not coming off nearly fast enough; in fact it's much the opposite as we continue to see uneconomic plans propped up by huge subsidies in various forms.

The export of highly subsidized metal to developed markets has continued both directly and via circuitous routes. Products are being shipped to intermediate locations and then backward integrated, i.e. melted down into primary metal. There’s obviously no economic rationale for that type of activity.

Our assessment is that this behavior is not accidental, but is deliberate and decided strategy and thus it must be dealt with through various political processes. Some of these are shorter-term oriented with the objectives to draw attention to the problem and to stop the most egregious practices. Ultimately, we believe the solution will require government to government dialogue and agreements. As you know this type of thing has happened in the past in this and in other sectors and we're working aggressively with industry groups and others towards this end.

Turning inward, in the meantime we've set the company up to ride through what could be a prolonged ugly environment. We will only run each of our operations in a manner that yields nominally at breakeven results even in the current depressed environment.

We've got no interest in impairing our liquidity to fund losses. As you know the company has a strong capital structure with ample liquidity and low financial leverage with no near-term maturities.

The other leg on this stool is our insistence that no operation can or will put the other operations or certainly the total company at risk. Strategy to accomplish this is relatively straight forward. On the one hand we will continue to make modest investments that dollar out assuming these market conditions persist for some period of time.

On the other hand, we're reconfiguring the other operations to be viable in the current environment. First at Grundartangi, we'll continue the capacity creep project there that produces good returns even in the current commodity environment. In 2016, this plan will be running at greater than 50,000 metric tons per year above its rated capacity that's over 20% above its rated capacity. The plant is running well and continues to improve what's already an excellent production efficiency. And as you know this plant has a very competitive cost structure.

Turning to the Kentucky plants, if you look at market power prices in the Midwest recently, those dictate that these plants should run in all but the most extreme and protracted scenarios. They're very favorable to power prices.

We've developed an operating configuration at these plants that works even in today's metal prices. We'll give you our detailed assumptions for our annual plan as usual when we report our fourth quarter results in February.

We will give you just a sense now of what it's looking like. Based on the operating structures that we've developed for the Kentucky plants and the product premiums as we see them for 2016, these two Kentucky plants will run at a combined EBITDA breakeven, even at current commodity prices. And this we're convinced can be sustained for a reasonably prolonged period of time. We've brought down the consolidated company's cost structure and breakeven considerably and Rick will provide you some data on this in just a few moments.

Moving along now, as we announced during the third quarter we are moving to dispose of the West Virginia plants in the related site. This was truly a regrettable decision, but we simply came to the conclusion that the hill here was just too high to climb. Bottom line we've set the company up to be strong and sustainable in what could be a prolonged downturn and we also know well what's required if we were to see a significant additional sustained deterioration in market conditions.

Of course the other key issue facing us now is Mt. Holly. Here the only issue is power. With simply a competitive power price, this plant should always be the last man standing in the US. As a reminder we've announced already we have successfully procured from a third party all the power required to run this plant. It's a high quality provider with the power coming from neighboring regions.

We’ve proposed to pay the standard transmission rate to the local power company, to transmit that power from its border to the plant, regrettably thus far the local utility has declined to do this and thus we were forced last week as you saw to notify our employees that the plant will close at the end of December if we can’t find a solution. As a reminder, the present contract was put in place in 2012, power contract of course, and it expires this December.

Let me just remind you for a moment the basis of our decision to purchase our partner's share in this plant at the end of last year. First Mt. Holly is the newest smelter in the US, thus the most efficient and productive.

As a part owner we had high regard for the management team and employees and as we've gotten to know them up close they've exceeded our expectations. There is skill combined with the modern technology of the plant, yields are very low conversion cost to facility. In addition, most of the production is in the form of premium products that are sold to an excellent customer base. And lastly, we can say after the last year of owning the plant outright, that South Carolina is a terrific place to do business in a whole range of ways.

For these and other reasons it was the real tragedy if the parties were unable to find a solution here. As you would expect we're looking at all ranges of alternatives and considering every option. It is difficult to predict at this time how this will resolve itself, but given the attractiveness of this plant we're far, far from ready to even begin giving up.

With that, I'll turn it over to Shelly who will take you through a review of the market.

S. Harrison Thanks, Mike, if we move on Slide 5, please, I'll provide some comments to you on the industry environment. The cash LME price averaged $1,590 per ton in Q3. This reflects an additional $180 decline from Q2 and prices today are well below $1,500 per ton at the level we haven’t seen since 2009 during the heart of the global financial crisis.

Regional premiums continue to fall quarter-over-quarter, but appears to have found some stability and have even ticked up a bit in the past few weeks both in the US and in Europe.

The Midwest premium is currently sitting at $0.075 per pound and the European duty paid premium is around $160 per ton. In the Western world we continue to see good demand growth driven primarily by a robust transportation sector.

Aluminum use in Q3 grew by 2.6% in North America and 1.2% in Europe. Chinese aluminum demand continued to soften along with the broader economic and grew at a rate of 8% in Q3. While this still appears to be good demand growth on a very large base these levels are well below the low double-digit growth rate we've seen out of China over the last decade.

On a global basis demand growth showed a healthy 4.7% increase in Q3 but the real driver of our market right now is on the supply side. As we discussed last quarter oversupply coming out of China continues to weigh heavily on the aluminum market despite the significant decline at aluminum prices and premium over the last several quarters, we are not seeing any significant reduction in supply growth out of China. In Q3 Chinese production was actually up 12% as compared to the same period in 2014.

The lack of smelter curtailments in China and continued supply expansion is being driven by what we believe to be unfair trade subsidies. These subsidies are coming in many forms, including land grants, power prices, taxes, interest rates and other state support that result in overcapacity and unfair trade practices which must be corrected through government action.

Western world supply growth was essentially flat in Q3 with some modest curtailments offsetting new capacity from planned project startup. On a worldwide basis, global supply was up just under 7% in the quarter.

Overall the aluminum market is expected to generate a modest surplus this year, which is entirely attributable to excess capacity from China. Excluding China, the aluminum market would be in a deficit of over one million tons in 2015.

Just a couple of quick comments on the alumina market before I hand it back to Mike. Alumina prices have traded down sharply over the last several months. The Australian index price is currently around $250 per ton just down about $100 from the beginning of the year.

Rick will talk about this more in a minute, but I wanted point out here that there will be a lag between the timing of falling alumina prices and when that benefit will be reflected in our financial statement. Pricing for Atlantic Alumina continued to trade at a discount of $5 to $10 per ton to the Australian index price. And overall the global alumina market is expected to be in a surplus position for the balance of 2015.

With that, I'll hand it back it to Mike.

M. Bless Thanks, Shelly, if we could turn to Slide 6 please, let me just take you through a quick review of the quarter that just ended. First at the top you see we had a mixed performance on safety this quarter. First and foremost I should say how proud we are of the excellent performance at Hawesville given the situation at the plant.

Just to review as you remember, we came out of a labor dispute obviously in June going into the quarter and the difficult situation that came out of that. Then of course we had uncertainty and the significant work required to move the plant down to 40% of capacity as we announced a couple of weeks ago. And it’s in this very difficult environment that the management and employees work to keep themselves and each other safe and they should be absolutely commended for that.

Sebree also had a lot going on, especially activities around returning the cast test to more normal operations and so in that context performance there was terrific as well. Uncharacteristically we had slightly worse performance quarter-to-quarter from Mt. Holly and Grundartangi on the safety side.

Going down the chart here you can see production at Hawesville, no surprise there of course as we were working through the quarter to take the plant down to where it sits today at 40% of capacity and as you see the other plants were flattish quarter-to-quarter. Production efficiencies again moving down the chart here as you can see generally stable, again a commendable performance at Hawesville given the situation there and I would say the same about Mt. Holly given the growing uncertainty on the status of the power contracts.

At the bottom of the page on conversion cost as you see Hawesville was essentially no change from a conversion cost standpoint quarter-to-quarter. Let me make a couple of comments to put that into context.

As you remember if you go back to Q2 we had very high costs at Hawesville, a direct cause to the labor dispute. And then in Q3 some of those costs were trailing plus of course we were operating in an environment where we were bringing the production capacity down significantly to the 40% level. That resulted in Q3 costs as you see here essentially equal to the cost that we had in Q2.

We've now got the cost structure setup for the reduced production level and thus the significant unabsorbed fixed costs we saw in Q3 are largely behind us with a small amount that will be trailing in Q4. We also have a very different product mix now. We're now producing only high purity aluminum and molten and thus this produces a much higher weighted average product premium.

So we’ll see some very different results from this plant going forward and Rick will make some comments about the fixed cost absorption during the quarter. At Sebree and Mt. Holly you see a reasonably consistent performance on the cost side quarter-to-quarter.

Now, I'll now hand it over to Rick.

R. Dillon Thanks, Mike, if we turn to Slide 7 of the presentation, I'll provide a few additional details on our financial performance in the third quarter. Our net sales were down 13% from the second quarter, reflecting the unfavorable market conditions we've discussed and lower sales volume at our North American operations.

Looking at the market impact the two-month lag basis the average cash LME price was down 5% and the Midwest transaction price was down 15% sequentially. Realized prices in the US were down 12% in the third quarter reflecting this two-month lag pricing. Actual Midwest transaction prices have declined approximately 12% since the end of the second quarter and the balance of this further decline will show up in realized prices in our fourth quarter results.

For Iceland the all-in two-month lag LME and European duty paid premium decreased approximately 13% in the third quarter consistent with the decline in realized prices. On a consolidated basis, global shipments were down 1% in the third quarter of 2015 versus the second quarter. Iceland shipments were up 7% in the third quarter inclusive of 4,000 tons of finished goods that were awaiting shipment in Iceland at the end of the second quarter due to the timing of sales cut off.

North American shipments were down 5% from the second quarter. The decrease is attributable to the decision to reduce operations at Hawesville resulting in lower shipments of approximately 9,500 tons.

Turning our attention to operating profit, we are reporting an adjusted EBITDA loss this quarter of $25 million, a decrease of $76 million when compared to the $51 million of adjusted EBITDA in the second quarter of 2015.

The adjustments include approximately $3 million in costs related to partial curtailment of Hawesville operations, additional costs in the third quarter directly attributable to the Hawesville labor disruption, which ended late in the second quarter, as well as non-cash adjustments to the carrying value of our inventories which reflects the further decline in market prices at the end of the quarter.

The Hawesville partial curtailment costs of $3 million include liquidated damages under certain take or pay raw material contracts and employee severance costs. Lower all-in pricing, including the impact of a declining LME, declining regional premiums and net of the impact of the LME on our power and certain aluminum costs, all combined to reduce EBITDA by $67 million during the third quarter of 2015.

The impact of lower sales volume on EBITDA at our US operations was offset by increased volume in Iceland. As Shelly noted we have seen the market prices of alumina decline sharply over the last several months. As we noted on our last call given the high inventory levels due to reduced production activities we did not realize favorable alumina pricing in this quarter.

As we stated previously it will take one or two more quarters for us to start realizing the lower prices of alumina currently held in our inventory. Increased operating costs per ton at Hawesville and lower fixed costs absorption negatively impacted EBITDA on $9 million.

In summary lower market pricing during the quarter and lower fixed cost absorption drove a $76 million decrease in EBITDA resulting in an adjusted loss per share of $0.48, a decrease of $0.73 from the second quarter of 2015.

Moving on to liquidity, there are no outstanding borrowings under our revolver other than letters of credit. As noted in our release at the end of the quarter our available liquidity was at $223 million consisting of $122 million in cash and a $100 million of net availability under our revolving credit facilities.

Now let's turn Slide 8. Cash decreased during the quarter by $44 million after consideration of the loss of $25 million on an adjusted EBITDA basis. Capital spending during the quarter was $16 million with year-to-date spending at $48 million. We anticipate annual spending in 2015 of approximately $60 million consistent with our previous communication. The favorable impact of receivable collections and inventory reductions during the quarter was fully offset by trade payables to provide the timing of payment of alumina receipts.

Our preliminary estimate of our consolidated cash flow breakeven for 2016 at current premium levels is at approximately $1,525 per metric ton, which is a direct comparative to the LME. This is excluding Mt. Holly and assumed as Mike noted that we have configured our remaining US plants to operate at or near breakeven at the plant level.

The consolidated breakeven point represents cash flow after sustaining capital expenditures, cash taxes, interest expenses, SG&A expenses and pension contributions, everything, excluding any discretionary capital spending. We will provide an update on this and more details on our 2016, on our next call.

With that I'll now turn call back to Mike.

M. Bless Thanks, Rick. If you could just turn to Slide 9 please, I'd just like to give you a quick sense of what we'll be focusing on here over the next couple of months and then we'll get right to your questions. So obviously critical to keep pushing the ball forward on attacking the significant issues playing in the sector on an overall basis.

The prize to us is obvious given the attractive demand picture in the sector. We're convinced that a fair global market based upon economic realities would be a very attractive environment for primary aluminum producers over the coming years.

At Mr. Holly as I said the situation is very fluid, and thus it's difficult to predict what turns it might take here over the coming weeks. Again I want to say we're absolutely committed to finding a solution to maintain operations at this truly excellent plant.

Last, we'll continue to take actions necessary to set the company up, as Rick was saying, for a protracted weak environment. We've got no intention to drawdown on our liquidity to fund losses at these plants. We're in a good position based upon current market conditions and even at somewhat lower commodity prices. Lastly, we know well what needs to be done if we were to see further meaningful deterioration that we believe was going to be sustained.

With that, Pete, I think we can move to questions.

P. Trpkovski: Thanks, Mike. Tony, if you could go ahead and queue up the Q&A session please?

Moderator: (Operator instructions.) First question will come from David Gagliano with BMO Capital Markets. Please go ahead.

D. Gagliano I actually just wanted to ask a quick question on this free cash flow breakeven number that you just mentioned. I think you said it was $0.69 a pound. So I actually had two questions, one, how long will it take to get to that number? And the second question I just wanted to clarify, does that include or exclude the premium I couldn't quite understand what you said there?

M. Bless So let me take it, David. It's an LME equivalent number and the assumption is current premiums, so about $160 bucks both Europe or $150 is in there for both Europe and the USA. So it assumes those premiums unless that $1,525 your $0.69, sounds right, is a direct LME comparable number.

On your second question the Kentucky plants are largely where they need to be today. As I said there will be some additional reconfiguration that's taking place in the fourth quarter as well, but we're almost there right now.

D. Gagliano So beginning of 2016 we should be at that.

M. Bless Before that but most definitely.

Moderator (Operator instructions.) Next in queue is Michael Gambardella with JPMorgan. Please go ahead.

M. Gambardella I just have a question on Slide 7. What caused the revolver availability to decline from $123,000 to $100,000 over the last quarter?

S. Harrison Yes, Mike. There were several things that contributed to that. Obviously lower prices and premiums will impact our receivables and inventory as well as lower production will impact it as well.

One of the big drivers this quarter though was it was at the absolute low point in the receivable cycle. Quarter end was actually the day we get paid on and so that can change from quarter-to-quarter, so that was also a contributing factor this quarter.

M. Gambardella So do you anticipate that to move back up in the fourth quarter?

S. Harrison There will be one extra day in the payable cycle next quarter. So there is a little bit of movement there obviously a lot of variables go into that. It depends on prices and other things, but just based on the payment cycle there should be a small improvement.

M. Gambardella — What's the duration on the revolver?

S. Harrison — The revolver goes through 2018.

P. Trpkovski — 2020.

S. Harrison — 2020 yes.

Moderator — (Operator instructions.) I actually do have a question coming in from Jeremy Kliewer with Deutsche Bank. Please go ahead.

J. Kliewer — Do you guys have any update as to the cost reductions you introduced last quarter? You had $40 million to $65 million at the time, but I don't see any update on this quarter.

M. Bless — It's a good question, thanks. Those are all proceeding exactly. I guess there are two parts, those actions that we had implemented at that time and described to you on the July call was an important addition, I will get that in a sec, are proceeding exactly as we had expected.

Of course the major change here is we have taken Hawesville down to a lower production level. So that changes the basis of that whole presentation if you will or calculation but all of those actions, those were all implemented are those in either done or in execution phase. So there has been no change there other than as I said the change on the configuration of Hawesville.

Moderator The next question in queue will come from John Tumazos, and your line is open.

J. Tumazos With the effect of the different cost reduction actions, would you estimate your profit and loss breakeven will be by the March or June quarter?

M. Bless Rick gave you the EBITDA breakeven, pardon me. In terms of accounting profit and loss adding in depreciation—what specifically are you asking and then we'll try to answer it the best we can?

J. Tumazos Earnings per share, accounting profit and loss.

M. Bless — We haven't put that out, John. I think you can work back from EBITDA by you know the cost below the EBITDA line just to go over them for everybody I guess Shelly or Rick will tell me if I get this wrong. We obviously have interest expense of about $20 million on an annual basis.

Depreciation is let's see here about $70 million annualized, taxes are an estimated this at these LME levels, you're not paying very many taxes.

Shelly go ahead and—

S. Harrison — Essentially zero in the US and around breakeven levels that's not going to be much in Iceland either so it's been zero for taxes. And in Rick's number that is cash covered interest. Really depreciation is going to be the big issue not in Rick's number.

M. Bless — Thank you of course you give a cash breakeven number; thank you for that.

Moderator — We do have another one coming in from Paul Massoud with Stifel. Please go ahead.

P. Massoud I am just curious given the elevated run rate at Grundartangi, does that change maintenance cap ex figures going into next year?

M. Bless No, thanks, Paul, that's a good question. Now that you ask we'll just—maintenance cap ex, as we have said before and we have obviously confirmed this in discussion with all the plants recently as you would hope and expect, are relatively low at these plants especially Grundartangi which is our newest plant. And so the answer to your question is no and I could expand maintenance cap ex for 2016, just strictly maintenance, if were to make a decision to stop all discretionary cap ex you're talking about well under $50 million for the consolidated company.

Moderator Presenters, there are no additional questions at this time. Please continue.

M. Bless Well then we do appreciate everybody's time again and we look forward to talking with you over the coming months. Take care.

Moderator Ladies and gentlemen, that does conclude your conference call for today. We do thank you for your participation and for using AT&T Executive TeleConference. You may now disconnect.