Final Transcript

CENTURY ALUMINUM COMPANY: 2nd Quarter 2018 Earnings

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SPEAKERS

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PRESENTATION

Moderator Ladies and gentlemen, thank you for standing by and welcome to the 2nd Quarter 2018 Earnings Call. At this time, all lines are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. [Operator instructions]. And as a reminder, today's call is being recorded.

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

P. Trpkovski

Thank you very much, Kerry. Good afternoon, everyone, and welcome to the conference call. I'm joined today by Mike Bless, Century's President and Chief Executive Officer; Craig Conti, Executive Vice President and Chief Financial Officer; and Shelly Harrison, Senior Vice President of Finance and Treasurer. After our prepared comments, we'll take your questions.

As a reminder, 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.

Turning to Slide 2 of today's presentation, please take a moment to review the cautionary statement shown here with respect to forward-looking statements and non-GAAP financial measures contained in today's discussion.

With that, I'll hand the call to Mike.

M. Bless Thanks very much, Pete, and thanks as always for all of you for joining us this afternoon.

As Pete said, we're joined here in the room by Craig Conti, our new CFO. We are delighted to have him here. He has got a fantastic background, great experience at ITW and before that at GE. He is going to add huge value here we're quite confident, and we're looking forward to working with him. It's truly his day three here so we're going to give him a break and let him stay in listen-only mode for this call, but obviously you all, I'm confident, enjoy working with him and you will be hearing plenty from him in the months and obviously quarters to come.

If we can turn to Slide 4, please, I'll give you a quick rundown of the last couple of months. We think we had a really good quarter in the second quarter. Financial results, if you had a chance to have a quick look, came in consistent with our expectations and Shelly will deconstruct the numbers for you in just a minute.

All the plants have been stable with strong and consistent production in metrics. Given the complexity of the capacity restart projects that are in full swing, the stability of the operations are even more important than they normally are. And, I'll give you an update on the Hawesville restart program in just a minute.

Peter will give you some detail on the industry environment, but in a nutshell the picture remains good both in respect to demand growth and the growing global deficit. We see this at present and continuing to the foreseeable future.

The alumina price, as we talked to you about last time, did come down significantly over the last couple of months. As you'll recall it peaked at almost $700 a metric ton after the sanctions on Russel [ph] were announced and then it slid back to the mid-$400s before recently rising again to over $500 a ton.

We remain quite confident in the consensus view that the fundamental value of alumina is somewhere in the mid-$300s. That's especially with metal kind of where it is right now in the low 2,000s. We further believe there should be continued downward pressure over the next couple of years, especially in the Atlantic region. That's obviously due to the recent capacity additions at Jamaica, we talked about all this, and those coming in the next year or so in the Persian Gulf.

That said, a significant overhead does remain and we and others believe once it's cleared up the price will swiftly revert to its norms. Obviously, I'm talking about the continuing curtailment of half of the world's largest alumina refinery; it's in Brazil as you all know. As we discussed with you a couple of months ago, we believe the physical market had quickly and effectively adjusted to alternate supply lines, at least over the reasonably short and mid-term.

The majority owner of the refinery says it's continuing to work with the Brazilian authorities several times over the last couple of months. The consensus of market participants has been that an agreement to allow a restart is imminent. We believe it's simply not productive to speculate at this point, but are very confident the parties will figure out a solution during the reasonably near-term.

Moving onto the metal price, as you know, it's moved around a bit. Again, after sanctions were announced, it rose quickly to 2,700, give or take. And after that short-term pressure was relieved, it reverted back to around 2,300 and it kind of stayed in that range within a reasonably tight range for a period of time.

As you know, it’s recently come off by as much as 10%. This has been obviously wholly in concert with the sell-off of risk assets in general. If you’ve had a look, aluminum has actually performed better than most, if not all, of the other base metals.

Obviously the tariffs have been a subject of significant attention in commentary and thus, given everything that’s out there, I’ll just give you a quick update now, and then I’m happy to take all your questions. We’ve seen a very limited number of country exemptions and these have been modest in nature as you’ve seen.

We just need to point out the plain facts here. The tariff has simply accomplished the administration’s goals. If you take a step back and remember what they talked about they wanted to accomplish, there were two main parts of it. The first was creating the conditions to support the restart of the US primary aluminum capacity. That’s been accomplished. Once all the announced restarts are back online, US in production will be up 60%. Secondly, they wanted to ensure that the industry with the other advantages it has is competitive over the longer term. Obviously, this is so the US can maintain some amount of indigenous supply in primary aluminum.

We do continue to hear some tired and misleading arguments about the US industry and thus I think it's just helpful to take a pause here and restate some facts. Those of you who know the industry know of course the power cost is the most significant differentiator of the smelter's competitiveness. Independent data have now shown consistently for the last couple of years that US power costs to smelters are better than, obviously lower than the world median.

We know this to be true of our Kentucky plants, both the plants in Kentucky, and we know this to be true of the market power repurchase for 75% of Mt. Holly's requirements. Here the administration's policies have also been very helpful in providing an environment for the long-term competitiveness of the US fuel and electric power markets.

Some people also talk about the age of the US smelting technology and of course this is important. But they fail to mention, again, those of you who follow the sector know this, is that power usage in US plants is only about 10% less efficient than more modern smelters. This is more than offset by the favorable US power price. They also don't mention the value of the proximity to customers in the most vibrant downstream market in the world.

Bottom line, the tariffs are having their intended effect and that's to allow the US industry to reinvest for long-term competitiveness. And bottom line, this industry absolutely can be competitive over the long-term. Of course as long as the world's excess state-supported supply isn't allowed to flood this country and distort the market.

So in that context, we're moving along to restart the idle capacity at Hawesville, as I said. We began energizing the cells in the first of the three curtailed pot lines in June; the project is on track. This one, the first line here as we've described to you before, is reasonably straightforward. These cells haven't been touched since we curtailed the three lines in the third quarter of 2015 and thus, they don't require significant rebuilding. We continue to believe that the first of the three lines will be fully producing by the end of the third quarter.

We're also deep in the rebuild process of the other two curtailed lines as again as we told you, we have been regularly cannibalizing these lines as cells in the two currently producing lines normally fail. That's nearly all of the cells and that these last two lines require a rebuild, that's over 200 pots, so quite a significant effort. This part of the project is also proceeding on schedule, and we intend to begin restarting these lines during the fourth quarter. And, we continue to believe the plant will be fully operational by early 2019.

The most significant risk, it won't surprise you, of the schedule remains our ability to hire enough qualified pot line operators. As you all know, the manufacturing economy has really strengthened across the country and that's no different in Western Kentucky.

As a reminder, we've talked to you about this, we've been evaluating an upgraded cell technology and the five test cells that we've had online have now performed for six months. Actually it's about seven months now at levels above the model metrics. And thus we made a decision to move forward with the technology upgrade.

We do intend to break this project up into two pieces, and it's really three reasons. First is we want to mitigate any remaining technical risk; we think that's very low given the performance of the test cells and the longevity. Number two, we want to spread the investment over a longer period of time, and most importantly what we want to make sure is that we're able to focus on the rebuild and restart activities over the next nine months. We want to get these last three lines or the last two lines after the third quarter back up and running, and we don't want to risk spreading ourselves too thin.

So what we're doing first is we're now rebuilding all the cells with an upgraded cell line. We will realize some immediate benefits from that through more efficient power usage and higher metal output. And at a later time we'll introduce a new anode design. This will require some reworking of our anode rodding sub and at that point in time we'll derive additional benefit in cell performance. Again, the thesis here is to mitigate risk by ensuring we can focus on what we need to get done right now is to get those metal units back, that's where the money is, as fast as practical.

If you want to flip to Slide 5 please, just the next page, I thought it would make sense to give you a quick summary of the spending for the whole project. So if you a have look here as I said, the three pot lines we're rebuilding now and aggregate again through early 2019, $50 million for those three lines. And then as we have told you there is some capital projects to go along with that and then adding in that first phase of the technology upgrade about which I just spoke, that's $25 million in aggregate. So that first phase of the Hawesville project will have—it does have a total budget of $75 million. Again, we'll spend that through the first quarter of 2019 to get the plant in full production.

And against that full budget, Shelly will give you some detail on what we actually spent in the second quarter and what we expect to spend in the next couple of quarters. We have not yet decided the schedule for the remainder of the project. If you asked right now, it's likely to begin somewhere into the late part of 2019, early 2020. Again, as I said, this will include the rebuild of the two pot lines that are currently producing. It will clearly be at the end of their life by that point of time. And that will require each of those being taken down for a period of time for the cells to be rebuilt.

There's some remaining capital projects and then importantly the second phase of the technology upgrade. So, in aggregate that will be an additional $75 million in spending, $45 million for the rebuild of the two lines and $30 million for the capital projects. Most of that is attended to the technology upgrade, principally the work in the anode rodding sub.

If I can just ask you to go back, one page back to Page 4, I'll just hit a couple of additional topics before passing you on to Pete. At Sebree we have begun restarting cells after the power equipment failure on the last day of May. As you recall that resulted unfortunately in the curtailment of one of the three pot lines at the plant. We're on schedule there for the line to be returned to full production no later than the end of the third quarter. And Shelly will give you some detail on the restart spending and on the lost profit during the second quarter as well as what we expect for each of those items during the third quarter.

Last topic here, turning to Mt. Holly, those of you who have followed this situation know that the electric power environment in the state of South Carolina remains really, really complex. There was legislation passed at the end of June for example imposing rate reductions on Santee Cooper's partner in the failed nuclear projects. It also provided for a bunch of other power market reforms. And some of this we understand subject already to litigation.

Santee Cooper's largest customer has already sued to prevent Santee from recovering any portion of the failed nuclear costs under their contract together. The legislature created, near the end of June this happened, the committee to make recommendations concerning the future of Santee. And that committee includes—of legislators and the governor himself. Lastly Santee Cooper continues to be running with an interim CEO and an acting board chair, so that just gives you a flavor of the complexity of the situation.

We do remain absolutely convinced that a solution exists that's going to allow for the entire plan to run at some point in time, hopefully sooner rather than later. But given the complexity of the situation at this point, our immediate focus is to preserve the current production level for 2019 while we continue to explore all the options to enable the restart of the second pot line.

And with that, I'll hand it over to Pete.

P. Trpkovski — Thanks, Mike. If we can move on to Slide 6 please, I'll give you a quick update on the current state of the global aluminum market. The cash LME price averaged $2,260 per ton in Q2, which reflects a 5% increase over Q1. The LME price on a two-month lagged basis was up quarter-over-quarter 2%, and averaged $2,100.

As Mike discussed, the metal prices come off approximately 10% over the past couple of months similar with the rest of the base metal complex. Aluminum prices have averaged approximately $2,100 per ton for the month of July and are currently sitting right around $2035 per ton.

In the second quarter, regional premiums averaged approximately 21.7 cents per pound in the US, up 50% quarter-over-quarter and approximately $200 per ton in Europe, a 20% increase from prior quarter. However, spot premiums are down slightly to around 20.75 cents per pound in the US and a $160 per ton in Europe.

In the second quarter of 2018, global aluminum demand grew at a rate of 5% as compared to the year-ago quarter. We saw 6% year-over-year demand growth from China, and 3% growth in Europe and North America. Global production growth was mostly flat in Q2 versus the same period last year. China production was down 2%, while the world ex-China was up 2%. As a result, in Q2, the global aluminum market recorded a deficit of approximately 1.5 million tons and we continue to see a drawdown of inventories globally.

While most industry experts predict some slowing in Chinese demand growth in Q3, demand growth globally is predicted to remain strong, resulting in a continued supply deficit globally. We therefore expect a continued destocking of global inventories which should be positive for long-term price levels.

And with that, I will hand it back to Mike.

M. Bless — Thanks, Pete. If we can turn to Page 7, please, a couple of quick comments on the operations, as we normally provide. As you can see safety performance was mixed this quarter. First and most importantly, we were really pleased with the safety results at Hawesville. As I've said a couple of times it's a large and complex project, the rebuilds and the restarts. From the very beginning, the management and the union have worked extraordinarily well together to ensure that safety remains the absolute priority here and thus far the results have been really gratifying.

As I said, we have months of really heavy activity left, but we're quite proud of what the team has accomplished thus far. And we're very confident they can maintain their focus and their excellent performance.

At Grundartangi you can see a reasonably steady safety environment. The other two plants performed below our expectations this past quarter. That's very uncharacteristic at Sebree. They've had a fantastic run the last couple of years on safety performance. We've already seen much improvement over the last couple of months so we're assuming that was an aberration over the quarter during the second quarter.

At Mt. Holly we're concerned that the ongoing uncertainty with regard to the power contract is getting in the way of the plant's historical excellent safety focus and we're watching that situation very closely.

Moving down to production, no surprises here. At Hawesville you see the beginning of some incremental volume coming from the cells that we began restarting in June. Obviously, you see the lots of the single pot line at the end of May at Sebree and good stability at the other plants as we would expect.

Moving down to production metrics or KPIs, stable across plants. I need to reiterate that this really doesn't happen without significant and focused effort every single day. And just to emphasize one more time how important it is at times like this of industry volatility with a lot that's going on inside the company.

Conversion costs, lastly, there's a lot going on here due to the restart projects with the Kentucky plants as well as raw material costs so let me just give you a couple of comments to put all this in context. First, at Hawesville, carbon and power costs in aggregate account for a little more than half of that increase there. And the power cost is up simply due to the normal seasonal pricing being a little higher from the summer weather; we see that every summer.

The rest of the increase, just over half of that, is due directly to the restart project. You obviously have to start adding labor before the production comes back fully. And so that will start to reverse itself when the plant is back to full capacity towards the end of this year into next year.

Moving on to Sebree, that entire increase is due to the impact of the pot line loss, same concept there. You got a fixed cost. Remember these data are measuring per metric ton changes so you have got the same impact there. You've got the fixed cost spread across the lower production volume, nothing more. We've have also got some temporary labor in the plant to help the restart process get done as quickly as possible.

Mt. Holly, good performance there as you see. Power costs have actually been down due to a favorable natural gas price and labor and other costs down as well, so good cost management at Mt. Holly during the quarter.

And at Grundartangi, actually very good performance there. If you look at power and carbon together, they account for more than 100% of that change that you see there. And of course power is up solely due to the higher LME price. As you know we pay on reference, we pay for our power on reference to the LME price in Iceland. These increases were offset by good performance in controllable areas and the most notable of these was a reduction in pot reline costs as the stability of the Grundartangi operation has yielded a lower number of cell failures.

And with that, I will hand it over to Shelly.

S. Harrison Thanks, Mike. Let's turn to Slide 8, and I'll walk you through the high level results for the second quarter. On a consolidated basis, global shipments were down about 4% quarter-over-quarter primarily due to the equipment failure at Sebree that Mike mentioned. While shipments were down, realized prices were up more than 8% as a result of higher lagged LME prices and regional premiums.

Looking at operating results, adjusted EBITDA was $54 million this quarter, and we had adjusted net income of $0.32 per share. In Q2, adjusting items include $8.5 million related to the Sebree equipment plant failure and $3 million for expenses related to the Hawesville restart.

So let me give you a little more background on these two items. For Sebree, we expensed $1.5 million in Q2 for cost to prepare the line for restart. We also had reduced production of approximately 6,000 tons in the quarter which translates to about $7 million in lost profit and fixed cost.

For Q3, we estimate that we'll lose an additional 12,000 tons of production which will translate to a P&L impact of $10 million to $15 million. As a reminder, we expect to fully recover all of these losses from our insurance policies less our deductible of $7 million. However, the insurance proceeds and associated P&L benefit will probably lag the actual loss by a couple of quarters. We'll continue to call out the P&L impact of this loss as well as future insurance proceeds as adjusting items in the coming quarters.

For Hawesville, in Q2, we expensed about $3 million related to the restart of the curtailed lines. As we mentioned on our last call, we're capitalizing most of the spending associated with the restart and I'll talk about those costs when we get to the cash flow slide.

Turning to liquidity, our cash balance decreased by $7 million primarily as a result of a build in inventory, which I will talk about in a couple of slides. Availability under our revolving credit facilities was up by $26 million in Q2 as a result of an amendment to our US lines, increasing the revolver limit to $175 million. That facility was also extended by three years and now matures in 2023.

Let's go to Slide 9 and I can walk you through our Q-to-Q bridge of adjusted EBITDA. During Q2, we generated $54 million of EBITDA as compared to $22 million in Q1. The $32 million increase was driven by higher realized LME prices and regional premiums. On a lag basis, the LME was up $40 a ton and the US Midwest premium was up $178 a ton. These two items increased Q2 EBITDA by $27 million.

Second quarter results also benefited by $8 million from lower raw material pricing, which was primarily related to lower realized alumina costs. The alumina improvement is a bit less than we anticipated on our last earnings call due to timing of deliveries which can impact our average lag in pricing.

Looking ahead to Q3, the lagged LME is up another $40 a ton and the lagged US Midwest premium is up about $75 a ton. These two items translate to an improvement of about $10 million in EBITDA. Offsetting this, however, is the increase in lagged alumina prices. For Q3, we expect higher realized alumina prices to decrease EBITDA by $35 million to $45 million. So as a result of higher realized selling prices and higher alumina cost, we expect to see a net decrease in Q3 EBITDA of $25 million to $35 million.

Let's turn to Slide 10 and we'll take a quick look at cash flow. We started the quarter at $131 million in cash and ended June with $124 million.

During the quarter, we made the semi-annual interest payment on our bonds of just over $9 million. We have had $9 million in capitalized costs associated with the Hawesville restart, and we spent $6 million for non-restart capex. We also made a significant investment in working capital during the second quarter, primarily as a result of increased inventories. The majority of the increase related to alumina inventories driven by higher prices and volumes on hand. We also had some buildup of materials in anticipation of the restart at Hawesville and Sebree.

As Mike mentioned, we expect to spend around $75 million for the restart of the three curtailed lines at Hawesville, the vast majority of which will be in 2018. This includes the $12 million we spent in Q2, taking into account both the capitalized and expensed amounts. For Q3, we expect to spend $35 million to $40 million on the restart and in Q4 this should be around $25 million.

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

M. Bless — Thanks, Shelly. And as usual, we thank all of you for joining us this afternoon. I think, Pete, we should just get right to questions.

P. Trpkovski Sure. Thanks, Mike. Kerry, can you go and kick off the Q&A session, please?

Moderator Sure. Thank you. [Operator instructions]. And our first question comes from Jeremy Kliewer from Deutsche Bank. Please go ahead.

J. Kliewer Hi, guys. Good evening. You guys have a strong balance sheet and you have been for the past year or so, under one-times to EBITDA. I was going to see if you could provide some insight as potential uses of cash other than at Hawesville, which is going to use the majority of that over the next three, four quarters.

M. Bless Yes, so you've answered at least short-term, Jeremy, the question that Hawesville restart will take up. And again, as you of all people know, everybody on this call knows that the cash flow is going to be variable based on commodities prices and it will be tempered, I guess, is one word one might use until the alumina price reverts to where it belongs, as far as we're concerned and most people are concerned. So until that happens, the focus is going to be on Hawesville.

As I've told you, as we've told you, we are looking at some other projects to improve the company's product mix and production. We've been for some time looking at investments to enable us to produce more value-added products, a significant quantum change in value-added products at our plant in Iceland. As you know only about one-sixth of that production today is value-added products and the rest is standard grade ingot. So that's something at which we're looking.

And then as we've talked about over the quarters, to the extent we were to see—because we do agree that the balance sheet given the earnings power of the company with commodities, especially alumina at normalized levels is strong. At that point in time, we would look hard at the return of capital to shareowners, which we believe is the first call on cash against which we measure any investment.

J. Kliewer Okay. Thank you for that. And then just to follow-up at Hawesville, what type of energy-savings, I guess, are you guys seeing with the new technology there?

M. Bless Yes, that's a great question. So based on, again, divided into—let me answer the question once the project is done, i.e. we'll call it the Phase 1 technology improvements, which as I said are more modest than the Phase 2. Phase 1 being a new cell lining design and—I mean, Phase 1 being the new cell line design, Phase 2 being the new anode—the material that holds the anode to the cell design.

So when you get through all that, it's going to be upwards of 10%, which is a significant improvement and it's one of the things, again, going back to the tariffs that the administration has said from the beginning. It was their hope that this would accomplish would be not just bring capacity back on for the sake of bringing it back on, but investing in these assets so that they can be more competitive over the long-term. So that's the modeled answer to your question and thus far in the test cells that's what we're seeing at the very least.

J. Kliewer Thank you. Good luck.

M. Bless Yes. Thank you very much.

Moderator Thank you. And now to the line of Lucas Pipes from B. Riley. Please go ahead.

L. Pipes Hi, good afternoon everybody. Maybe to follow-up on that last point a quick clarification when you said upwards of 10% improvement, is that on the electricity cost at Hawesville or did I miss something?

M. Bless No, no, not the cost. The cost doesn't change. We obviously are a buyer of power in the wholesale market, so what I'm talking about here is what in the industry is in layperson's terms power efficiency. So the unit of input of electric power required to make one kilogram or one metric ton of electricity; it's a standard measure in the primary aluminum industry.

L. Pipes Got it. So we should think about once those improvements are completed, you will consume 10% less electricity?

M. Bless Correct.

L. Pipes Got it. Okay. Thank you for that.

M. Bless No problem.

L. Pipes And then obviously there's been a tremendous amount of volatility in the alumina market. And I wondered if this is altered maybe in the short-term your purchasing activity and hopefully of course this volatility and elevated alumina prices will all subside and return to more normalized prices in a reasonably short order. But anyway, I would appreciate your perspective about managing that risk and that exposure. Thank you.

M. Bless — Thank you very much. So just before answering your question, I'll pile on and agree with the statement at the end of your question. If we look at all the fundamentals, if you look at industry balance of supply and demand, capacity coming on as we said, the implicit cost of refining bauxite into alumina, etc., there's been no fundamental changes in the macroeconomics of the alumina market over the last year.

All that's happened, of course, is these major disruptions. As you'll recall just winding up the way the machine way back in commodity, I suppose, six months ago, alumina was trading as we expected it in the low to mid-300s. I think, Pete, it came down to 330? And then of course the excursion in Brazil occurred and that was compounded some time later of course by the sanctions on Russel [ph].

And so nothing has changed since back in January from a fundamental basis. So we remain convinced the market will revert to where it belongs once these temporary things are settled.

Now to answer your question, it's a tough one. Obviously, you need safety stock in a smelter. Standard industry practice is anywhere from, Shelly, 20 days to maybe 30 days of alumina on hand. In the US, frankly we've been carrying a little bit more than that to mitigate. I'm sure you've read in just the general press the severe problems that the Army Corps of Engineers has been having with Lock and Dam 52 and 53 on the Ohio River. And so until that our replacement is fully up and functioning, scheduled I believe for the third quarter of next year, 2019, you have to mitigate that risk because the one thing you can't do is to run out of alumina smelter, dry [ph] alumina; that's catastrophic. And so that's been push a little bit the other way.

So in answer to your question is in the US at least for the Kentucky plants the risk-reward trade is just wrong there to run those ducts down. At the other plants, to your perceptive point, we are running a little bit leaner than we would normally do from a units of volume standpoint. But as

Shelly said, the real driver in that alumina balance that you see on the face of balance sheet is the price.

As we discussed many times, you see the impact of alumina pricing roll through our cost of goods sales and that's through our profitability on a lagged basis because of course of A, our type of accounting, and B, the fact that we paid for our alumina on a lagged month basis. But you see the impact on our cash and thus our balance sheet immediately as soon as we pay for the alumina. So it's a bit complex.

L. Pipes Got it. Got it. I know that's helpful. Maybe one other one here, just in terms of capital allocation, one option would be from a longer term perspective—so different from the question before, which focused more on the immediate term here. But from a longer term perspective, you could argue vertical integration might be a solution. Are you spending much time thinking about that or are you really just happy kind of with where you sit in the value chain? And you mentioned to an earlier question, returning capital to shareholders is a priority, so how do you balance those factors? I appreciate your perspective. Thank you.

M. Bless

Great question. So we would like to grow, and it's our intent to grow and vertical integration for us, we don't call it that here, but your term vertical integration to us is backwards-looking, back into the supply chain, not forward. So bauxite and alumina is something that we look at a lot. And we believe that—we wouldn't wish to be 100% covered, i.e. have 100%, I'll use the term again that we don't use here, captive alumina production versus our smelting needs. But, we do think there's a balance somewhere between where we are now and being 100% covered, to answer, perhaps, part of your question.

To answer the other part, we don't see the utility at this point in time in considering downstream investments. It's a very different competency in terms of the operations talent that you need and that's really how we believe we produce value here is through squeezing these operations and the talent that we have in the operations.

It's just so different. One is a manufacturing business downstream. One is an electrochemical process business, upstream, what we do, of course reduction. And so we just don't see the value add there that our company and our management team would bring, and I guess my personal experience is that it's just I've seen a lot of companies and management teams destroy shareowners' value by that kind of integration in places that they had no business in going.

And so, the standard on that, if you will, though the risk adjusted return, cost of capital, whatever fancy term one wants to use, that we'd apply to that kind of investment will be much, much higher than an investment in our wheelhouse, i.e. smelting and backwards. Because, ultimately we do have to compare it to returning cash to shareowners. That's the default as far as we're concerned.

L. Pipes — It makes perfect sense to me, and I appreciate all that insight and best of luck.

M. Bless — Thank you so much for the questions.

Moderator — Thank you. [Operator instructions]. And now to the line of David Gagliano from BMO Capital Markets. Please go ahead.

D. Gagliano — Hi. I just had a quick clarification. Shelly, you said $10 million to $15 million in the third quarter for Sebree, right? Is that incremental to 2Q or is that total?

S. Harrison Yes, so that is incremental. So Q2 we had $7 million of lost profit and fixed cost. In Q3 it will be additional $10 million to $15 million, and we will call that out as an adjusting item again next quarter.

M. Bless So it's a pretty simple. Let's take the midpoint or take the high end to do the math, just as a use of point. So $8 million is what we realized in "Q2", let's say it's $15 million, Shelly, in Q3, that's $23 million. So we would get a check from the insurers for $16 million depending on the timing and perhaps late this year, swapping in for some of it early next year, might not all be in the same month or quarter. Right?

S. Harrison Yes.

M. Bless And so we'll adjust all that out for you. Obviously, when we receive those insurance proceeds we'll show you that "adjust that out" so you can see as if we hadn't received it.

D. Gagliano Okay, that's helpful. Thanks. And then I got on a little late, so I apologize if you covered this, but regarding the restart at Hawesville, and the tightness in the alumina market, is there any change in the commentary regarding the ability to procure alumina?

M. Bless No, that's a good question. And no, you didn't miss that, David. We didn't cover that. What I would say is we're looking at it closely just in terms of cash flow liquidity whatnot. I mean the alumina market as we all know right now, it's not for the faint of heart, but we do have confidence within the reasonably foreseeable future, we will get it sorted out.

No the procurement of alumina hasn't been the issue. As I said, I did say earlier in my comments, perhaps you missed it, is that the market did reasonably quickly after the second hammer fell, that was the Russel [ph] sanctions, the market did sort out ultimate supply lines reasonably quickly and reasonably well. So it's a price issue, pure and simple.

D. Gagliano Hello?

M. Bless David?

D. Gagliano Sorry, I thought I lost you there for a second. Sorry, one last question. You mentioned $75 million for Phase 2. Is that all capitalized or is any of that expense?

M. Bless Most of it, David, will be capitalized at this point in time, at least the capital portion of it, the capital projects and the technology upgrade. The $40 million line rebuild, we're studying the right accounting of that in the future. As you know we studied quite comprehensively the right treatment for the rebuild of the three lines that have been down, and the accounting treatment there is pretty straightforward. You sort of treat it as if you're building it for the first time, just in layperson's terms.

For the two lines that are currently producing, I mean, the cash we're pretty clear on the budget. So to us cash is what principally matters, but as to whether that effort will be expensed or capitalized, I wouldn't want to conclude right now. That will take some additional work over the next couple of months.

D. Gagliano Okay. That's it for me. Thanks.

M. Bless Thanks, David.

Moderator Thank you. And now to the line of John Tumazos from John Tumazos Independent Research. Please go ahead.

J. Tumazos Thank you. How do you expect the Chinese pollution restrictions to work this winter? They restarted all their steel output and more, but their aluminum output appears to be about the same, maybe a little less this year.

M. Bless Yes. Good question, John. We're watching that closely. You may have seen some of the data that we're getting more and more data, this is kind of we're in the belly of the beast right now looking forward to that season. So maybe you're seeing a lot of the same data as are we, some fresh information last week. People running around counting noses [ph] or smelters and refineries in this case.

We think at this point in time, and it's really difficult to predict at this point in time, as you've seen the government has on all of these industries, not just ours and steel, all the so-called polluting industries I think it's the term as it translates from Mandarin into English has really been clamping down. And so, we do see when you look at last year at least some consistency with last year in both smelting and refining.

But John, I wouldn't want to call it and I certainly wouldn't want to behave in the marketplace consistent with a strong opinion, because it's just, it's too volatile and it's too difficult to tell at this point in time. There is too much else sort of up in the air.

I know that sounds like skirting around the question, and perhaps it is. That's an honest answer.

J. Tumazos — We have the same problems in all the markets we study. Thank you.

M. Bless — Thank you, John.

Moderator — All right. Thank you. And now to the line of Jeremy Kliewer from Deutsche Bank. Please go ahead.

J. Kliewer — Yes. I have follow-up question here.

M. Bless — No problem.

J. Kliewer — On your prepared comments you stated you guys are trying to plan for Mt. Holly capacity at yearend kind of cut off your electrical supply. So can you just confirm that if it does go into 2019, would it be on that same 75% market rates or do you guys still have to work that out with Santee Cooper or how is that work going forward?

M. Bless — The latter, still have to work that out. The current contract expires on the 31st of December, and so that needs to worked out. Good question.

J. Kliewer — So, I guess, if your contract negotiations are ongoing, would you still give that 60-day heads up notice or how—

M. Bless — Now you're fast forwarding, let's see we're 1 August right now and you're fast forwarding to 1 November. So you're fast forwarding three months, a lot's going to happen between now and then. I wouldn't want to predict. It will be—again, this will sound like skirting the question, Jeremy. It will be fast in circumstances at the time.

If it feels like we're close to something that makes sense, i.e. something consistent with where we've been, I certainly wouldn't want to do that.

There's a lot of implications in doing that the constituencies; the two constituencies I care the most about are our employees and our customers. And so those are the constituencies that you're thinking about when you make a decision like that, but I'm going to be reasonably optimistic that we'll sort it out before the 1st of November.

J. Kliewer — Great. Thank you.

M. Bless — Thanks, Jeremy.

Moderator — Thank you. And now to the line of Lucas Pipes from B. Riley. Please go ahead.

L. Pipes — Thanks for taking my follow-up question. I wanted to ask you a little bit about the tariff situation, and it appears that there's some background negotiations just picking up headlines from the press in regards to the tariffs and our allies. I wondered if you have a perspective on that and if hypothetically Europe or Canada would be excluded, what do you think would be the impact to the Midwest premium?

M. Bless Yes. I will give you direct answer on the second part of your question in just a sec. On the first part, we don't know. We don't know any more than anybody else does. We read the press, we talk to the same folks in Washington, to whom everybody else talks. It seems like those negotiations are ongoing. Obviously there were some—it looked like positive developments just last week now.

On the second part of your question, we believe there would be no impact, because we're quite confident, very confident as we said in the past that if there are any further additional country exceptions granted that they'll come with quotas that really bite. The net impact of all that will be that there will be enough, a significant amount, of imports that are still subject to the quotas that it will have no impact on the Midwest.

And that's what you've seen the administration, from the highest levels of the White House and the trade experts and responsible persons say very directly over and over. So that's why we have such confidence there.

L. Pipes Got it. Great. Thank you very much.

M. Bless Thank you very much.

Moderator	Thank you. We have no one else in queue. Please continue.
M. Bless	We very much appreciate your time and interest and look forward to speaking with you in a couple of months if not before. Take care.
Moderator	Thank you. And ladies and gentlemen, that does conclude our conference for today. Thank you for your participation and for using AT&T Executive TeleConference Service. You may now disconnect.