

Alcoa Inc. (AA)

Rating	OUTPERFORM* [V]
Price (07 Oct 09, US\$)	14.20
Target price (US\$)	(from 15.00) 18.00 ¹
52-week price range	16.71 - 5.22
Market cap. (US\$ m)	12,010.81
Enterprise value (US\$ m)	21,826.81

*Stock ratings are relative to the relevant country benchmark.

¹Target price is for 12 months.

[V] = Stock considered volatile (see Disclosure Appendix).

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INCREASE TARGET PRICE

The Rebound Continues, Raising TP

Following Q3 results, we reiterate our Outperform. We are raising our target price from \$15 to \$18, to reflect our view that the previous remnants of any liquidity concerns should now be alleviated.

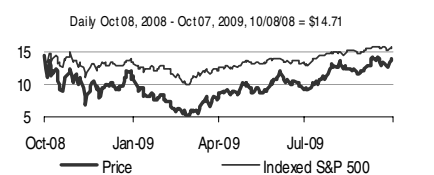
Q3 results - Excluding restructuring and special items, Alcoa reported operating earnings of \$0.04, vs Consensus loss of \$0.09, and CS estimated loss of \$0.10. Adjusted after-tax operating income was \$107m, vs. our estimated ATOI of \$56m.

Earnings revisions – We are raising our Q4 estimate from a loss of \$0.11 to a loss of \$0.02. Our Q4 estimate is based on a \$0.78/lb avg price (avg of Sept. actual plus global house est of \$0.75 for remainder). Our 2010 EPS estimate of \$1.00 is unchanged. (Based on \$0.90/lb price assumption).

Valuation – Our revised 12-month target price of \$18 translates into 8.4x our 2010 EBITDA estimate (based on 2010 aluminum price of \$0.90/lb).

Our Thoughts – Better than expected results were largely driven by improved demand in the downstream segments. AA appears to be exceeding the cost initiatives that it set out in Q1, with procurement savings at 107% of budget YTD and overhead savings more than 188% above its 2009 target, but currency headwinds largely offset cost savings. Looking ahead, in our view seasonal weakness and production shutdowns will limit the likelihood of another sequential improvement in Q4 results in our view, assuming aluminum prices remain range bound, before a more sustainable demand recovery materializes in 2010.

Share price performance



On 10/07/09 the S&P 500 index closed at 1057.58

Quarterly EPS	Q1	Q2	Q3	Q4
2008A	0.50	0.66	0.37	-0.28
2009E	-0.58	-0.26	0.04	-0.02
2010E	0.22	0.27	0.27	0.24

Financial and valuation metrics

Year	12/08A	12/09E	12/10E
EPS (CS adj., US\$)	1.25	-0.75	1.00
Prev. EPS (US\$)	—	-0.99	—
P/E (x)	11.4	NM	14.2
P/E rel. (%)	68.7	NM	100.2
Revenue (US\$ m)	26,901.0	17,318.0	20,301.2
EBITDA (US\$ m)	3,372.0	776.9	3,171.6
OCFPS (US\$)	1.51	0.59	2.11
P/OCF (x)	7.5	24.0	6.7
EV/EBITDA (current)	6.5	27.4	6.3
Net debt (US\$ m)	9,816	9,273	7,996
ROIC (%)	3.34	-2.23	3.14
Number of shares (m)	845.83	IC (12/09E, US\$ m)	33,035.02
BV/share (current, US\$)	26.9	EV/IC (x)	0.64
Net debt (current, US\$ m)	9,007.0	Dividend (current, US\$)	0.03
Net debt/tot. cap. (current, %)	23.6	Dividend yield (%)	0.21

Source: Company data, Credit Suisse estimates.

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Q3'09 Results

Excluding net restructuring and special items of \$34 million, Alcoa reported Q3 operating income of \$0.04 vs. our estimate of a loss of \$0.10, vs. the First Call Consensus estimate of a loss of \$0.09, and prior-year operating EPS of \$0.37. Segment after-tax operating income (ATOI) totaled \$107m versus our estimate of \$56m.

Business Segment Highlights

Q3'09 after-tax operating income (ATOI) by segment:

- Alumina and Chemicals: ATOI of \$30m (excluding the \$35m gain from the Suriname acquisition) vs. prior year of \$206m and vs. our estimate of a loss of \$13m.
- Primary Metals: Loss of \$8m vs. prior year loss of \$101m and vs. our estimate of income of \$68m.
- Flat Rolled: ATOI of \$10m vs. prior year loss of \$106m and vs. our estimate of a loss of \$59m.
- Engineered Products and Solutions: \$75m vs. prior year of \$73m and vs. our estimate of \$59m.

Total Adjusted Segment ATOI: \$107 million vs. prior-year income of \$665 million, Q2 ATOI loss of \$132m, and vs. our estimate of \$56m.

Alumina Segment

Exhibit 1: Segment Highlights

Alumina	Q3'08	Q2'09	Q3'09	Q-Q%	Y-Y%	2007	2008	2009E	% Chg.	2010E	% Chg.
Shipments (Kt)	2,010	2,011	2,191	9.0%	9.0%	7,834	8,041	7,939	-1.3%	8,000	0.8%
Third Party Revenues (\$MM)	805	441	530	20.2%	-34.2%	2,709	2,924	1,889	-35.4%	2,232	18.2%
After-tax operating income (\$MM)	206	(7)	30	NM	-85.4%	1,006	733	121	NM	366	NM
After-tax operating margin (%)	13.4%	-0.9%	3.1%	NM	-76.8%	18.5%	12.7%	2.6%	NM	9.2%	NM
Implied realized prices (US\$/lb)	400	219	242	10.3%	-39.6%	346	364	238	-34.6%	279	17.3%

Source: Company data, Credit Suisse estimates

After-tax operating income (ATOI) for the alumina segment decreased \$176m vs. the same quarter last year to a gain of \$30 million (excluding the \$35m gain from the Suriname acquisition) (+\$37m sequentially), but was better than our estimated loss of \$13m. Third party alumina shipments of 2.2m tonnes were better than our estimate of 2.0m tonnes. ATOI margins in Q3 were +3.1% vs. our estimate of -1.7%, Q2'09 of -0.9% and 13.4% in Q3'08.

Looking forward, Alcoa expects Q4 results to be partially impacted by start-up costs at the Brazilian projects (~\$13m drag on ATOI in Q4), although the inclusion of Suralco during the quarter should improve shipments. Continued cost savings from previous program initiatives are expected to continue, as lower caustic and pitch costs are realized. We are currently forecasting ATOI for the alumina segment of \$32m in Q4.

Primary Metals Segment

Exhibit 2: Segment Highlights

Primary Metals	Q3'08	Q2'09	Q3'09	Q-Q%	Y-Y%	2007	2008	2009E	% Cha.	2010E	% Cha.
Shipments (Kt)	704	779	698	-10.4%	-0.9%	2,291	2,926	2,920	-0.2%	3,040	4.1%
Third Party Revenues (\$MM)	2,127	1,146	1,362	18.8%	-36.0%	6,576	8,021	4,676	-41.7%	6,234	33.3%
After-tax operating income (\$MM)	297	(178)	(8)	NM	NM	1,445	931	(508)	NM	959	NM
After-tax operating margin (%)	9.3%	-11.9%	-0.4%	NM	NM	12.5%	7.8%	-8.0%	NM	11.6%	NM
Implied realized prices (US\$/lb)	1.34	0.76	0.89	18.3%	-33.0%	1.26	1.23	0.80	-34.8%	0.96	19.5%
Spread Over LME price (US\$/lb)	0.02	0.10	0.09	-1.7%	497.0%	0.05	0.01	0.09	NM	0.06	NM

Source: Company data, Credit Suisse estimates

Primary Metals after-tax operating income was a loss of \$8m, vs. a loss of \$178m in Q2'09, a profit of \$297m in the prior year and significantly better than our estimate of \$68m. ATOI margins of -0.4% were well below our estimate of 4.0% and Q2'09 of -11.9%. We estimate that the company's realized price was roughly \$0.9/lb higher vs. the Q3 average LME 15 day lagged price (of \$0.80/lb), offset by negative currency impact of \$29 million.

We are currently forecasting ATOI for the primary metals segment improves to positive \$2m in Q4 (based on an LME aluminum price forecast of \$0.78/lb), with ongoing procurement cost improvements partially offset by rising energy costs.

Flat Rolled Products segment

Exhibit 3: Segment Highlights

Flat Rolled Products	Q3'08	Q2'09	Q3'09	Q-Q%	Y-Y%	2007	2008	2009E	% Cha.	2010E	% Cha.
Shipments (Kt)	580	448	476	6.3%	-17.9%	2,441	2,296	1,829	-20.3%	2,440	33.4%
Revenues (\$MM)	2,343	1,427	1,529	7.1%	-34.7%	9,932	8,966	5,895	-34.3%	8,069	36.9%
After-tax operating income (\$MM)	22	(35)	10	NM	-54.5%	204	(3)	(81)	2588.7%	77	NM
After-tax operating margin (%)	0.9%	-2.4%	0.6%	NM	-30.3%	2.0%	0.0%	-1.3%	4006.9%	0.9%	NM
Implied realized prices (US\$/lb)	1.87	1.47	1.49	1.5%	-20.5%	1.89	1.81	1.49	-17.8%	1.54	3.6%
Pre-tax Operating profit (est. US\$/lb)	0.031	(0.036)	0.026	NM	-17.8%	0.055	0.006	(0.015)	NM	0.020	NM

Source: Company data, Credit Suisse estimates

Alcoa's flat-rolled segment generated after-tax operating profit of \$10m vs. our estimate for a loss of \$59m, a loss of \$35m in Q2 and a profit of \$22m in Q3'08. ATOI margins were +0.6% in Q3, vs. -2.4% in Q2'09 and prior year of 0.9%.

Alcoa expects ongoing end market weakness, weakness in Russia and seasonal weakness to impact Q4, offset by continued cost-saving initiatives. We are currently estimating the flat rolled segment generates an ATOI profit of \$5m in Q4.

Engineered Solutions segment

Exhibit 4: Segment Highlights

Engineered Solutions	Q3'08	Q2'09	Q3'09	Q-Q%	Y-Y%	2007	2008	2009E	% Cha.	2010E	% Cha.
Shipments (Kt)	45	50	43	-14.0%	-4.4%	207	-	-	-	-	-
Revenues (\$MM)	1,596	1,194	1,128	-5.5%	-29.3%	6,719	6,199	4,664	-24.8%	3,766	-19.2%
After-tax operating income (\$MM)	140	88	75	-14.8%	-46.4%	382	533	345	-35.3%	346	0.2%
After-tax operating margin (%)	8.8%	7.4%	6.6%	-9.8%	-24.2%	5.7%	8.6%	7.4%	-13.9%	9.2%	24.0%

Source: Company data, Credit Suisse estimates

The engineered solutions segment posted Q3 ATOI of \$75 million, which was better than our estimate of \$59m, Q2 ATOI of \$88m and \$140m in Q3'08. ATOI margins were 6.6% in Q3, vs. 7.4% in Q2'09 and prior year of 8.8%.

Alcoa expects continued weak end-markets and the typical seasonal slowdown to further impact demand in Q4, offset by continued benefits from cost savings initiatives. We estimate ATOI will rise slightly in Q4 to \$87m.

Exhibit 5: Summary Income Statement

	Q3'08	Q2'09	Q3'09	% change vs.		2007	2008	2009E	% Chg.	2010E	% Chg.
				Q3'08	Q2'09						
Sales & Operating Revenues	7,234	4,244	4,615	-36.2%	8.7%	31,201	26,901	17,318	-35.6%	20,301	17.2%
Cost of Sales and Op Expenses	5,944	3,966	3,888	-34.6%	-2.0%	24,248	22,175	15,588	-29.7%	16,130	3.5%
Selling, General & Administrative	283	240	234	-17.3%	-2.5%	1,472	1,167	968	-17.1%	800	-17.4%
Research & Development	64	38	39	-39.1%	2.6%	249	246	163	-33.7%	200	22.7%
Depreciation	316	317	342	8.2%	7.9%	1,268	1,234	1,273	3.1%	1,179	-7.4%
Interest Expense	97	115	120	23.7%	4.3%	401	407	456	12.0%	513	12.5%
Other Expense (Income)	43	(89)	(123)	NM	NM	(1,336)	(59)	(182)	n.m.	-	n.m.
Special Items (Income)	17	82	17	NM	NM	(45)	939	168	n.m.	-	n.m.
Profit Before Taxes	470	(425)	98	NM	-123.1%	4,944	792	(1,116)	n.m.	1,480	n.m.
Income Taxes	117	(108)	(22)	NM	NM	1,555	342	(439)	n.m.	414	n.m.
Tax Rate	33%	24%	-18%								
Income from Operations	353	(459)	120	NM	-126.1%	3,389	450	(677)	n.m.	1,066	n.m.
Minority Interests	84	(5)	47	NM	NM	365	221	60	n.m.	-	n.m.
Inc. from Continuing Operations	269	(454)	73	NM	-116.1%	3,024	229	(737)	n.m.	1,066	n.m.
Income (loss) from disc. operations	(1)	(142)	4			-	(303)	-	n.m.	-	n.m.
Extraordinary Gain (loss)	-	-	-			-	-	-	n.m.	-	n.m.
Cumulative effect of accounting change	-	-	-			-	-	-	n.m.	-	n.m.
Net Income	268	(312)	77	NM	NM	3,024	229	(737)	n.m.	1,066	n.m.
Preferred Dividends	-	-	-			-	-	-	n.m.	-	n.m.
Net Income to Common Shrs	268	(312)	77	NM	NM	3,024	229	(737)	n.m.	1,066	n.m.
Per share:											
Fully Diluted (As reported)	\$0.33	(\$0.32)	\$0.07	NM	-121.9%	2.96	\$0.20	(\$0.79)	n.m.	\$1.00	n.m.
Fully-diluted non-recurring/non-operating	0.04	0.06	(0.03)			(0.50)	1.05	0.04		-	
Fully Diluted EPS (operating)	\$0.37	(\$0.26)	\$0.04	NM	NM	2.46	\$1.25	(\$0.75)	n.m.	\$1.00	n.m.
Shares Outstanding (fully diluted)	815	974	978	19.9%	0.3%	869	818	937	14.5%	1,062	13.4%
EBIT	644	(317)	120	NM	NM	3,919	2,138	(492)	n.m.	1,993	n.m.
EBITDA	960	-	454	NM	NM	5,187	3,372	781	n.m.	3,172	n.m.

Source: Company data, Credit Suisse estimates

Companies Mentioned (Price as of 07 Oct 09)

Alcoa Inc. (AA, \$14.20, OUTPERFORM [V], TP \$18.00)

Disclosure Appendix

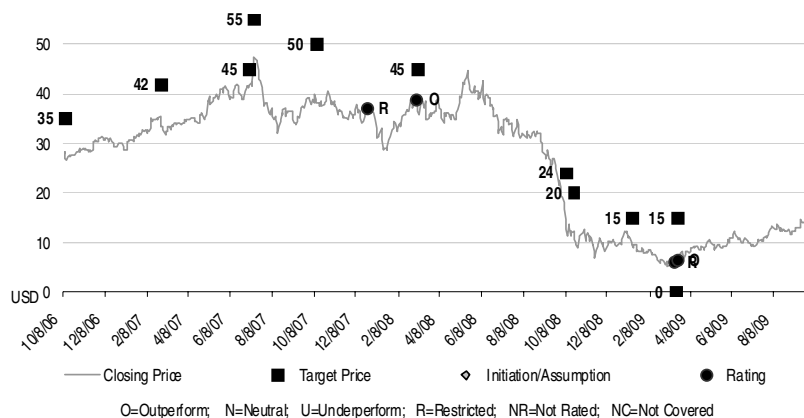
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See the Companies Mentioned section for full company names.

3-Year Price, Target Price and Rating Change History Chart for AA

AA	Closing Price (US\$)	Target Price (US\$)	Initiation/ Rating Assumption
10/11/06	26.85	35	
2/27/07	33.79	42	
7/6/07	41.66	45	
7/13/07	47.35	55	
10/10/07	38.73	50	
12/24/07	37.01		R
3/5/08	38.73		O
3/6/08	38.37	45	
10/8/08	14.71	24	
10/20/08	12.41	20	
1/13/09	9.55	15	
3/16/09	6.12		R
3/17/09	5.59	0	
3/19/09	6.4	15	O



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Price Target: (12 months) for (AA)

Method: Our 12-month target price of \$18 for Alcoa is based on our sum of the parts estimate for the company, as well as an EV/EBITDA enterprise value/earnings before interest, depreciation, and amortization) multiple of 8.4x and a P/E multiple of 18.0x based on a long-term aluminum price assumption of \$0.90/lb.

Risks: Primary risks to our \$18 target price for Alcoa are: 1. Volatility in aluminum price, 2. Aluminum Supply & Demand Imbalance, 3. Sustainability of economic recovery, 4. Currency exposure, 5. Country risks (economic as well as political), and 6. an unfavorable cost position in primary aluminum smelting.

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