

# ALCOA INC

## FORM 10-K (Annual Report)

Filed 02/18/10 for the Period Ending 12/31/09

Address	201 ISABELLA ST ALCOA CORPORATE CTR PITTSBURGH, PA 15212-5858
Telephone	4125532576
CIK	0000004281
Symbol	AA
SIC Code	3350 - Rolling, Drawing, And Extruding Of Nonferrous
Industry	Metal Mining
Sector	Basic Materials
Fiscal Year	12/31

<http://www.edgar-online.com>

© Copyright 2010, EDGAR Online, Inc. All Rights Reserved.

Distribution and use of this document restricted under EDGAR Online, Inc. Terms of Use.

## Stock-based Compensation

Stock options under Alcoa's stock-based compensation plans have been granted at not less than market prices on the dates of grant. Performance stock options are also granted to certain individuals. For performance stock options granted in 2009, the final number of options granted is based on Alcoa's adjusted free cash flow against a pre-established target. For performance stock options granted in 2008 and 2007, the final number of options granted is based on the outcome of Alcoa's annual return on capital results against the results of a comparator group of companies. Stock option features based on date of original grant are as follows:

Date of original grant	Vesting	Term	Reload feature
2002 and prior	One year	10 years	One reload over option term
2003	3 years (1/3 each year)	10 years	One reload in 2004 for 1/3 vesting in 2004
2004 – 2009	3 years (1/3 each year)	6 years	None

In addition to the stock options described above, Alcoa granted stock awards that vest in three years from the date of grant. Certain of these stock awards were granted with the same performance conditions described above for performance stock options.

Plan participants can choose whether to receive their award in the form of stock options, stock awards, or a combination of both. This choice is made before the grant is issued and is irrevocable.

The following table summarizes the total compensation expense recognized for all stock options and stock awards (there was no stock-based compensation expense capitalized in 2009, 2008, or 2007):

	2009	2008	2007
Compensation expense recognized:			
Stock option grants	\$ 53	\$ 15	\$ 31
Stock award grants	34	79	66
Total compensation expense before income taxes	87	94	97
Benefit for income taxes	29	31	34
Total compensation expense, net of income taxes	\$ 58	\$ 63	\$ 63

The fair value of new options is estimated on the date of grant using a lattice-pricing model with the following assumptions:

	2009	2008	2007
Weighted average fair value per option	\$ 3.34	\$ 6.41	\$ 6.04
Average risk-free interest rate	0.3-2.65%	3.01-3.66%	4.75-5.16%
Dividend yield	1.2%	2.1%	2.2%
Volatility	38-76%	31-34%	22-29%
Annual forfeiture rate	3%	3%	3%
Exercise behavior	43%	39%	35%
Life (years)	4.2	4.0	3.8

The fair value of each reload option grant is estimated on the reload date using the lattice-pricing model. In 2009, there were no reload option grants. In 2008, the fair value and related assumptions for reload option grants were the same as the new option grants reflected in the table above. In 2007, the weighted average fair value per reload option grant was \$5.56 based on the following assumptions: an average risk-free interest rate of 4.94-5.11%; dividend yield of 2.2%; volatility of 22-24%; exercise behavior of 26%; and life of 1.5 years.

The following assumption descriptions are applicable to both new option grants and reload option grants. The range of average risk-free interest rates is based on a yield curve of interest rates at the time of the grant based on the contractual life of the option. For 2009, the dividend yield was based on a three-month average as a result of the significant decline in Alcoa's stock price in 2008 due to the global economic downturn and the previously mentioned reduction in Alcoa's quarterly common stock dividend. In 2008 and 2007, the dividend yield was based on a five-year average. Volatility is based on historical and implied volatilities over the term of the option. Alcoa utilizes historical option exercise and forfeiture data to estimate annual pre- and post-vesting forfeitures. The exercise behavior assumption represents a weighted average exercise ratio of the intrinsic value resulting from historical employee exercise behavior, which is based on exercise patterns for grants issued in the most recent six years. The life of an option is an output of the lattice-pricing model based upon the other assumptions used in the determination of the fair value.

The activity for stock options is as follows (options in millions):

	2009	2008	2007
<b>Outstanding, beginning of year:</b>			
Number of options	46.2	52.3	80.0
Weighted average exercise price	\$35.61	\$35.63	\$33.97
<b>Granted:</b>			
Number of options	27.1	2.9	6.1
Weighted average exercise price	\$ 8.34	\$31.20	\$41.14
<b>Exercised:</b>			
Number of options	-	(6.0)	(28.8)
Weighted average exercise price	\$ -	\$32.68	\$31.88
<b>Expired or forfeited:</b>			
Number of options	(7.8)	(3.0)	(5.0)
Weighted average exercise price	\$34.60	\$37.64	\$37.19
<b>Outstanding, end of year:</b>			
Number of options	65.5	46.2	52.3
Weighted average exercise price	\$24.44	\$35.61	\$35.63
<b>Exercisable, end of year:</b>			
Number of options	37.7	42.3	44.9
Weighted average exercise price	\$35.51	\$36.19	\$35.16

The total intrinsic value of options exercised during 2008 and 2007 was \$86 and \$269, respectively.

The following tables summarize certain stock option information at December 31, 2009 (number of options and intrinsic value in millions):

**Options Fully Vested and/or Expected to Vest\***

Range of exercise price	Number	Weighted average remaining contractual life	Weighted average exercise price	Intrinsic Value
\$6.12 - \$19.93	26.4	5.07	\$ 8.35	\$ 205
\$19.94 - \$27.71	2.9	2.96	22.59	-
\$27.72 - \$35.49	11.6	1.73	30.44	-
\$35.50 - \$48.10	24.6	0.80	39.13	-
<b>Total</b>	<b>65.5</b>	<b>2.78</b>	<b>24.44</b>	<b>\$ 205</b>

\* Expected forfeitures are immaterial to the Company and are not reflected in the table above.

**Options Fully Vested and Exercisable**

Range of exercise price	Number	Weighted average remaining contractual life	Weighted average exercise price	Intrinsic Value
\$9.91 - \$19.93	-	4.48	\$ 11.82	\$ -
\$19.94 - \$27.71	2.9	2.96	22.59	-
\$27.72 - \$35.49	10.2	1.45	30.58	-
\$35.50 - \$48.10	24.6	0.80	39.13	-
<b>Total</b>	<b>37.7</b>	<b>1.15</b>	<b>35.51</b>	<b>\$ -</b>

In addition to stock option awards, the Company has granted stock awards and performance share awards, both of which vest three years from the date of grant. Performance share awards are issued at target and the final award amount is determined at the end of the performance period.

The following table summarizes the outstanding stock and performance share awards (awards in millions):

	Stock Awards	Performance Share Awards	Total	Weighted average FMV per award
Outstanding, January 1, 2009	6.9	1.3	8.2	\$ 29.89
Granted	1.3	0.2	1.5	8.45
Converted	(1.9)	(0.4)	(2.3)	29.26
Forfeited	(0.4)	-	(0.4)	24.78
Performance share adjustment	-	0.2	0.2	16.74
Outstanding, December 31, 2009	5.9	1.3	7.2	23.81

At December 31, 2009, there was \$41 (pretax) of unrecognized compensation expense related to non-vested stock option grants, and \$28 (pretax) of unrecognized compensation expense related to non-vested stock award grants. These expenses are expected to be recognized over a weighted average period of 1.4 years. As of December 31, 2009, the following table summarizes the unrecognized compensation expense expected to be recognized in future periods:

	Stock-based compensation expense (pretax)
2010	\$ 46
2011	22
2012	1
<b>Totals</b>	<b>\$ 69</b>

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (333-149623), Form S-4 (No. 333-141419), and Form S-8 (Nos. 33-60305, 333-27903, 333-62663, 333-79575, 333-32516, 333-36208, 333-37740, 333-39708, 333-106411, 333-128445, 333-146330, 333-153369, 333-155668 and 333-159123) of Alcoa Inc. and its subsidiaries of our reports dated February 18, 2010 relating to the financial statements, financial statement schedule, and the effectiveness of internal control over financing reporting, which appear in this Form 10-K.

/s/ PricewaterhouseCoopers LLP  
Pittsburgh, Pennsylvania  
February 18, 2010