

CLM Heard on the Street
HD **Rio Tinto Already Has Metallic Tinge**
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All hail the metal of the future.

Headline-grabbing announcements from the likes of Ford Motor, which is using aluminum to lighten the latest version of its F-150 truck, have highlighted the metal's lightweight, malleable qualities.

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Meanwhile, ultracheap money available for financing trades has kept aluminum piled up in warehouses. That has pushed up the premiums over London Metal Exchange prices paid by customers actually wishing to get their hands on physical metal. Aluminum producers have benefited: shares in Alcoa, which reported better-than-expected second-quarter earnings this week, are up more than 40% this year.

That should be good news for Rio Tinto, the world's second largest producer of aluminum by volume which has had a torrid time in that business since its ill-timed **acquisition** of Alcan for \$38 **billion** in 2007. Investors hoping to reap the benefit of that, however, may find it is already priced into the stock.

Rio's aluminum business has been improving. The miner has written down the value of these assets by some \$30 **billion** since the Alcan deal. The division produced better-than-expected earnings last year, at \$557 **million**—thanks to \$574 **million** in pretax cost cuts. Meanwhile, a 10% price increase in average aluminum prices would have added about \$550 **million** to Rio's overall earnings last year, or about 5%.

But the near-term outlook for aluminum still isn't clear-cut. Rule changes around LME warehousing arrangements or rising interest rates could free up warehoused metal, prompting prices to fall. And even with the hype around aluminum cars, it will take time for demand growth to eat into global inventories. With **China** largely self-sufficient, older smelting capacity elsewhere must close to keep supply in check as more efficient plants start up.

Rio investors must await more details from new divisional boss Alfredo Barrios of his plans. Those could include more cost cutting and potentially shifting Rio's focus away from producing aluminum toward the higher-margin **mining** of bauxite, the critical raw ingredient for the metal that **China** lacks.

Meanwhile, it isn't clear that Rio is being egregiously shortchanged on its aluminum business.

Alcoa, which has built a downstream business making specialist products for sectors such as aerospace and defense, trades on about seven times 2015 Ebitda. Putting the same multiple on Rio's business, which is more focused upstream on **mining** bauxite and producing aluminum, suggests a value of about \$15 **billion**, based on Morgan Stanley's forecasts. That would leave Rio's remaining business, which makes most of its money in **iron ore**, trading at about 6.2 times—in line with closest rival BHP Billiton.

Aluminum's years in the Rio doghouse are coming to an end. But Rio looks like it is already getting a decent enough price for a business still being bashed into shape.

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CO frdmo : Ford Motor Company | rtz : Rio Tinto PLC | craaus : Rio Tinto Ltd

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