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HD **Aluminum to Add Shine to Rio Tinto --- Investors Expect Metal to Outperform Iron Ore as Chinese Smelters Cut Back, Demand From West Buoys Revenue**

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SYDNEY -- Rio Tinto's results have followed a predictable theme in recent years: strong earnings from iron ore and weak numbers from aluminum.

This year, investors expect something different.

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A run-up in aluminum prices amid cutbacks by Chinese smelters and stronger-than-expected demand in the West is providing positive earnings momentum to Rio Tinto Alcan.

In 2007 Rio Tinto spent US$38 billion on the acquisition of Canadian aluminum maker Alcan Inc., one of the costliest deals in global mining history in a bet that China and other developing Asian economies would need more of a metal used in everything from soda cans to jumbo jets. The deal -- struck as aluminum prices reached their highest level in decades -- quickly soured as demand plummeted during the financial crisis and China increased production.

For resource companies contemplating big acquisitions, the Alcan deal is held up as a cautionary tale. Rio Tinto's aluminum business has taken US$25 billion in write-downs over the past seven years and contributed to the departure of Tom Albanese as chief executive last year. When Rio Tinto tried to sell aluminum assets in 2011, there was no buyer.

But investors expect that Rio Tinto's first-half earnings report on Thursday will show that aluminum isn't only enjoying improved prospects, but outperforming many other commodities that the company produces, including coal for energy production.

Even iron ore, which accounts for the majority of Rio Tinto's earnings, is sputtering. The price of the steel ingredient has fallen sharply this year amid fears of a supply glut. UBS expects Rio Tinto's iron-ore profit to fall 11% from a year earlier.

Rio Tinto is expected to report underlying group earnings of US$4.69 billion for the half, up 11%, based on the median forecast of seven analysts polled.

"Finally, aluminum may have its day," said Ric Ronge, a fund manager at Pengana Capital in Melbourne, Australia, who owns shares in Rio Tinto.

UBS analyst Glyn Lawcock late last month increased his forecast for annual earnings at Rio Tinto's aluminum unit by 4% to US$659 million -- compared with the unit's US$557 million profit last year.

The Sydney-based analyst said Rio Tinto's earnings from aluminum are likely to be driven by the same factors aiding U.S.-based Alcoa Inc., an industry bellwether. While higher prices play a part, Alcoa and other aluminum makers also have cut costs sharply. Alcoa recently said its primary metals business, long a drag on earnings, returned to a profit in the second quarter after it cut spending and reduced costs.

Analysts say that improved fundamentals in the aluminum market indicate that Rio Tinto's profit from the metal will continue to rebound. UBS thinks aluminum could contribute as much as US$1.01 billion to Rio Tinto's earnings in 2016, as **China** cuts output to reduce pollution from aging smelters and stem domestic overcapacity.

Some analysts believe demand will outpace supply this year for the first time since 2007. J.P. Morgan forecasts an aluminum deficit of 439,000 metric tons this year, compared with a surplus of more than two **million** tons during the financial crisis. The bank has raised its forecast for aluminum prices in 2015 by 12% to US$2,125 a ton, compared with around US$2,020 a ton today.

Australia & New Zealand Banking Group says the outlook for metal prices is uncertain, however, explaining that **Chinese** production cuts may be shallower than expected amid pressure for provinces to meet economic-growth targets.

Still, aluminum's fledgling recovery is good news for investors and analysts who worry that Rio Tinto is too reliant on **iron**-**ore** production and vulnerable to hiccups in **China**'s urbanization, which has driven global demand for steel used in new skyscrapers, bridges and railways.

Rio Tinto's Alcan deal was driven by a desire to become more diversified, able to balance drops in prices of some commodities with higher profit from others. Instead, commodity prices have tended to fall across the board, and Rio Tinto has responded by cutting exposure to smaller units, such as **coal** and **copper**, and seeking buyers for entire divisions, including diamonds.

Rio Tinto recently installed former **oil**-and-gas executive Alfredo Barrios to run the aluminum business. Few investors think his appointment will **lead** to a shift in strategy, with cost controls continuing to drive decisions.

Rio Tinto has closed or curtailed 600,000 tons of aluminum production since 2009. It also has scaled back output of **alumina**, an ingredient in aluminum, notably through the closure of its Gove refinery in Australia's Northern Territory. In December, Rio Tinto said it wouldn't make significant new investments in **alumina** or aluminum for the foreseeable future.

Investors expect that strategy will pay off.

"The combination of cleaning the division up, shutting sites and selling bits and pieces at a time when the aluminum price has exceeded expectations, could certainly **lead** to a positive surprise this week," said Pengana's Mr. Ronge.



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