KEY INFORMATION

D. Risk Factors

Alumina Limited’s net income is affected by movements in the prices of aluminium and alumina

AWAC’s revenue is derived from sales of alumina, alumina-based chemicals and aluminium. The price that can be obtained for these commodities is influenced by the price of aluminium in the world market, and in particular, the LME price of primary aluminium. World aluminium prices are affected by numerous factors outside Alumina Limited’s control, including the overall performance of world economies and the related cyclicality in particular industries that are significant consumers of aluminium.

The development of new alumina refineries and aluminium smelters, and increased production by new or existing alumina and aluminium producers may create overcapacity, which could reduce future prices of alumina, alumina-based chemicals and aluminium, thereby adversely affecting AWAC’s, and hence Alumina Limited’s, profitability.

AWAC’s, and hence Alumina Limited’s, financial performance and ability to service liabilities, pay dividends, undertake capital expenditure and finance further acquisitions would be adversely affected by a sustained material fall in the prices of alumina and aluminium.

Alumina does not separately hedge its exposure to aluminium prices. The Company expects that volatility in prices and demand for AWAC’s products will continue for the foreseeable future. For a statement of current hedging, and movements in the selling price of aluminium over the last five years, see Item 11 “Quantitative and Qualitative Disclosure about Market Risk”.

Fluctuations in the A$/US$ exchange rate can have a significant effect on earnings and profitability.

Alcoa of Australia contributes the majority of AWAC’s earnings. While a significant proportion of Alcoa of Australia’s costs are incurred in A$, sales are denominated in US$. AWAC’s future profitability, as expressed in A$, and hence that of Alumina Limited may be adversely affected by a strengthening of the A$ against the US$. AWAC’s profitability may also be adversely affected by a strengthening against the US$ of other currencies in which operating or capital costs are incurred by AWAC’s refineries outside Australia.

In the past, AWAC entered foreign exchange hedging contracts to manage its exposure to the US$/A$ exchange rate with those hedging contracts closing in 2003. Throughout the reporting period, and at balance sheet date, AWAC had no foreign exchange hedging contracts.

In addition, certain of the Company’s liabilities and assets are denominated in US$, particularly much of the borrowings and certain equity accounted assets. The accounts of certain foreign subsidiaries are also maintained in US$. Thus a change in the A$/US$ exchange rate would have an effect on the net asset value of the Company.

Fluctuations in the A$/US$ exchange rate will affect the US$ equivalent of the A$ price of the Company’s ordinary shares on the Australian Stock Exchange (“ASX”) and, as a result, are likely to affect the market price of the Company’s American Depositary Receipts (“ADRs”) in the United States. Such fluctuations would also affect the US$ amounts received by holders of ADRs on conversion of cash dividends paid in A$ on the Ordinary Shares underlying the ADRs. Alumina is not currently hedging its currency exposures. See Item 11 “Quantitative and Qualitative Disclosure about Market Risk”.

An increase in AWAC’s production costs could reduce Alumina’s profitability.

Changes in AWAC’s costs have a major impact on the Company’s profitability. AWAC’s mining, refining and smelting operations are subject to conditions beyond its or Alumina Limited’s control that can delay deliveries or increase costs for varying lengths of time. These conditions include weather and natural disasters, unexpected maintenance or technical problems, key equipment failures, disruptions to or other problems with infrastructure, variations in geological conditions and increases in the cost of key inputs or the non-availability of key inputs. In addition, industrial disruptions, work stoppages, refurbishments and accidents at operations can result in production losses and delays in the delivery of product, which may adversely affect profitability. A key risk in the cost of production of alumina and aluminium is the cost of energy. Increases in world oil and gas prices will increase the cost of production of alumina. Further key risks associated in the cost of production of alumina are the sourcing of bauxite and the volatile price of caustic soda. Approximately 1 tonne of caustic soda is used for every 13 tonnes of alumina produced. Accordingly, an increase in caustic soda prices has the potential to reduce profitability.

Certain costs are also affected by government imposts and regulations in the countries in which AWAC operates. AWAC’s costs depend upon the efficient design and construction of mining, refining and smelting facilities and competent operation of those facilities.

Changes to sales agreements could adversely affect Alumina’s results.

AWAC’s revenue from existing sales agreements depends on a variety of factors, such as price adjustments and other contract provisions. The modification or termination of a substantial portion of AWAC’s sales agreements could adversely affect its results and financial performance, to the extent that AWAC is unable to renew contracts or find alternate buyers for production at the same level of profitability.

Availability of bauxite.

AWAC’s production of alumina is dependant upon continuing availability of bauxite supply. AWAC obtains bauxite from bauxite resources to which it has access under mining leases and under short term and long term contracts. AWAC’s present sources of bauxite are sufficient to meet the forecasted requirements of its alumina refining operations for the foreseeable future.

AWAC is exposed to regulatory and court action, each of which could adversely affect Alumina’s results.

Governments extensively regulate AWAC’s mining operations. National, state and local authorities in Australia and other countries in which AWAC operates regulate the mining industry with respect to matters such as employee health and safety, permitting and licensing requirements and environmental compliance, plant and wildlife protection, reclamation and restoration of mining properties after mining is completed, and the effects that mining has on groundwater quality and availability. Numerous governmental permits and approvals and leases are required for AWAC’s mining operations. AWAC is required to prepare and present to national, state or local authorities data pertaining to the effect or impact that any proposed exploration or production activities may have upon the environment. The costs, liabilities and requirements associated with these regulations may be costly and time-consuming and may delay commencement or continuation of exploration, expansion or production operations. Failure to comply with the laws regulating AWAC’s businesses may result in sanctions such as fines or orders requiring positive action by AWAC which may involve capital expenditure or the curtailment of operations. This relates particularly to environmental regulations.

The possibility exists that new legislation or regulations may be adopted which may materially adversely affect AWAC’s mining operations or AWAC’s cost structure. New legislation or regulations or more stringent interpretations or enforcement of existing laws and regulations may also require AWAC’s customers to change operations or incur increased costs. These factors and legislation, if enacted, could have a material adverse effect on AWAC’s, and hence Alumina Limited’s, financial condition and results of operations.

Political risks exist in some of the countries in which AWAC operates.

AWAC operates in a number of countries, some of which have a higher political risk than Australia. Political activities in these countries may be destabilising and disruptive to AWAC’s operations. The impact of any such disruption could range from a minor increase in operating costs or taxes to a material adverse impact, such as the closure of an operation.

Uncertainty of development projects and production performance could adversely affect AWAC’s ability to sustain production and profitability levels.

AWAC’s ability to sustain or increase its current level of production, and therefore its (and hence Alumina Limited’s) potential revenues and profits, in the medium to long-term is partly dependent on efficient operation of its facilities, the development of new projects and on the expansion of existing operations. No assurance can be given that the planned development and expansion projects will result in the anticipated construction cost being achieved, the entire anticipated additional production or that operation of existing facilities will be at desired rates of production. The economics of any project are based upon, among other factors, estimates of reserves, recovery rates, production rates, capital and operating costs and future commodity prices and exchange rates.

Capital costs for development of alumina refinery and other mineral resource projects have increased substantially in recent years, due to higher steel and other raw material prices and significant increase in labour and contractor costs. In particular, shortages of skilled labour due to an increase in the number of mineral resource project developments, including in Australia and Brazil, has resulted in cost increases for the development of projects in those locations. Also, the US dollar has fallen in value against currencies such as the Australian dollar, the Euro and Brazilian Real. Where development projects, such as AWAC's Alumar and Juruti projects, incur labour and material costs in the currency of the project country, a weaker US dollar results in a higher project cost in US dollar terms.

Native title in Australia poses risks to the status of some of AWAC's properties

'Native title' describes the rights and interests of Aboriginal and Torres Strait Islander people in land and waters according to their traditional laws and customs that are recognised under Australian law. There are current claimant applications for native title determinations in the Federal Court of Australia over areas that include Alcoa of Australia's operations. Court decisions and various pieces of legislation make it evident that there are complex legal and factual issues affecting existing and future Alcoa of Australia interests. At this stage, we cannot make any assessment of the impact of the recent and pending court cases on AWAC's operations or the current claimant applications for native title over AWAC's operations. See Item 8A "Legal Proceedings – Native Title in Australia.

Alumina Limited cash flows depend on the availability of dividends from AWAC

Alumina Limited's cash flows will be generated, primarily from distributions made by AWAC, by way of dividend or capital return. The Strategic Council determines the timing and magnitude of AWAC dividends and capital returns, subject to the relevant provisions of the AWAC Agreements. Alumina Limited cannot unilaterally determine AWAC's dividend policy or the quantum or timing of dividends to be paid by AWAC. AWAC must distribute by way of dividends, in each financial year, at least 30% of the net income of the prior year of the entities comprising AWAC, unless the Strategic Council agree by a super majority vote to pay a smaller dividend.

During 2006 the AWAC partners entered a new funding agreement under which future capital expenditure are to be funded by the partners contributing directly to cash calls issued by the relevant AWAC entity. When such cash calls are issued, additional dividends equal to the amount of the cash call will, subject only to availability of cash and earnings, be paid by AWAC entities to the partners. The funding agreement is expected to largely eliminate the risk identified above, during the five year term of the funding agreement, of Alumina Limited being constrained in its ability to pay franked dividends to its shareholders.

The AWAC joint venture decides certain matters by an 80% supermajority vote (refer Item 10). AWAC's decisions are otherwise by majority vote. Alcoa has a 60% interest in AWAC and has a majority vote. Subject to the application of fiduciary duties, it could occur that AWAC decisions by majority vote are not in the best interests of Alumina Limited.

Alumina is liable for further capital calls by Alcoa under the AWAC arrangements.

AWAC may make an annual capital request of the partners of up to US$1 billion following approval by a majority vote of AWAC's Strategic Council. Alcoa has a majority of the votes on the AWAC Strategic Council. Alumina Limited is required to fund its share of the request subject to the provisions of the agreement. If Alumina Limited is unable or unwilling to obtain equity or debt funding or has insufficient retained earnings (ie cash) to make this capital contribution, it may ultimately run the risk of its equity interest in AWAC being diluted. Accordingly, there is a risk that Alumina Limited will be unable to fund an AWAC capital request made unilaterally by Alcoa, in the future, and that its interest in AWAC could be diluted.

Constraints on availability of highly trained employees could have an adverse impact on AWAC's operations

AWAC manages its business with a number of key personnel, the loss of whom could have a material adverse effect on its business. AWAC's, and hence Alumina Limited's, future success will depend on AWAC's continued ability to attract and retain highly skilled and qualified personnel. There can be no assurance that key personnel will continue to be employed by AWAC or that AWAC will be able to attract and retain qualified personnel in the future. Failure to retain or attract key personnel could have a material adverse effect on AWAC's, and hence Alumina Limited's, business. These same issues exist with respect to Alumina Limited's key personnel, the loss of whom could have a material adverse effect on Alumina Limited's business and its ability to manage its joint venture interests in AWAC.