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 has not sought to 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$, sales are denominated in US$. The US$/A$ exchange rate rose during 2004 and continued to rise into 2005 from the historic lows experienced in 2001 and 2002. 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 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. At present, AWAC has not entered into any foreign exchange hedging contracts.

In addition, certain of the Company’s liabilities and assets are denominated in US$, particularly much of the borrowings and certain equity accounted assets. The accounts of certain self-sustaining foreign subsidiaries are also maintained in US$. Thus a change in the A$/US$ exchange rate may 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 is 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 affect profitability. A further key risk in the cost of production of alumina and aluminium is the cost of energy. Increases in world oil prices will increase the cost of production of alumina.

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.

Alumina 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 Alumina 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 Alumina'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 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.

Alumina is now a separate entity with no benefits of diversification among products.

As a result of the demerger, Alumina Limited is now exposed to alumina and aluminium markets, without the diversification provided by exposure to the markets of the operations now residing in WMC Resources Ltd. Previously the Company had investments in nickel, copper, fertilizer and alumina and this spread of assets in various commodities gave a diversified exposure to different commodities. The Company's performance is now substantially dependent upon the alumina and aluminium markets.

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 agrees by a super majority vote to pay a smaller dividend. The practice of AWAC, confirmed by the Strategic Council in September 2002, has been to distribute 100% of free cash flow from the AWAC entities. However, Alcoa's current policy is that AWAC should fund growth in production from internally generated cash flow. This would reduce dividends paid by AWAC and may reduce Alumina Limited's ability to pay franked dividends to shareholders. Alumina Limited is currently exploring solutions to this issue through alternative AWAC structures, but there can be no assurance that a revised structure can be agreed and implemented in the short term or at all.

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

AWAC may make an annual capital request 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 to obtain equity or debt funding 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.

Employees

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.