KEY INFORMATION

D. Risk Factors

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

Alumina Limited's source of income is dividends derived from AWAC. The revenue of AWAC (40% ownership of AWAC is the principal asset of Alumina Limited) is derived from sales of alumina, alumina-based chemicals and aluminium. The price that can be obtained for these products is influenced by global prices of alumina and aluminium, and in particular, the LME price of primary aluminium. Pricing mechanisms for alumina have changed over time from primarily long term contracts with pricing expressed as a percentage of the aluminium price, to shorter term contracts. Pricing has historically been based on a percentage of traded LME aluminium contract, however there is increased momentum for the industry to move away from LME linked contracts. World aluminium prices are affected by numerous factors outside Alumina Limited's control, including general economic conditions, expectations for supply and demand level of global inventories, the influence of hedge funds and other financial investment funds participating in commodity markets and 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 oversupply or overcapacity, which could reduce future prices of alumina, alumina-based chemicals and aluminium, thereby adversely affecting AWAC's, and also Alumina Limited's, profitability.

AWAC's and Alumina's financial performance and ability to service liabilities, pay dividends and undertake capital expenditure would be adversely affected by a material fall in the prices of alumina and aluminium.

AWAC earnings are also influenced by the accounting for embedded derivatives in Alcoa of Australia Limited's contracts for the supply of natural gas and electricity. If the aluminium price as quoted on the LME at a period end, and the estimate of long term aluminium prices in any relevant period beyond the period covered by forward LME prices, are higher than at the commencement of that period, a charge against income would result. Conversely, a fall in those aluminium prices would result in a credit to income for the period. Those effects on AWAC income would have a corresponding proportional negative or positive impact on Alumina Limited's income for the period.

In 2010, AWAC indicated it would seek to price its new third party alumina contracts on a basis using alumina indices for 2011. AWAC based all new contracts entered in the second half of 2010 on the alumina price indices. These contracts are for delivery in 2011 and beyond. About 20 per cent of AWAC's alumina sales contracts expire each year.

AWAC's revenue will fluctuate in accordance with changes in the alumina price indices upon which some of AWAC's alumina is sold. The index prices may go up or down due to numerous factors outside Alumina Limited's control such as supply and demand of alumina, the industry's capital and operating costs, general economic conditions and other factors.

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 exchange rates can have a significant effect, on Alumina Limited's earnings, profitability and construction costs

Alcoa of Australia contributes the majority of AWAC's net income including over 90% in 2009 and 2010. While a significant proportion of Alcoa of Australia's costs are incurred in Australian dollars, sales are denominated in US dollars. AWAC's future profitability (and therefore that of Alumina Limited) may be adversely affected by a strengthening of the Australian dollar against the US dollar. AWAC's profitability and financial position may also be adversely affected by a weakening of the US dollar against other currencies in which operating or capital costs are incurred by AWAC's refineries outside Australia.

An increase in the cost of key inputs could reduce Alumina's profitability.

Changes in AWAC's costs have a major impact on Alumina Limited's profitability. AWAC's mining, refining and smelting operations are subject to conditions beyond its control that can delay deliveries or increase costs for varying lengths of time. These conditions include increases in the cost of key inputs (including increases in the cost of raw materials (including energy and caustic soda), labour and freight) and the non-availability of key inputs.

A key risk in the cost of production of alumina and aluminium is the cost of energy. Alumina refineries and aluminium smelters consume substantial amounts of energy in their operations. The costs and profitability of AWAC's alumina refineries and aluminium smelters can be affected by:

- significant increases in domestic or world electricity, coal, natural gas and oil prices;
- unavailability of electrical power or other energy sources due to insufficient supplies; or
- curtailment of one or more refineries or smelters due to an inability to extend energy contracts upon expiration or to negotiate new arrangements on cost-effective terms or unavailability of energy at competitive prices.

Other events could increase AWAC's production costs or decrease its production and therefore reduce Alumina's profitability

In addition to any increase in the cost of AWAC's key inputs discussed previously, certain events which may be beyond AWAC's or Alumina's control can decrease production, delay deliveries or increase costs for varying lengths of time. These include weather and natural disasters, fires or explosions at facilities, unexpected maintenance or technical problems, key equipment failures, disruptions to or other problems with infrastructure, war or terrorist activities and variations in geological conditions. In addition, industrial disruptions, loss of key staff, work stoppages, refurbishments and accidents at operations can result in production losses and delays in the delivery of product, which may adversely affect 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.

Alumina's ability to raise funds and refinance its debt is subject to external factors

Alumina's ability to refinance its debt on favorable terms as it becomes due or to repay the debt, its ability to raise further finance on favorable terms, and its borrowing costs, will depend upon a number of factors, including AWAC's operating performance, general economic conditions, political, capital and credit market conditions, external credit ratings and the reputation, performance and financial strength of Alumina's business.

Debt which has recently been refinanced, or which may be refinanced in the future, may be at higher interest margins than previously held debt.

If a number of the risks outlined in this section eventuate, including deterioration in the Australian and global credit markets, or if its operating performance, external credit rating or profitability is negatively impacted as a result of these risks, there is a risk that Alumina may not be able to refinance any expiring debt facilities or the costs of refinancing its debt may increase substantially.

In addition, Alumina Limited's primary assets consist of its interests in the various companies that make up the AWAC joint venture. Although Alumina does not hold itself out as, or carry out its operations as, an "investment company" as contemplated under the Investment Company Act of 1940, as amended (the "Investment Company Act"), uncertainty exists as to whether its interests in AWAC would be considered to be investment securities under the Investment Company Act. If the AWAC interests are determined to be investment securities, Alumina Limited may be determined to be an 'investment company" as defined in the Investment Company Act. As a non-U.S. operating company, it is not practical or feasible for Alumina Limited to register as an "investment company" under the Investment Company Act. While the uncertainty regarding its status continues, Alumina Limited is constrained in its ability to conduct capital raising activities in the U.S. capital markets as it is unable to register as an investment company under the Investment Company Act.

Alumina Limited does not hold a majority interest in AWAC, and decisions made by majority vote may not be in the best interests of Alumina

AWAC's strategic direction is determined by a five member Strategic Council, consisting of three Alcoa Inc. representatives and two Alumina Limited representatives. An 80 per cent majority is required to approve changes that effect:

- a change of the scope of AWAC;
- a change in AWAC's dividend policy;
- sale of all or a majority of, the assets of AWAC;
- equity calls on behalf of AWAC totalling, in any one year, in excess of $1 billion; and
- loans to Alcoa Inc., Alumina or their respective affiliates by AWAC entities (including loans between AWAC entities).

AWAC's decisions are otherwise by majority vote. Alcoa Inc. has a 60 per cent interest in AWAC and has a majority vote. Subject to the application of fiduciary duties, it may occur that AWAC decisions by majority vote are not in the best interests of Alumina Limited.

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

Alumina Limited's cash flows are generated almost exclusively from distributions made by AWAC, by way of dividend or capital return. AWAC's joint venture partners determine 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 per cent of the net income of the prior year of the entities comprising AWAC, unless the Strategic Council agrees by an 80 per cent majority vote to pay a smaller dividend.

During 2006, the AWAC joint partners entered into the Enterprise Funding Agreement, under which capital expenditures are to be funded by the joint venture partners contributing directly to cash calls issued by the relevant AWAC entity. During 2010, the Enterprise Funding Agreement was extended on the basis that two years notice is required to terminate the Enterprise Funding Agreement. When such cash calls are issued, additional dividends equal to the amount of the cash call will, subject generally to availability of cash and earnings, be paid by AWAC entities to the joint venture partners. The Enterprise Funding Agreement is expected to substantially reduce the risk, during the term of the agreement, of only the minimum 30 per cent dividend being paid during times of AWAC growth capital expenditure.

An increase in the capital costs of AWAC's growth projects and operations would impact Alumina's profitability

A significant increase in the capital costs associated with AWAC's growth projects and operations or delays in commissioning of the projects would impact Alumina's cashflow and profitability.

Capital costs for development of an alumina refinery and other mineral processing projects have increased substantially in recent years.

KEY INFORMATION

Regulatory change by governments in response to greenhouse gas emissions may represent an increased cost to AWAC

Energy is a significant input in a number of AWAC's operations. AWAC uses electricity in its operations and is an emitter of greenhouse gases.

A number of governments or governmental bodies have introduced or are contemplating legislative and regulatory change in response to the potential impacts of climate change. As part of the Australian environmental strategy, the Australian Federal Government set out the details of its then proposed Carbon Pollution Reduction Scheme (CPRS) in a White Paper released in December 2008. Exposure draft legislation implementing the CPRS was released in March 2009 for stakeholder comment.

The Australian Federal Government in 2010 announced that it was deferring further consideration of its proposed emissions trading scheme until 2013 at the earliest. However, following the formation of a new government, in February 2011, the Australian Federal Government announced that it was proposing a two-stage plan for a carbon price scheme (Scheme) which would start with a fixed price period for three to five years (through the issuance of fix price units) before transitioning to an emissions trading scheme. The Australian Federal Government intends that the Scheme commence on July 1, 2012, subject to the availability to negotiate agreement with a majority in both Houses of Parliament and pass legislation during 2011.

Due to the considerable uncertainty as to the details of the Scheme, the assistance to be provided and its implementation, it is difficult to accurately forecast the financial impact on Alcoa of Australia or Alumina.

There is also current and emerging regulation in Australia, such as the mandatory renewable energy target scheme and the proposed expanded scheme that may substantially increase Alcoa of Australia's energy costs, although it is unclear as to the extent to which the alumina and aluminium industry would receive assistance or partial exemption from those schemes as an emission-intensive trade-exposed industry.

The costs associated with AWAC's obligations under such a scheme may impact Alumina and AWAC's operations. Data on the carbon dioxide emissions of Alumina are contained in its Sustainability Report (which can be viewed on the Alumina website (www.aluminalimited.com)). In 2010, Alumina's imputed share of carbon dioxide equivalent emissions from Alcoa of Australia's operations was approximately 1.94 million tonnes of direct emissions and approximately 2.9 million tonnes of indirect emissions (from producers of electricity which is supplied to Alcoa of Australia).

Other current and emerging legislation (such as existing and potential carbon trading schemes) may also affect energy prices. These regulatory mechanisms may be either voluntary or legislated. Inconsistency of regulations may also change the attractiveness of the locations of some of AWAC's assets. It is difficult to assess the potential impact of future climate change regulation given the wide scope of potential regulatory change in countries in which Alumina and AWAC operate. It is difficult to estimate the financial impact on AWAC of the carbon reduction schemes operating in Europe. The free allocation of allowances, the extent of the mitigation measures for which AWAC's San Ciprián smelter in Spain might qualify and the treatment of indirect emissions are uncertain.

The potential physical impacts of climate change on AWAC's operations are highly uncertain and will be particular to the geographic circumstances. These may include changes in rainfall patterns, shortages of water or other natural resources, changing sea levels, changing storm patterns and intensities and changing temperature levels. These effects may adversely impact the cost, production and financial performance of AWAC's operations.

Impact of global economic downturn

Both Alumina's and AWAC's operating and financial performance are influenced by a variety of general economic and business conditions, including changes to monetary policy, fiscal policy, interest rates, foreign currency exchange rates, tax rates, commodity prices and inflation across the range of countries in which Alumina and AWAC operate.

In particular, Alumina's future financial performance and condition may be influenced by the demand for alumina, alumina-based chemicals and aluminium, which is currently supported by the industrialisation and urbanisation of China and other developing countries. Decline in the rate of economic growth of these developing countries or reduction in demand for these products, could adversely affect Alumina's future financial performance.

A reduction in demand for, or prices of AWAC's products may require a curtailment or closure of production capacity at AWAC's operations. A curtailment of an operation's production capacity generally results in an increase in the cost of production per tonne of output and can also result in additional costs, including redundancy costs and continuing contractual purchase commitments for production inputs. Closure or change in ownership of production capacity at AWAC's operations may result in an impairment loss being incurred in the Income Statement as a result of the carrying value of an asset exceeding its recoverable value.

Some of AWAC's operations are conducted by joint ventures with external parties. To the extent that AWAC's joint venturers do not meet their respective share of joint venture financial obligations, AWAC and Alumina may be required to bear a disproportionate share of joint venture obligations, including provision of funding. A deterioration in global economic conditions may also affect the financial position and consequent performance by contractual counterparties of AWAC of obligations owed to AWAC.

Alumina could be adversely affected by changes in the business or financial condition of one or more of a significant supplier, a joint venturer or a significant customer.

Global financial conditions have been characterised by increased market volatility in recent years. Several financial institutions have either gone into bankruptcy or have had to be recapitalised by governmental authorities. Access to financing was also negatively impacted by the global economic downturn. Alumina's financial risk metrics could also be negatively impacted by a tightening of credit in Australia and globally. These factors may adversely affect Alumina's ability to obtain financing in the future or the terms of such financing.

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 volume 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.

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

Governments extensively regulate AWAC's mining and processing 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 and processing 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 removal of licences and/or the curtailment of operations. This relates particularly to environmental regulations.

AWAC has obligations under various laws, licences and permits for the rehabilitation (including remediation and/or restoration) of land used in bauxite mining, alumina refining, aluminium smelting and related activities. AWAC recognises these obligations and provides for Asset Retirement Obligations under US GAAP. Alumina recognises and provides for additional amounts for certain AWAC Asset Retirement Obligations as required by AIFRS.

The possibility exists that new legislation or regulations may be adopted which may materially adversely affect AWAC's mining and processing 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.

The Australian Federal Government has announced a Minerals Resource Rent Tax ("MRRT"), which is expected to apply from July 1, 2012, subject to the legislative process. The tax has yet to be legislated. As the MRRT applies to mined iron ore and coal it does not apply to the minerals (primarily bauxite) that Alumina mines. Therefore it is anticipated that there will be no direct impact on Alumina Limited.

On February 24, 2011, the Australian Federal Government announced its intention to introduce a carbon price mechanism, which is expected to commence on July 1, 2012, subject to the legislative process. The carbon price is a price on the emission of carbon pollution. As details of the carbon price are not final Alumina Limited is unable to estimate the impact of this tax on its operations until further details are available.

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 mineral deposits, recovery rates, production rates, capital and operating costs and future commodity prices and exchange rates. There is no assurance that those estimates will be realised, or that actual economic conditions might not cause the profitability of projects to be materially different to that estimated at the time the projects were approved.

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

AWAC may make annual capital calls of Alumina and Alcoa Inc. of up to $1 billion in aggregate following approval by a majority vote of AWAC’s Strategic Council, and of more than $1 billion in aggregate following approval by a super majority vote of the Strategic Council.

Alumina Limited is required to fund its share of the calls, subject to the provisions of the AWAC Agreements. If Alumina Limited is unable or unwilling to obtain equity or debt funding or has insufficient retained earnings (i.e. cash) to fund its share of capital requirements up to $1 billion, 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 a capital call made by AWAC in the future, and that its interest in AWAC could be diluted. To the extent the aggregate annual capital calls that are approved are in excess of $1 billion and Alumina is unable or unwilling to fund its share of such capital calls, Alumina’s equity interest in AWAC is not diluted. However, Alcoa Inc. will be otherwise compensated in respect of its funding of such annual calls above $1 billion, possibly by means of a disproportionate allocation of returns associated with the excess contribution by Alcoa Inc.

The $1 billion threshold in respect of the funding of AWAC’s capital requirements will be increased by the amount of relevant dividends paid in the relevant year with respect to valid calls to the extent they are funded by equity contributions in accordance with the Enterprise Funding Agreement. The $1 billion threshold above which super majority approval is required is not subject to increase in this way.

In addition to capital calls to fund existing AWAC projects, Alcoa Inc. could sell assets to AWAC or cause AWAC to purchase assets. The purchase of these assets by AWAC may require a proportionate investment from Alumina.

Unavailability of bauxite may reduce AWAC’s profitability.

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

With respect to the Paranam refinery in Suriname, at current rates of production it is likely that all Suriname current bauxite deposits will be exhausted within the next several years. AWAC is actively exploring and evaluating alternate sources of bauxite, including deposits from Suralco’s concession in eastern Suriname such as the Nassau plateau and imported bauxite.

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

AWAC operates in a number of countries, some of which have a relatively high level of political and economic risk. Political activities in these countries may be destabilising and disruptive to AWAC’s operations. Risks include those associated with political instability, civil unrest, expropriation, nationalisation, renegotiation or nullification of existing agreements, mining lease and permits and changes in local laws, regulations or policies. 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.

KEY INFORMATION

A reduction in demand (or lack of increased demand) for aluminium by China or a combined number of other countries could negatively impact AWAC's results

The Chinese market is a significant source of global demand for commodities, including aluminium. A sustained slowdown in China's economic growth, or the combined slowdown in other markets, could have an adverse effect on the demand for aluminium and aluminium prices. In addition, China's investments to increase its self-sufficiency in aluminium and alumina may impact future demand and supply balances and prices.

The future trading price of shares is subject to uncertainty

Investors should be aware that there are risks associated with any share or ADR investment. The value of shares or ADRs may rise above or fall depending on the financial condition and operating performance of Alumina or AWAC. Further, the price at which shares or ADRs trade may be affected by a number of factors unrelated to the financial and operating performance of Alumina or AWAC and over which Alumina and its Directors have no control. These external factors include:

- economic conditions in Australia and overseas;
- relative changes in foreign exchange rates;
- the impact of significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving Alumina, AWAC or their competitors;
- local and international stock market conditions;
- changes in government regulations or in fiscal, monetary and regulatory policies (such as environmental and land management, regulation, taxation and interest rates);
- industrial disputes;
- geo-political conditions such as acts or threats of terrorism or military conflicts; and
- volatility of comparable companies' share prices, including Alcoa Inc.

There is no guarantee of profitability, dividends, return of capital, or the price at which shares or ADRs will trade. No assurances can be given that the shares or ADRs will not be adversely affected by market fluctuations or other factors. The past performance of the shares and ADRs is not necessarily an indication as to future performance as the trading price of shares and ADRs can fluctuate.

AWAC could be required to make additional contributions to its defined benefit pension plans as a result of adverse changes in interest rates and the capital markets

Estimates of liabilities and expenses for pensions and other post-retirement benefits incorporate significant assumptions, including the interest rate used to discount the future estimated liability, the long term rate of return on plan assets and several assumptions relating to the employee workforce (salary increases, medical costs, retirement age and mortality). AWAC's results of operations, liquidity or shareholders' equity in a particular period could be affected by a decline in the rate of return on plan assets, the interest rate used to discount the future estimated liability, or changes in employee workforce assumptions.

Operation of the AWAC Agreements could act as a disincentive to a potential acquirer of Alumina

The AWAC Agreements provide that AWAC is the exclusive vehicle for the pursuit of Alumina's and Alcoa's interests in the bauxite, alumina and organic industrial (alumina-based) chemicals businesses included within the scope of AWAC. Neither party may compete, within that scope, with AWAC so long as it maintains an ownership interest in AWAC.

Any acquirer of Alumina would become an 'affiliate' of Alumina or Alcoa (as relevant) and trigger the application of the exclusive vehicle provisions contained in the AWAC Agreements in respect of the business and interests of the acquirer. If the acquirer already operates a bauxite, alumina or industrial (alumina-based) chemicals business, the exclusive vehicle provisions would be contravened. Therefore, the exclusive vehicle provisions contained in the AWAC Agreements could act as a disincentive to a potential acquirer or bidder for Alumina.

The AWAC Agreements are silent on the action that Alumina or Alcoa (as relevant) and the acquirer must take to avoid any contravention. It is possible that the relevant business could be offered to AWAC for purchase, with the value to be agreed. Alternatively, the acquirer might divest itself of the relevant business or undertake some other action consistent with the exclusive vehicle provisions of the AWAC agreements.

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 some of 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 faces significant competition in the aluminium market

The markets for most aluminium products are highly competitive. AWAC, and hence Alumina Limited's, competitors include a variety of companies in all major markets. Additionally, aluminium competes with other materials such as steel, plastics, composites and glass. The willingness of customers to accept substitutes for aluminium and other developments by or affecting AWAC's competitors or customers could adversely affect AWAC, and hence Alumina Limited's results of operations.