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### ***Complimentary Report Not Intended for Compensation***

RIO TINTO (RTP \$310.71, 7-20-07, rated Overweight) AMOUNT OF THE \$44 BIL.  
BID FOR ALCAN A SURPRISE

	2007E	2008E	2009E	2010E
Earnings per share	\$23.04	\$21.56	\$21.77	\$22.23

Rio Tinto forecasts a continuation of upward Chinese and world aluminum demand growth, no recessions, and a decline in matching rates of growth of Chinese aluminum output. It expects climate change regulations to reduce aluminum output in some parts of the world, and increase the advantage of Alcan's hydro generation.

Rio Tinto appears to make a "bottom fishing" or "contrarian" bull bet on aluminum that it will outdo other metals after lagging.

It judges that aluminum will thrive under future climate change regulations. It does not appear to forecast a drop in global industrial production or auto output owing to carbon taxes, for example, and perhaps expects aluminum pounds in vehicles to grow faster.

In effect, RTP appears to estimate Alcan's profits and future aluminum prices will rise from current levels, and that it will have a 4% less aftertax cost of funding in predicting earnings accretion.

We will review our earnings estimates after Rio Tinto reports first-half earnings. Metals prices and iron ore output are higher than we expected. We will incorporate the Alcan acquisition into our model after we better understand the treatments of purchase accounting, depreciation of stepped up asset values, intangibles and assets to be sold. We expect 2007 earnings to beat our forecasts as copper prices and iron ore volumes have been strong. Future earnings depend on the levels of asset sales and accounting treatment of the Alcan purchase as well as commodity prices.

Iron ore output up 11% despite a Canadian strike and little gain at Robe River was most impressive as Hamersley gained 20% in the first half.

### **OUR BEST GUESS OF RIO TINTO'S UNDERLYING ASSUMPTIONS IN BUYING ALCAN**

We do not believe Chinese or other high cost aluminum smelters will die off or decline easily. We recall the commentary of Smurfit-Stone Container, which wrote off its Chinese liner plant after Communist party members at supplier firms took the plant

manager hostage after he obeyed a U.S. directive to cut output to reduce unsold inventories.

Further, it is conceivable that climate change protocols, such as carbon or energy taxes or higher gasoline prices or fuel economy standards, simply reduce global demand for vehicles by 10%-15%, reduce the average curb weight of light vehicles 10% and reduce miles driven. While the share of aluminum within the average vehicle undoubtedly will continue to rise, it is possible the number and weight of vehicles drops even more to create a net reduction in aluminum demand. While a \$250 or \$500 per barrel crude oil climate with gasoline costing over \$10 per gallon might encourage all-aluminum, electric or hybrid vehicles, many fewer vehicles may be sold overall.

1. Long-term aluminum prices near \$1.25 per pound while other nonferrous metals prices decline, or a contraction in the year-to-date \$1.88 per pound differential between aluminum and copper currently resting at \$2.48 per pound. In other words, Rio Tinto expects the price of aluminum to outperform its other products going forwards.
2. Aluminum demand grows 1%-2% faster than smelter output worldwide.
3. Rio Tinto used the Commodity Research Unit of London 7.7% CAGR for 2007-11, which equates to about a 7% 2008-11 rate after a 9%-10% rate in 2007.
4. Rio Tinto expects smelter output will grow more slowly than demand or even decline in China, whose coal-fired energy and imported bauxites are more expensive. WE NOTE THAT NO SIGNIFICANT OUTPUT DECLINE HAS OCCURRED AS OF YET IN ANY CHINESE BASIC INDUSTRY. FURTHER, CHINA'S ATTITUDES CONCERNING WORKER SAFETY, THE ENVIRONMENT OR HYGIENE ARE NOT THE SAME AS OURS. Rio Tinto expressed no pessimism concerning new smelter construction rates in Russia, the Mideast, Iceland, India or other regions.
5. Rio Tinto may expect "residential" electricity users to "crowd out" smelters in Brazil, Australia, the U.S., EU or other places around the world as greenhouse gas accords restrict electricity generation, especially from coal.
6. We presume Rio Tinto expects the C\$ to be between \$0.80-\$0.85 and the euro between \$1.25-\$1.30, which would tend to reduce the costs of Alcan's Canadian units 15% and European units 7% from current levels.
7. We presume Rio Tinto expects the global average aluminum content per vehicle to grow 100 pounds or 5% in the next decade, even if record petroleum prices cause the "share" of SUVs or light trucks to fall by half or the average vehicle curb weight to fall 25%.
8. Rio Tinto may expect crude oil or gasoline or coal or electricity prices to rise in such a way as to magnify or increase Alcan's comparative advantage in hydro generation.
9. It may be safer from a risk-adjusted basis to buy Alcan's already-built, already-permitted hydro, bauxite, alumina, smelting and other assets than to build mines. For example, Mongolian government negotiations, Alaskan permitting of the Pebble copper-gold-moly deposit, underground feasibility of Resolution in Arizona, underground transition at Grasberg in June 2015, the Simandou iron ore

project in Guinea and related new protect tax, political or engineering issues each involve risk. Cost overruns have been widespread, and engineering contractors have been overbooked. Certainly Alcan's hydro assets already exist, and will never be duplicated again.

10. Rio Tinto is not "put off" by the limitation that power in Canada must be used to make aluminum and generate jobs. Excess power must be resold to provincial governments at provincially-set rates near \$0.03 per kwh today, and no opportunity exists ever to sell power to California, Ontario or New England at \$0.10-\$0.50 per kwh.

## PURCHASE ACCOUNTING ISSUES

Rio Tinto agreed to pay about \$30.5 billion more than our estimate of Alcan's tangible net worth at 12-31-07.

It is unclear to us as to how Rio Tinto's financial advisors will appraise Alcan's captive hydro assets, bauxite deposits, alumina refineries, smelters, etc. One working assumption might be for half of the premium to be classified as "intangible," and not depreciated. The remaining half or \$15 billion or so might be depreciated over a very long period involving water leases. Thus, a \$500 mm annual added depreciation could result if half of the premium is "written up" via appraisal of long-life items.

Further, the ultimate asset sale program of perhaps twice Rio Tinto's goal might be able to cut the amount of debt to be serviced to \$18 billion rather than \$28 billion, for example, aside from the nearly \$6 billion of Alcan debt to be assumed. We are optimistic that the new interest expense to be created might be closer to \$1 billion, which might cut the amount of new financing burden to \$1.5 billion in the most optimistic scenario we can imagine.

## BUYING ALCAN VERSUS BUYING BACK STOCK

A Rio Tinto share repurchase program would seem to us to create better financial returns than buying Alcan because it would create no intangibles, no new depreciation and could be managed in increments smaller than \$38.1 billion.

We presume Rio Tinto wanted to diversify its sources of earnings, or in effect dilute its exposures to iron ore, coal, copper, etc. Further, the Alcan auction was a "once in a lifetime" opportunity to buy the largest chunk of Canadian hydro not owned by a provincial government.

## CAPITAL RETURN PROGRAM COULD BE RESUMED IN 2009

While Rio Tinto suspended its \$8 billion share buyback or special dividend "capital return" program, we can imagine scenarios in which it resumes. We suggest investors not become too despondent or disappointed as we expect Rio Tinto's financial planning to be rigorous.

If Rio Tinto's bullish contrarian view of the aluminum industry proves accurate, if global commodity prices rise even more or if Rio Tinto doubles its \$10 billion asset sale target, Rio Tinto might resume share repurchases or special dividends in 18 months or sometime in 2009.

#### ASSETS THAT MIGHT BE SOLD COULD EXCEED \$10 BILLION TARGET

It is conceivable that Rio Tinto raises \$15 billion or more from asset sales and sidesteps over \$5 billion of future capital spending in a conservative effort to permanently fund the \$38.1 billion paid for Alcan's equity. We estimate Alcan's packaging division could command up to \$7 billion, which is more than the \$5 billion Rio Tinto predicted.

A large population of Rio Tinto assets could be sold to reduce the \$38.1 billion cash portion of the acquisition to be funded. Rio Tinto referred to "smaller" businesses, which we presume means something other than iron ore, coal, copper or aluminum. We do not expect it to sell uranium, which could grow quickly.

Candidates could include (1) Northwest Territories diamond output, (2) its 40% stake in the Cortez gold mine in Nevada jointly owned with Barrick Gold, (3) industrial minerals assets including borax, salts, talcs or titanium dioxide, (4) the 93,000 acre potential residential real estate development effort in the Salt Lake City valley and (5) diverse development projects in a wide variety of minerals.

We believe it is possible Rio Tinto sells some very high P/E businesses like diamonds, a Nevada gold mine or Utah lands in a manner accretive to earnings.

Further, it is possible that Rio Tinto sells "projects" in a manner that sidesteps over \$5 billion of future capital spending to raise cash or enjoy one-time net gains in the near term. For example, the Simandou iron ore project in Guinea could be very marketable, the Resolution copper project in Arizona partnered with BHP Billiton, the equity stake in Ivanhoe Mines in Mongolia, the equity stake in Northern Dynasty Minerals in Alaska or other projects could be sold. Each might reduce a future risk, generate a profit and avoid multi-billion capital outlays down the road. Indian diamond exploration, several greenfield nickel projects and various industrial minerals development projects could be sold as well.

We do not expect Rio Tinto to "drop" any promising projects just to walk away. However, in those cases in which joint venture or government concessions permit, it may take several extra years to engineer and evaluate projects in an effort to slow down capital spending. It could also slow down a greenfield aluminum project or two from its or Alcan's project queue as well.

PRODUCTION REPORT JULY 18<sup>TH</sup>

Rio Tinto enjoyed a 12% first-half iron ore output gain driven by a 20% gain from Hamersley as Robe River stagnated and IOC fell owing to a strike.

The HiSmelt iron plant operated as a joint venture partly with Nucor had no output in the June quarter as it had major rebuilds. It has resumed operation in July.

Outputs rose for diamonds, uranium, coking coal, moly, bauxite and others.

Outputs fell for Australian thermal coal, copper due to lower grades in Utah and Indonesia, alumina, and others.

## EXPLORATION, EVALUATION AND DEVELOPMENT

Rio Tinto highlighted “near mine” exploration at eight locations. Such successes could be more immediate, easily permitted or lower capital cost in order to provide higher returns with less risk than greenfield projects.

The Mongolian government will take a 34% stake in the copper-gold project.

Pre-feasibility or related work on nine near projects was noted. Five involve copper or polymetallic copper deposits, two iron ore, one uranium and one potash.

## CHANGE IN THIS RESEARCH OPERATION

This report reflects an initiation of research coverage by JTVIR, LLC. In no way shape or form should it be misconstrued as involving PEG, which shut down on June 6, 2007 as noted. The continuation of that same quarterly or full year earnings estimate for 2007 as JTVIR, LLC should not be construed or mistaken to involve PEG, which shut down on June 6, 2007. Certain data, such as the logic of the earnings model, are similar owing to the same primary author, but this coverage initiation herein involves a different entity and no employment or affiliation with the former Prudential Equity Group, LLC.

## DISCLOSURES

“John Tumazos Very Independent Research, LLC” (JTVIR) is a Delaware Corporation with pending registration as an investment advisor in the state of New Jersey owing to our place of business in New Jersey.

JTVIR is not a broker-dealer, and conducts no trades. Its primary business is to provide “unbundled” metals and paper industry securities and market research to institutions or corporations in a zero commission, electronic execution, electronic dissemination, unbundled format for a specified annual fee structure.

Our investment rating system for securities recommendations is Overweight, Neutral Weight or Underweight. Overweight or Underweight recommendations are estimated to vary from the relative performance of the S&P 500 by more than 10% annually, and the

intended time horizon is up to 24 months. Our securities research is intended for institutional investors that might buy up to 10% of a given company, and as such focuses more towards longer-term dynamics impacting the net present value of future cash flows rather than “day trading” sorts of near-term issues.

Neither JTVIR, its members or its employees own or have a financial interest in any securities discussed in this report. Our policy is full disclosure.

Our policy permits personal trading in the metals or paper industries, though no positions were taken in companies within regular research coverage after July 2001 after joining Prudential Financial and until after one month of completed New Jersey registration of JTVIR. Our policy is that any personal trading must be consistent with our recommendation, made two business days or more AFTER a recommendation or change in recommendation and held for a minimum of 30 days or one month. We believe it is virtuous for a securities analyst to “put his or her money where his mouth is” to invest consistent with the recommendation to clients after such recommendation has been made, and we disagree with some restrictions made upon broker-dealer employees after 2000 era scandals.

Our policy permits up to three directorships and up to five consulting projects, advisory assignments or financial advice to corporations that might supplement, backcheck or substitute for certain services of a large investment banking firm. For example, we would accept an engagement to evaluate investment banking advice on behalf of a manufacturing company concerned whether advice is sincere or intended to maximize fees. Currently no such relationships exist.

Our policy is full disclosure of any advisory relationship or conflict going back three years. None currently exist.

Numerous prior investment banking relationships existed prior to three years history to the pre-1997 time frame under the employment of Donaldson, Lufkin and Jenrette or Oppenheimer & Co., Inc. Some of these we can recollect included 14 different gold mine valuations or sales for Barrick Gold, LAC Minerals (later acquired by Barrick), Addington Resources (gold assets in Montana acquired by Canyon Resources), Westworld Industries (Bolivian assets acquired by Battle Mountain Gold later acquired by Newmont Mining), Coeur d’Alene Mines, Crown Resources (acquired by Kinross Gold), Freeport-McMoRan Gold (acquired by Minorco later AngloGold later Queenstake Resources), FMC Gold (later renamed Meridian Gold) and others. Sole managed initial public offerings included Reliance Steel & Aluminum and Huntco. Lead-managed initial public offerings included American Steel & Wire (later acquired by Birmingham Steel) and lead-managed underwritings included Quanex. Co-managed underwritings included the IPO of Century Aluminum and offerings for AK Steel, Kaiser Aluminum, Agnico-Eagle Mines, Cameco and others. Asset sales or purchase advisories, fairness opinion or trusteeships were done for Thyssen Steel (sold to Ryerson Tull), Cyclops Corp. (sold to Armco later sold to AK Steel), Allegheny Corp., Bethlehem Steel, the U.S. Dept. of Justice pursuant to the June 1984 merger of LTV and Republic Steel to sell the Gadsden,

AL integrated flat-rolled mill, Cobre Copper, and others. Typically more than five investment banking assignments were evaluated, partly executed or “due diligenced” for any completed transaction. Some examples we can recall for which a prospectus was either drafted or partly drafted indicating much work included stock underwritings not completed for Wheeling-Pittsburgh Steel, Steel Dynamics, Atlas Corp., Webco, Sharon Steel, IPSCO, Co-Steel Inc., and others.

#### **ANALYST UNIVERSE COVERAGE:**

John C. Tumazos, CFA: Rio Tinto, Louisiana-Pacific, Nucor Corp., Newmont Mining, U.S. Steel, International Paper, BHP Billiton, MeadWestvaco Corp., Antofagasta PLC, Allegheny Technologies, Alcoa Inc., Inco Limited, Bowater, Inc., Temple-Inland, Barrick Gold, Abitibi-Consolidated, Weyerhaeuser Co., Alcan Inc., Smurfit-Stone Container, Plum Creek Timber, Worthington Industries, Goldcorp Inc., AngloGold Ashanti, Freeport McMoRan Copper & Gold, Novelis Inc., FNX Mining.

Dynatec is a company not continued in the research coverage of JTVIR, LLC that was previously included in the prior June 6, 2007 Prudential Equities Group universe owing to a pending takeover by Sherritt International.

In accordance with applicable rules and regulations, we note above parenthetically that our stock ratings of “Overweight,” “Neutral Weight,” and “Underweight” most closely correspond with the more traditional ratings of “Buy,” “Hold,” and “Sell,” respectively; however, please note that their meanings are not the same. (See the definitions above.) We believe that an investor’s decision to buy or sell a security should always take into account, among other things, that the investor’s particular investment objectives and experience, risk tolerance, and financial circumstances. Rather than being based on an expected deviation from a given benchmark (as buy, hold and sell recommendations often are), our stock ratings are determined on a relative basis (see the foregoing definitions).

There is no intention to “balance” the number of Overweight or Underweight ratings, as instances of broad over- or under-performance among basic industrials may occur. JTVIR makes each investment judgment in a “bottoms up” manner based on the assets of each individual company.

#### **Price Target – Methods/Risks**

The methods used to determine the price target generally are based on future earning estimates, product performance expectations, cash flow methodology, historical and/or relative valuation multiples. The risks associated with achieving the price target generally include customer spending, industry competition and overall market conditions.

Additional risk factors as they pertain to the analyst's specific investment thesis can be found within the report.

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