COMMENTARY

February 11th, 2010

Dear clients and colleagues,

Earnings season is coming to a close. The last quarter of 2009 represented the first quarter since mid 2008 where most companies reported year over year increases for both sales and profits. Most of our companies so far have reported results in-line or exceeding expectations. Q1 2010 should also produce no surprises because of the easy comparison with 2009. However, the market is already looking past 2010 and trying to assess how strong the recovery will be later in 2010 and 2011.

The last few weeks have been dominated by the deficit and debt problems of some Countries, first the Baltic States, then Dubai and now the PIGS, a new acronym found for Portugal, Ireland, Greece and Spain. With it, a serious test for the Euro as a common currency thus explaining the recent relative strength of the US Dollar. In our portfolio, there are 2 companies headquartered in Spain and 1 in Portugal. Although they have substantial operations outside of their home Country, their stock prices have suffered in the past few weeks. As is often the case when the markets sell and think later, we have used the sell-off as an opportunity to increase our holdings in Prosegur and Baron de Ley, our two Spanish Companies.

Another big piece of news in the past few weeks has been the humiliation of Toyota following the many quality issues with some of its vehicles. Although we believe the company will rebound stronger than ever from that episode, it shows that smaller companies are no more risky that large ones, a commonly held belief amongst investors.

The company we will profile this week is Alumina Inc.

Business Description

Created in 2002 from the demerger of WMC (now BHP), Alumina, through its 40% ownership of Alcoa World Alumina and Chemicals (AWAC), is the largest "pure play" company involved in the Bauxite and Alumina business, the raw material to make aluminium. Awac is the low cost producer and largest net seller of Alumina.

AWAC

- World's largest alumina producer, with 17% of world production capacity.
- Annual alumina production capacity = 15.9 million tonnes.
- Alumina production in 2009 = 13.9 million tonnes.
- Aluminium capacity = 388,000 tonnes.
- Employs 7,000 people.
- Operates 8 alumina refineries and 2 aluminium smelters.
- Owns or has an interest in 7 bauxite mining operations.
- Owns and runs a shipping operation that transports alumina, aluminium and raw materials around the world.

Market Data

market cap A$4.1B, Net Debt A$342M, dividend yield 1.2%, P/B: 1.01x, P/CF (trailing): 9.0x

Market Size

The market for Alumina is estimated at 88 MTPY and has been growing with Aluminium growth (around 2 tons of alumina per ton of aluminium), the fastest growing of the major non ferrous metals in the last 20 years. In the next few years, the market for Alumina should grow at around 8-10% per year, demand driven by the growth in emerging economies and sectors such as transportation and packaging.

Alumina Ltd with its recently completed and future expansions and currently idled capacity should grow with the market.

Competitive Advantages

AWAC is the low cost producer with most of its capacity in the lowest quartile of cash cost (total capacity at 30^{th} percentile);
EBITDA margins maintained at 20%+ even through cyclical lows.
Strong balance sheet. Low net debt. Substantial free cash flow generation;
Most alumina refineries are integrated with the bauxite mine.
Alumina is the largest net exporter of Alumina.
Relationship with Alcoa.

Competition

The industry is fairly consolidated with the top 4 players controlling more than 50%. The current supply/demand is in balance. Market price and cash cost will determine the marginal production. Chinese producers are all between $200 and $300 per ton cash cost.

Growth Strategy

In the short term, with the rebound in demand, the company, through the recent completion of major expansion projects in Australia and Brazil, will increase production by 2 million ton per year in 2010 (+13%)
The company has the best inventory of low cost brownfield and greenfield capacity expansion opportunities.

Management

Management does not own many shares. Both the President and CFO have joined the company in the last 3 years. The shares of the company are widely held with no controlling shareholder.

Investment Thesis

Owning shares in Alumina allows us to participate in the growth of Aluminium, the fastest growing of the major non ferrous metals due to its compelling attributes of strength, weight, availability and recyclability.

The company owns a low-cost well diversified portfolio of assets, the majority in low risk Countries such as Australia and Brazil.

The company is undervalued and could be an acquisition candidate.

Risks

The main risk is the commodity price risk.
Royalty rates are another risk.

Valuation

The company currently is valued at A$456 per ton of capacity. Replacement cost is well in excess of A$1 000 per ton. Chinese capacity costs over $500/Ton to build.

Using a long term cash flow estimate of A$0.40 per share, 60% payout ratio, a discount rate of 10% and 5% growth rate at maturity, we have a price target of $2.47.

Have a good week.

The Global Alpha Team