AMERICAN PUBLIC EDUCATION INC
Form DEF 14A
April 24, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨	Preliminary Proxy Statement
¨	Confidential, For Use of the Commission Only (as permitted by Rule 14-(e)(2))
x	Definitive Proxy Statement
¨	Definitive Additional Materials
¨	Soliciting Material Pursuant to Section 240.14a-12

American Public Education, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

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(3)	Filing Party:
(4)	Date Filed:

AMERICAN PUBLIC EDUCATION, INC.

111 W. Congress Street

Charles Town, West Virginia 25414

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

The 2015 Annual Meeting of Stockholders will be held on June 12, 2015 at 7:30 a.m. local time, at the Gaylord National Resort and Convention Center, 201 Waterfront Street, National Harbor, Maryland 20745, for the following purposes:

1. to elect the eight nominees for election to the Board of Directors as set forth in the accompanying proxy statement;

2. to hold an advisory vote on the compensation of our named executive officers as disclosed in our Proxy Statement for the 2015 Annual Meeting;

3. to ratify the appointment of McGladrey LLP as the independent registered public accounting firm for the Company for the fiscal year ending December 31, 2015; and

4. to consider any other matters that properly come before the Annual Meeting or any adjournment or postponement thereof.

Each outstanding share of American Public Education, Inc. common stock (NASDAQ: APEI) entitles the holder of record at the close of business on April 21, 2015, to receive notice of and to vote at the Annual Meeting or any adjournment or postponement of the Annual Meeting.

We are pleased to take advantage of Securities and Exchange Commission rules that allow us to furnish our proxy materials and our annual report to stockholders on the Internet. We believe that posting these materials on the Internet enables us to provide stockholders with the information that they need more quickly, while lowering our costs of printing and delivery and reducing the environmental impact of our Annual Meeting.

WHETHER OR NOT YOU EXPECT TO ATTEND THE MEETING, WE URGE YOU TO VOTE YOUR SHARES BY INTERNET, TELEPHONE, OR BY SIGNING, DATING AND RETURNING THE PROXY CARD YOU WILL RECEIVE IF YOU REQUEST PRINTED MATERIALS. IF YOU CHOOSE TO ATTEND THE ANNUAL MEETING, YOU MAY STILL VOTE YOUR SHARES IN PERSON, EVEN THOUGH YOU HAVE PREVIOUSLY VOTED OR RETURNED YOUR PROXY BY ANY OF THE METHODS DESCRIBED IN OUR PROXY STATEMENT. IF YOUR SHARES ARE HELD IN A BANK OR BROKERAGE ACCOUNT, PLEASE REFER TO THE MATERIALS PROVIDED BY YOUR BANK OR BROKER FOR VOTING INSTRUCTIONS.

All stockholders are extended a cordial invitation to attend the meeting.

By Order of the Board of Directors

Dr. Wallace E. Boston, Jr.
President and Chief Executive Officer
April 24, 2015

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AMERICAN PUBLIC EDUCATION INC.

111 W. Congress Street

Charles Town, West Virginia 25414

PROXY STATEMENT FOR ANNUAL MEETING OF STOCKHOLDERS

To Be Held On June 12, 2015

This Proxy Statement (the "Proxy Statement") and the accompanying proxy are furnished to the stockholders of American Public Education, Inc. (hereinafter, "we," "us," "APEI" and the "Company") in connection with the solicitation of proxies by the Board of Directors (the "Board"), to be voted at the Annual Meeting of Stockholders (the "Annual Meeting") and at any adjournment or postponement of the Annual Meeting, which will be held at 7:30 a.m. local time on June 12, 2015, at Gaylord National Resort and Convention Center, 201 Waterfront Street, National Harbor, Maryland 20745, for the purposes set forth in the accompanying Notice of Annual Meeting of Stockholders. The Board has made this Proxy Statement and the accompanying Notice of Annual Meeting available on the Internet. The Company mailed a Notice of Internet Availability of Proxy Materials to each of the Company's stockholders entitled to vote at the Annual Meeting on or about April 24, 2015.

ABOUT THE ANNUAL MEETING

Purpose of the Annual Meeting

The purpose of the Annual Meeting is for our stockholders to consider and act upon the proposals described in this Proxy Statement and any other matters that properly come before the Annual Meeting or any adjournment or postponement thereof. In addition, management will report on the performance of the Company and respond to questions from stockholders.

Proposals to be Voted Upon at the Annual Meeting

At the Annual Meeting, our stockholders will be asked to consider and vote upon the following four proposals:

- Proposal No. 1: To elect the eight nominees to the Board set forth in this Proxy Statement, each of whom will hold office until the next annual meeting of stockholders and until his or her successor is elected and qualified or until his or her earlier death, resignation or removal.
- Proposal No. 2: To approve, by advisory vote, the compensation of our named executive officers as disclosed in these proxy materials.
- Proposal No. 3: To ratify the appointment of McGladrey LLP ("McGladrey") as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2015.

In addition, any other matters that properly come before the Annual Meeting or any adjournment or postponement thereof will be considered. Management is presently aware of no other business to come before the Annual Meeting.

Recommendation of the Board

The Board recommends that you vote FOR each of the nominees to the Board (Proposal No. 1); FOR the approval of the compensation of our named executive officers (Proposal No. 2); and FOR the ratification of the appointment of McGladrey as our independent registered public accounting firm for the fiscal year ending December 31, 2015 (Proposal No. 3).

Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting To Be Held on June 12, 2015

Pursuant to the “notice and access” rules adopted by the Securities and Exchange Commission (the “SEC”), we have elected to provide stockholders access to our proxy materials over the Internet. Accordingly, we sent a Notice of Internet Availability of Proxy Materials (the “Notice”) on April 24, 2015 to all of our stockholders as of the close of business on April 21, 2015 (the “Record Date”). The Notice includes instructions on how to access our proxy materials over the Internet and how to request a printed copy of these materials. In addition, by following the instructions in the Notice, stockholders may request to receive proxy materials in printed form by mail or electronically by e-mail on an ongoing basis.

Choosing to receive your future proxy materials by e-mail will save the Company the cost of printing and mailing documents to you and will reduce the impact of the Company’s annual meetings on the environment. If you choose to receive future proxy materials by e-mail, you will receive an e-mail next year with instructions containing a link to those materials and a link to the proxy voting site. Your election to receive proxy materials by e-mail will remain in effect until you terminate it.

Our Annual Report to Stockholders and this Proxy Statement are available at http://phx.corporate-ir.net/phoenix.zhtml?c=214618&p=proxy.

Voting at the Annual Meeting

Stockholders will be entitled to vote at the Annual Meeting on the basis of each share held of record at the close of business on the Record Date.

If on the Record Date you hold shares of our common stock that are represented by stock certificates or registered directly in your name with our transfer agent, American Stock Transfer & Trust Company (“AST”), you are considered the stockholder of record with respect to those shares, and AST is sending these proxy materials directly to you on our behalf. As a stockholder of record, you may vote in person at the meeting or by proxy. Whether or not you plan to attend the Annual Meeting in person, you may vote over the Internet by following the instructions on the Notice. If you request printed copies of the proxy materials by mail, you may also vote by signing and submitting your proxy card or by submitting your vote by telephone. Whether or not you plan to attend the Annual Meeting, we urge you to vote by way of the Internet, by telephone, or by filling out and returning the proxy card you will receive upon request of printed materials. If you submit a proxy but do not give voting instructions as to how your shares should be voted on a particular proposal at the Annual Meeting, your shares will be voted in accordance with the recommendations of our Board stated in this Proxy Statement. Any proxy given pursuant to this solicitation may be revoked by the person giving it at any time before its use by (1) delivering a written notice of revocation addressed to American Public Education, Inc., Attn: Corporate Secretary, 111 W. Congress Street, Charles Town, West Virginia 25414, (2) a duly executed proxy bearing a later date, (3) voting again by Internet or by telephone, or (4) attending the Annual Meeting and voting in person. Your last vote or proxy will be the vote or proxy that is counted. Attendance at the Annual Meeting will not cause your previously granted proxy to be revoked unless you vote or specifically so request.

If on the Record Date you hold shares of our common stock in an account with a brokerage firm, bank, or other nominee, then you are a beneficial owner of the shares and hold such shares in street name, and these proxy materials will be forwarded to you by that organization. As a beneficial owner, you have the right to direct your broker, bank, or other nominee on how to vote the shares held in their account, and the nominee has enclosed or provided voting instructions for you to use in directing it how to vote your shares. The nominee that holds your shares, however, is considered the stockholder of record for purposes of voting at the Annual Meeting. Because you are not the stockholder of record, you may not vote your shares in person at the Annual Meeting unless you bring to the Annual Meeting a letter from your broker, bank or other nominee confirming your beneficial ownership of the shares. Whether or not you plan to attend the Annual Meeting, we urge you to vote by following the voting instructions provided to you to ensure that your vote is counted.

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If you are a beneficial owner and do not vote, and your broker, bank or other nominee does not have discretionary power to vote your shares, your shares may constitute “broker non-votes.” Shares that constitute broker non-votes will be counted for the purpose of establishing a quorum at the Annual Meeting. Voting results will be tabulated and certified by the inspector of elections appointed for the Annual Meeting. If you receive more than one Notice, it is because your shares are registered in more than one name or are registered in different accounts. Please follow the instructions on each Notice received to ensure that all of your shares are voted.

A list of stockholders of record as of the Record Date will be available for inspection during ordinary business hours at our offices located at 111 W. Congress Street, Charles Town, West Virginia 25414, from June 1, 2015 to the date of our Annual Meeting. The list will also be available for inspection at the Annual Meeting.

Quorum Requirement for the Annual Meeting

The presence at the Annual Meeting, whether in person or by valid proxy, of the persons holding a majority of shares of common stock outstanding on the Record Date will constitute a quorum, permitting us to conduct our business at the Annual Meeting. On the Record Date, there were 17,146,418 shares of common stock outstanding, held by 460 stockholders of record. Abstentions (i.e., if you or your broker mark “ABSTAIN” on a proxy) and “broker non-votes” will be considered to be shares present at the meeting for purposes of a quorum. Broker non-votes occur when shares held by a broker for a beneficial owner are not voted with respect to a particular proposal and generally occur because the broker (1) does not receive voting instructions from the beneficial owner and (2) lacks discretionary authority to vote the shares. Brokers and other nominees have discretionary authority to vote on ratification of our independent public accounting firm for clients who have not provided voting instructions. However, without voting instructions from their clients, they cannot vote on “non-routine” proposals, including the election of directors, the authorization of equity compensation plans, and matters related to executive compensation.

Required Votes

Election of Directors. Each director will be elected by the vote of the majority of the votes cast with respect to that director’s election. For purposes of electing directors, a majority of the votes cast means that the number of shares voted “FOR” a director’s election exceeds the number of the votes cast against that director’s election. Abstentions and broker non-votes are not taken into account in determining the outcome of the election of directors.

Advisory vote on executive compensation and ratification of our independent public accounting firm. The advisory vote on compensation of our named executive officers and approval of the proposal to ratify the Audit Committee’s appointment of McGladrey as our independent registered public accounting firm for the fiscal year ending December 31, 2015 each require the affirmative vote of the holders of at least a majority of the shares of common stock present in person or represented by proxy at the Annual Meeting and entitled to vote. Broker non-votes are not taken into account in determining the outcome of these proposals, and abstentions will have the effect of a vote against these proposals.

Solicitation of Proxies

We will bear the cost of solicitation of proxies. This includes the charges and expenses of brokerage firms and others for forwarding solicitation material to beneficial owners of our outstanding common stock. We may solicit proxies by mail, personal interview, telephone or via the Internet through our officers, directors and other management employees, who will receive no additional compensation for their services.

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CORPORATE GOVERNANCE STANDARDS AND DIRECTOR INDEPENDENCE

The Board has adopted Corporate Governance Guidelines (the “Guidelines”), a Code of Business Conduct and Ethics (the “Code of Ethics”), and a Policy for Related Person Transactions as part of our corporate governance practices and in accordance with rules of the SEC and the listing standards of The NASDAQ Stock Market (“NASDAQ”).

Corporate Governance Matters

The Guidelines set forth a framework to assist the Board in the exercise of its responsibilities. The Guidelines cover, among other things, the composition and certain functions of the Board, director independence, stock ownership by our non-employee directors, management succession and review, Board committees, the selection of new directors, and director expectations.

The Code of Ethics covers, among other things, compliance with laws, rules and regulations, conflicts of interest, corporate opportunities, confidentiality, protection and proper use of company assets, and the reporting process for any illegal or unethical conduct. The Code of Ethics is applicable to all of our officers, directors and employees. The Code of Ethics includes provisions that are specifically applicable to our Chief Executive Officer, Chief Financial Officer and other Principal Officers (as defined in the Code of Ethics).

Any waiver of the Code of Ethics for our directors, executive officers or Principal Officers may be made only by our Board and will be promptly disclosed as may be required by law, regulation or rule of the SEC or NASDAQ listing standards. If we amend our Code of Ethics or waive the Code of Ethics with respect to our Chief Executive Officer, Chief Financial Officer or other Principal Officers, we will post the amendment or waiver on our corporate website, which is www.americanpubliceducation.com. The information on our corporate website is not incorporated by reference into this Proxy Statement.

The Guidelines and Code of Ethics are each available in the Governance section of our corporate website. The Guidelines, Code of Ethics, and Policy for Related Person Transactions are reviewed periodically by our Nominating and Corporate Governance Committee, and changes are recommended to our Board for approval as appropriate.

Certain Relationships and Related Person Transactions

Policies and Procedures for Related Person Transactions

As a supplement to and extension of our Code of Ethics, our Board has adopted a Policy for Related Person Transactions pursuant to which our Nominating and Corporate Governance Committee, another independent committee of our Board or the full Board, must give prior consent before we may enter into a related person transaction with our executive officers, directors, nominees for director and principal stockholders, including their immediate family members and affiliates. Any request for us to enter into a related person transaction with an executive officer, director, nominee for director, principal stockholder or any of such persons' immediate family members or affiliates must first be presented to our Nominating and Corporate Governance Committee for review, consideration and approval. A related person transaction is a transaction in which the Company is or will be a participant and in which a related person has or will have a direct or indirect material interest, other than (i) a transaction involving $120,000 or less when aggregated with all related transactions, (ii) a transaction involving compensation to an executive officer that is approved by the Board or the Compensation Committee, (iii) a transaction involving compensation to a director or director nominee that is approved by the Board, the Compensation Committee or the Nominating and Corporate Governance Committee, and (iv) any other transaction that is not required to be reported pursuant to Item 404(a) of Regulation S-K under the Securities Exchange Act of 1934. All of our directors, executive officers and employees are required to report to our Nominating and Corporate Governance Committee any such related person transaction. In approving or rejecting the proposed agreement, our Nominating and Corporate Governance Committee shall consider the facts and circumstances available and deemed relevant to the Nominating and Corporate Governance Committee, including, but not limited to the risks, costs and benefits to us, the terms of the transaction, the availability of other sources for comparable services or

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products, and, if applicable, the impact on a director's independence. Our Nominating and Corporate Governance Committee shall approve only those agreements that, in light of known circumstances, are in, or are not inconsistent with, our best interests, as our Nominating and Corporate Governance Committee determines in the good faith exercise of its discretion. Under the policy, if we should discover related person transactions that have not been approved, the Nominating and Corporate Governance Committee will be notified and will determine the appropriate action, including ratification, rescission or amendment of the transaction.

Related Person Transactions

There were no related person transactions in 2014.

Stock Ownership Guidelines

To further align the interest of our executive officers and directors with the interest of our stockholders, and after evaluation of best practices and consultation by the Compensation Committee with Towers Watson & Co. ("Towers Watson"), its independent consultant, our Board has implemented stock ownership guidelines applicable to our executive officers and directors. Each executive officer is expected to hold shares of common stock with an aggregate value greater than or equal to a multiple of the executive officer's base salary as set forth below:

- the Company's Chief Executive Officer — six times base salary;
- the Company's Executive Vice Presidents — two times base salary; and
- the Company's Senior Vice Presidents — one times base salary.

Each of the Company's non-employee directors is expected to hold shares of Common Stock with an aggregate value greater than or equal to at least three times the amount of the annual retainer paid to non-employee directors for service on the Board, excluding additional committee retainers, if any.

Under the stock ownership guidelines, common stock held directly, including shares of common stock held in a separate brokerage account or in a 401(k) account, and common stock held indirectly (*e.g.*, by a spouse, minor dependent, or a trust for the benefit of the executive or director, or the executive's or director's spouse or minor dependent), count toward satisfaction of the levels set forth in the guidelines. For purposes of the guidelines, the "value" of the common stock is based on the closing price of the common stock on the day on which a determination under the guidelines is being made. The determination of compliance with the guidelines will be measured annually on the last business day of each year.

Our executives and non-employee directors are expected to comply with these guidelines within five years of the later of March 2, 2011 (the date of adoption of the guidelines) and the date the person first became an executive or non-employee director, as applicable. If an executive officer has not achieved the stock ownership level as outlined above by that date, the executive officer will be required to retain 50% of the net shares of common stock acquired pursuant to restricted stock or option awards made after the adoption of these guidelines until such levels are achieved. "Net shares" are those shares that remain after shares are sold or withheld to pay withholding taxes and/or the exercise price of stock options (if applicable).

The stock ownership guidelines superseded the existing policy applicable to our non-employee directors. That policy provided that directors were expected to hold a number of shares of our common stock equivalent to one-half of all shares of restricted stock they receive.

Restrictions on "Hedging"

We have adopted a policy prohibiting our directors, officers and employees from engaging in short sales, transactions in derivative securities (including put and call options), or other forms of hedging and monetization transactions, such as zero-cost collars, equity swaps, exchange funds and forward sale contracts, that allow the holder to limit or eliminate the risk of a decrease in the value of our securities. We have adopted this policy in order to further align the interests and objectives of our directors, officers and employees with our stockholders.

Board Independence and Leadership Structure

Our Board believes, and our Guidelines require, that a substantial majority of its members should be independent directors. In addition, the respective charters of the Audit, Compensation and Nominating and Corporate Governance Committees, currently require that each member of such committees be independent directors. Consistent with NASDAQ's independence criteria, the Board has affirmatively determined that all of our directors are independent of the Company and our management, with the exception of Dr. Boston, who is our President and Chief Executive Officer. NASDAQ's independence criteria includes a series of objective tests, such as that the director is not an employee of the Company and has not engaged in various types of business dealings with us. In addition, as further required by NASDAQ rules, the Board has made a subjective determination as to each independent director that no relationship exists that, in the opinion of the Board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. In making these determinations, the Board reviewed and discussed information provided by the directors and management with regard to each director's business and personal activities as they may relate to us and our management.

In accordance with our Guidelines, the independent members of our Board will hold at least two "executive session" meetings each year. If the chairperson of the Board is not an independent director, an independent chairperson will be selected for each executive session. In general, these meetings are intended to be used as a forum to discuss the annual evaluation of the Chief Executive Officer's performance, the annual review of the Chief Executive Officer's plan for management succession and such other topics as the independent directors deem necessary or appropriate.

Our Guidelines specify that the Board shall select its chairperson based on the Board's determination of what is then in the best interests of the Company. Historically, the Company has split the positions of the Chairperson of the Board and Chief Executive Officer because we believe that this structure is appropriate given the differences between the two roles in our management structure. Our Chief Executive Officer, among other duties, is responsible for setting the strategic direction for the Company and the day-to-day leadership and performance of the Company, while the Chairperson of the Board, among other responsibilities, provides guidance to the Chief Executive Officer, and presides over meetings of the full Board.

Board's Role in Risk Oversight

Our management is responsible for managing risks in our business, including by developing processes to monitor and control risks. The Board views its role as one of oversight and of responsibility for setting a tone that risk management should be properly integrated with our strategy and culture. The Board focuses on understanding management's risk management processes, the effectiveness of those processes and the way in which management proactively manages risks. The Board regularly meets with our management, particularly our Chief Executive Officer and Chief Financial Officer, as well other executives, to receive updates on how management is assessing and managing risk in particular functional areas of our business. The Board and its committees also request and receive regular reports from management on particular areas of risk.

The Board is assisted in carrying out its oversight of risks by the Committees. In this regard, each of the charters of the Board's committees specifically address issues of risk. At the request of the full Board, from time to time the Nominating and Corporate Governance Committee may discuss or examine in more depth specific risk areas and request presentations and information from management for that purpose. The Nominating and Corporate Governance Committee considers and makes recommendations on how the Board is approaching its role of risk oversight. The Audit Committee reviews and assesses the qualitative aspects of financial reporting and our processes to manage financial and financial reporting risk. The Audit Committee regularly reports its findings to the Board.

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While the Audit Committee and the Nominating and Corporate Governance Committee have primary responsibility for assisting the Board with its risk oversight responsibilities, the Compensation Committee also assists the Board with risk oversight. When establishing executive compensation and director compensation and in its role in implementing incentive compensation plans, the Compensation Committee considers whether compensation practices properly take into account an appropriate risk-reward relationship or encourage unnecessary and excessive risks that threaten the value of the Company. The Board has concluded, on the recommendation of the Compensation Committee, that the Company's compensation policies and practices are not reasonably likely to have a material adverse effect on the Company; this conclusion has been confirmed by the Compensation Committee.

Meetings of the Board of Directors and its Committees

Information concerning the Board and its three standing committees is set forth below. Each Board committee currently consists only of directors who are not employees of the Company and who are "independent" as defined in NASDAQ's rules.

The Board and its committees meet regularly throughout the year, and also hold special meetings and act by written consent from time to time. The Board held a total of eight meetings during the fiscal year ended December 31, 2014. During this time all of our directors attended at least 75% of the aggregate number of meetings held by the Board and all committees of the Board on which such director served (during the period that such director served). The Board does not have a formal policy with respect to Board member attendance at annual meetings of stockholders. Our 2014 Annual Meeting of Stockholders was attended by all of our current directors who were then serving.

The Board has three standing committees: the Audit Committee; the Compensation Committee; and the Nominating and Corporate Governance Committee. The charters for the Audit, Compensation and Nominating and Corporate Governance Committees can be accessed electronically on the Committees page of our corporate website, which is www.americanpubliceducation.com. The information on our corporate website is not incorporated by reference into this Proxy Statement.

The Board conducts, and the Nominating and Corporate Governance Committee oversees, an annual evaluation of the Board's operations and performance in order to enhance its effectiveness. Recommendations resulting from this evaluation are made by the Nominating and Corporate Governance Committee to the full Board for its consideration.

BOARD COMMITTEES AND THEIR FUNCTIONS

The following table describes which directors serve on each of the Board's standing committees.

Name	**Audit Committee**	**Compensation Committee**	**Nominating and Corporate Governance Committee**
Eric C. Andersen	X	X	
Wallace E. Boston, Jr.			
Barbara G. Fast[3]		X (1)	X
Jean C. Halle	X (1)		
Barbara Kurshan			X
Timothy J. Landon	X		X (1)
Westley Moore		X	X
Timothy T. Weglicki[2]	X		X

(1) Chair of the Committee.

(2) Chairperson of the Board.

(3) Vice-Chairperson of the Board.

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Audit Committee

The Board has established a separately designated standing Audit Committee in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, which met four times during 2014. The Audit Committee is responsible, among its other duties and responsibilities, for overseeing our accounting and financial reporting processes, the audits of our financial statements, the qualifications of our independent registered public accounting firm, and the performance of our internal audit function and our independent registered public accounting firm. The Audit Committee reviews and assesses the qualitative aspects of our financial reporting, our processes to manage financial reporting risk, and our compliance with significant applicable legal, ethical and regulatory requirements. The Audit Committee is directly responsible for the appointment, compensation, retention and oversight of our independent registered public accounting firm. The members of our Audit Committee are Ms. Halle, who serves as chair of the Committee, Mr. Andersen, Mr. Landon, and Mr. Weglicki. Our Board has determined that Ms. Halle and Mr. Andersen are each an "Audit Committee financial expert," as that term is defined under the SEC rules implementing Section 407 of the Sarbanes-Oxley Act of 2002. Our Board has determined that each member of our Audit Committee is independent under NASDAQ's listing standards and each member of our Audit Committee is independent pursuant to Rule 10A-3 of the Securities Exchange Act of 1934.

Compensation Committee

The Compensation Committee is responsible, among its other duties and responsibilities, for establishing the compensation and benefits of our Chief Executive Officer and other executive officers, monitoring compensation arrangements applicable to our Chief Executive Officer and other executive officers in light of their performance, effectiveness and other relevant considerations and administering our equity incentive plans. The Committee met eight times during 2014. The members of our Compensation Committee are MG (Ret) Fast, who serves as chair of the Committee, Mr. Andersen and Mr. Moore. Our Board has determined that each member of our Compensation Committee meets NASDAQ's independence requirements for approval of the compensation of our Chief Executive Officer and other executive officers.

The Compensation Committee has the sole authority to retain and terminate any compensation consultant to assist in evaluating executive officer compensation. In 2014, the Compensation Committee retained Towers Watson directly as an outside compensation consultant to assist in evaluating our compensation programs, as it has since 2007. The Compensation Committee assessed Towers Watson's independence, considering all relevant factors, including those set forth in NASDAQ rules. In connection with this assessment, the Committee considered Towers Watson's work and determined that it raised no conflicts of interest. Towers Watson does no work for the Company other than work that is authorized by the Compensation Committee or its chairperson. The Compensation Committee used information provided to it by Towers Watson in connection with making 2014 compensation determinations. Towers Watson also advised the Compensation Committee on the use of a peer group for comparative purposes. The consultant's role in recommending the amount or form of executive compensation paid to the Company's named executive officers during 2014 is described in the "Compensation Discussion and Analysis — Compensation Program Philosophy and Objectives — Competitive Compensation and Peer Group Review" section below.

The Compensation Committee considers the results of the annual advisory vote on the compensation of named executive officers. See “Proposal No. 2” below to review this year’s proposal. In 2013, approximately 89% of the stockholder votes cast on this proposal were voted in favor of our executive compensation proposal, which was the most recent shareholder vote before we set our 2014 compensation. The Compensation Committee considered this in the context of the recommendation of various proxy advisory firms and as part of its decision to continue to increase the proportion of compensation that is performance-based. In 2014, approximately 97% of the stockholder votes cast on this proposal were voted in favor of our executive compensation proposal.

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The Compensation Committee works closely with our Chief Executive Officer, Dr. Boston, on compensation decisions and has delegated certain aspects of the annual incentive plans for the other executive officers, including the named executive officers, to Dr. Boston. For a discussion of Dr. Boston's role in determining or recommending the executive compensation paid to the Company's named executive officers during 2014, see the "Compensation Discussion and Analysis — Role of Executives in Executive Compensation Decisions" section below. None of our other executive officers participates in any deliberations related to the setting of executive compensation with the exception of Peter W. Gibbons, our Senior Vice President, Chief Administrative Officer, who provides administrative support to the Compensation Committee and facilitates the requests for information received from the independent consultant.

Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee is responsible for recommending candidates for election to the Board. The Committee met five times during 2014. The Committee is also responsible, among its other duties and responsibilities, for making recommendations to the Board or otherwise acting with respect to corporate governance policies and practices, including board size and membership qualifications, recommendations with respect to director resignations tendered in the event a director fails to achieve a majority of votes cast in favor of his or her election, new director orientation, committee structure and membership, succession planning for our Chief Executive Officer and other key executive officers, and communications with stockholders. In addition, the Nominating and Corporate Governance Committee assists the Board in understanding and overseeing management's processes for the assessment and management of non-financial risks of the Company and the steps that management has taken to monitor and control exposure to such risks. The members of our Nominating and Corporate Governance Committee are Mr. Landon, who serves as chair of the Committee, MG (Ret) Fast, Dr. Kurshan, Mr. Moore, and Mr. Weglicki. Our Board has determined that each member of our Nominating and Corporate Governance Committee meets NASDAQ's independence requirements for director nominations.

DIRECTOR NOMINATIONS AND COMMUNICATION WITH DIRECTORS

Director Nomination Process

The Nominating and Corporate Governance Committee recommends, and the Board nominates, candidates to stand for election as directors. Stockholders may also nominate persons to be elected as directors. If a stockholder wishes to nominate a person for election as director, he or she must follow the procedures contained in our Bylaws and satisfy the requirements of Regulation 14A of the Securities Exchange Act of 1934. For a stockholder's nomination of a person to stand for election as a director at the annual meeting of stockholders to be considered, our Corporate Secretary must receive such nominations at our principal executive offices not more than 120 days, and not less than 90 days, before the anniversary date of the preceding annual meeting, except that if the annual meeting is set for a date that is not within 30 days before or 60 days after such anniversary, the nomination must be received no later than the close of business on the tenth day following the notice or public disclosure of the meeting. Each submission must include the following information:

- the name and address of the stockholder who intends to make the nomination and the name and address of the person or persons to be nominated;
- a representation that the stockholder is a holder of record of Company capital stock entitled to vote at the annual meeting and intends to appear in person or by proxy at the meeting to nominate the person or persons;
- if applicable, a description of all arrangements or understandings between the stockholder and each nominee and any other person or persons, naming such person or persons, pursuant to which the nomination is to be made by the stockholder;
- such other information regarding each nominee to be proposed by such stockholder as would be required to be included in a proxy statement filed under the SEC's proxy rules if the nominee had been nominated, or intended to be nominated, by the Board;

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- if applicable, the consent of each nominee to serve as a director if elected;
- a statement whether each nominee, if elected, intends to tender an irrevocable resignation in the form required by the incumbent directors under the Bylaws; and
- such other information that the Board may request in its discretion.

The Board may require any proposed nominee to furnish such other information as it may reasonably require to determine the eligibility of such proposed nominee to serve as one of its directors.

Each director will be elected by the vote of the majority of the votes cast with respect to that director's election, provided that if, as of the tenth (10th) day preceding the date we first mail notice of the meeting for such meeting to our stockholders, the number of nominees exceeds the number of directors to be elected, which we refer to as a "Contested Election", the directors shall be elected by the vote of a plurality of the votes cast. Our Bylaws require that the Board or a committee of the Board shall not nominate any incumbent director who, as a condition to such nomination, does not submit a conditional and, in the case of an uncontested election, irrevocable letter of resignation to the Chairperson of the Board. If an incumbent nominee is not elected in an uncontested election, the Nominating and Corporate Governance Committee will promptly consider such director's conditional resignation and make a recommendation to the Board regarding the resignation. Each incumbent director nominated for election to the Board at the Annual Meeting as described under "Proposal No. 1" below has submitted the conditional letter of resignation as required by our Bylaws.

In the event an incumbent director fails to receive a majority of the votes cast in an election that is not a Contested Election, the Nominating and Corporate Governance Committee, or such other committee designated by the Board pursuant to our Bylaws, shall make a recommendation to the Board as to whether to accept or reject the resignation of such incumbent director, or whether other action should be taken. The Board shall act on the resignation, taking into account the Committee's recommendation, and publicly disclose (by a press release and filing an appropriate disclosure with the SEC) its decision regarding the resignation and, if such resignation is rejected, the rationale behind the decision, within ninety (90) days following certification of the election results. The Committee in making its recommendation and the Board in making its decision each may consider any factors and other information that it considers appropriate and relevant.

Additional information regarding requirements for stockholder nominations for next year's annual meeting is described in this Proxy Statement in the section titled "General Matters — Stockholder Proposals and Nominations" below.

Contacting the Board of Directors

Stockholders wishing to communicate with our Board may do so by writing to the Board, the Chairperson of the Board, or the non-employee members of the Board as a group, at:

American Public Education, Inc.
111 W. Congress Street
Charles Town, West Virginia 25414
Attn: Corporate Secretary

Complaints or concerns relating to our accounting, internal accounting controls or auditing matters will be referred to members of the Audit Committee. Other correspondence will be referred to the relevant individual or group. All correspondence is required to prominently display the legend "Board Communication" in order to indicate to the Corporate Secretary that it is communication subject to our policy and will be received and processed by the Corporate Secretary's office. Each communication received by the Corporate Secretary will be copied for our files and will be promptly forwarded to the addressee. The Board has requested that certain items not related to the Board's duties and responsibilities be excluded from the communication so forwarded under the policy. In addition, the Corporate Secretary is not required to forward any communication that the Corporate Secretary, in good faith, determines to be frivolous, unduly hostile, threatening, illegal or similarly unsuitable. However, the Corporate Secretary will maintain a list of each communication subject to this policy that is not forwarded, and on a quarterly basis, will deliver the list to the Chairperson of the Board. In addition, each communication subject to this policy that is not forwarded because it was determined by the Corporate Secretary to be frivolous shall nevertheless be retained in our files and made available at the request of any member of the Board to whom such communication was addressed.

PROPOSAL NO. 1 — ELECTION OF DIRECTORS

Our Board is currently comprised of eight members. Our nominees for the election of directors at the Annual Meeting include seven independent non-employee directors and our Chief Executive Officer. Each director is elected to serve a one-year term, with all directors subject to annual election. At the recommendation of the Nominating and Corporate Governance Committee, the Board has nominated the following persons to serve as directors for the term beginning at the Annual Meeting on June 12, 2015: Eric C. Andersen, Dr. Wallace E. Boston, Jr., Barbara G. Fast, Jean C. Halle, Dr. Barbara Kurshan, Timothy J. Landon, Westley Moore, and Timothy T. Weglicki. All of the nominees are currently serving on the Board.

It is intended by the persons named as proxies that proxies received in response to this solicitation will be voted FOR the election of each nominee named in this section unless otherwise stated in the proxy or in the case of a broker non-vote with respect to the proposal. Proxies submitted for the Annual Meeting can only be voted for those nominees named in this Proxy Statement. If, however, any director nominee is unable or unwilling to serve as a nominee at the time of the Annual Meeting, the persons named as proxies may vote for a substitute nominee designated by the Board, or the Board may reduce the size of the Board. Each nominee has consented to serve as a director if elected, and the Board does not believe that any nominee will be unwilling or unable to serve. Each director will hold office until his or her successor is duly elected and is qualified or until his or her earlier death, resignation or removal.

Criteria for Evaluating Director Nominees

The Board provides strategic direction to the Company and oversees the performance of the Company's business and management. The Nominating and Corporate Governance Committee periodically identifies and reviews with the Board desired skills and attributes of both individual Board members and the Board overall within the context of current and future needs. The Nominating and Corporate Governance Committee is responsible for developing the general criteria, subject to approval by the full Board, for use in identifying, evaluating and selecting qualified candidates for election or re-election to the Board. The Nominating and Corporate Governance Committee reviews the appropriate skills and characteristics required of directors in the context of the current composition of the Board, our operating requirements and the long-term interests of our stockholders. It may use outside consultants to assist in identifying candidates. Among the characteristics the Committee may consider are the collective knowledge and diversity of professional skills and background, experience in relevant industries, age and geographic background in addition to the qualities of integrity, judgment, acumen, and the time and ability to work professionally and effectively with other Board members and management and make a constructive contribution to the Board. The Committee considers candidates submitted by directors and management, as well as candidates recommended by stockholders, which are evaluated in the same manner as other candidates identified to it. Final approval of director candidates is determined by the full Board.

The Board has determined that all of our director nominees are qualified to serve as directors of the Company.

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The name of each nominee for director, their ages as of April 21, 2015, and other information about each nominee is shown below. In addition, the biographies of each of the nominees below contain information regarding the experiences, qualifications, attributes or skills that caused the Nominating and Corporate Governance Committee and the Board to determine that the person should serve as a director for the Company.

Name	**Age**	**Principal Occupation**	**Director Since**
Eric C. Andersen	53	Partner, Milestone Partners	2012
Wallace E. Boston, Jr.	60	President and Chief Executive Officer of the Company	2004
Barbara G. Fast	61	Senior Vice President, CGI Federal	2009
Jean C. Halle	56	Independent Consultant	2006
Barbara Kurshan	66	Executive Director of Academic Innovation, University of Pennsylvania, Graduate School of Education	2014
Timothy J. Landon	52	Chief Executive Officer, Aggrego, LLC	2009
Westley Moore	36	Independent Consultant	2013
Timothy T. Weglicki	63	Founding Partner of ABS Capital Partners	2002

Eric C. Andersen has served on our Board since June 2012. Mr. Andersen also serves on the board of NWHW Holdings, Inc. as the APEI representative. Mr. Andersen is a partner with Milestone Partners, a lower middle market private equity firm that specializes in making control equity investments in established operating businesses. Prior to joining Milestone Partners in 2011, from 2006 to 2011 Mr. Andersen served as a Managing Director of private equity firm Silver Lake Partners, before which he worked in the consulting industry with IBM Business Consulting Services (BCS), serving as Managing Partner, Asia Pacific responsible for IBM's business solutions and business process outsourcing business across Asia Pacific, and Managing Partner, Distribution Sector responsible for IBM's consulting business in the pharmaceutical, retail, consumer goods and travel/transportation industries. Before working with IBM, Mr. Andersen was a senior partner at PwC Consulting, where he served in a variety of positions. Mr. Andersen currently serves on the board of directors of several private companies.

We believe that Mr. Andersen's qualifications to serve on our board include his experience as a principal of two private equity firms, as well as his expertise in outsourcing, business processes and international operations.

Dr. Wallace E. Boston, Jr. joined us in September 2002 as Chief Financial Officer and, since June 2004, has served as President, Chief Executive Officer and a member of our Board. From August 2001 to April 2002, Dr. Boston served as Chief Financial Officer of Sun Healthcare Group. From July 1998 to May 2001, Dr. Boston served as Chief Operating Officer and, later, President of NeighborCare Pharmacies. From February 1993 to May 1998, Dr. Boston served as Vice President — Finance and, later, Senior Vice President of Acquisitions and Development of Manor Healthcare Corporation, now Manor Care, Inc. From November 1985 to December 1992, Dr. Boston served as Chief Financial Officer of Meridian Healthcare. Dr. Boston currently serves on the Board of the Presidents' Forum of Excelsior College, the Board of Avalere Health LLC, and the Board of Overseers of the University of Pennsylvania

Graduate School of Education.

We believe that Dr. Boston’s qualifications to serve on our Board include his service as our Chief Executive Officer since 2004 and his service as our Chief Financial Officer between 2002 and 2004. Dr. Boston’s leadership has been pivotal to the Company in some of our most significant events, including our accreditation by the Higher Learning Commission in 2006, our 2007 initial public offering, the receipt by American Public University System of the 2009 Ralph E. Gomory Award for Quality Online Education, also known as the Sloan-C Award, our reaccreditation in 2011, and our 2013 acquisition of National Education Seminars, Inc., which we refer to as Hondros College of Nursing.

Major General (Retired) Barbara G. Fast has served on our Board since May 2009 and was appointed Vice-Chairperson of the Board in August 2014. MG (Ret) Fast also serves as Chairperson of the Board of Directors of the Company’s subsidiary National Education Seminars, Inc., which operates

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as Hondros College of Nursing. She has served as Senior Vice President, Strategic Engagements, CGI Federal, since June 2014. Prior to that she served as Senior Vice President, Army Defense and Intelligence Programs, CGI Federal, beginning in November 2012. Prior to that she served as Vice President of Operations and Intelligence, CGI Federal, from June 2011. Previously she was the Vice President of Cyber and Information Solutions at The Boeing Company, which she joined in August 2008. MG (Ret) Fast retired from the Army in July 2008 after a 32-year career. Her most recent posts included: Deputy Director, Army Capabilities and Requirements Center, Training and Doctrine Command, from July 2007 until June 2008; Deputy and, later, Commanding General for the United States Army Intelligence Center and Fort Huachuca, Arizona, from August 2004 until June 2007; and Director of Intelligence, Multinational Forces — Iraq (Baghdad, Iraq) from July 2003 until July 2004. MG (Ret) Fast currently serves on the board of directors of several government and private organizations.

We believe that MG (Ret) Fast's qualifications to serve on our Board include her extensive experience and achievements in the U.S. Military, national and defense intelligence, and cyber security, culminating in over 32 years of military service until her retirement as a Major General, her service as Commanding General of Fort Huachuca, and her current work in industry.

Jean C. Halle has served on our Board since March 2006. Ms. Halle also serves on the board of Second Avenue Software as the APEI representative. Since 2010, Ms. Halle has worked as an independent consultant. From September 2013 until May 2014 she served as the Acting Chief Operating Officer for Curiosityville, a digital early learning company. From 2002 to 2010, Ms. Halle was the Chief Executive Officer of Calvert Education Services, a provider of accredited distance education programs and educational support services. From 1999 to 2001, Ms. Halle was the Chief Financial Officer and Vice President of New Business Development for Times Mirror Interactive, a digital media subsidiary of the former Times Mirror Company. From 1986 to 1999, Ms. Halle held a number of positions with The Baltimore Sun Company, including Vice President of New Business Development, Chief Financial Officer and Vice President of Finance, President of Homestead Publishing, a subsidiary of The Baltimore Sun Company, and Director of Strategic Planning. From 1983 to 1986, Ms. Halle was the Chief Financial Officer and Vice President of Finance for Abell Communications, and Assistant Treasurer of A.S. Abell Company, the former parent company of The Baltimore Sun Company. From 1979 to 1983, Ms. Halle was a Senior Management Consultant with Deloitte, Haskins and Sells, now Deloitte & Touche, an international accounting and professional services firm. Ms. Halle currently serves on the President's Advisory Council for Stevenson University, the Board of Trustees of Catholic Distance University, the Advisory Board of Loyola University School of Education and the advisory boards of two private companies.

We believe that Ms. Halle's qualifications to serve on our Board include her multifaceted experiences in online education as Chief Executive Officer of Calvert Education Services, in media as Chief Financial Officer and Vice President of New Business Development for Times Mirror Interactive, and in financial consulting as a Senior Management Consultant at an international accounting and professional services firm. Ms. Halle was also a 2011 National Association of Corporate Directors Board Leadership Fellow, having completed a comprehensive program of study for experienced corporate directors spanning leading practices for boards and committees.

Dr. Barbara “Bobbi” Kurshan has served on our Board since August 2014, after having been recommended for nomination as a director by Dr. Boston. Dr. Kurshan is the Executive Director of Academic Innovation and a Senior Fellow in Education at the Graduate School of Education at the University of Pennsylvania, a position she has held since 2012. Dr. Kurshan also serves as a consultant of Educorp Consultants Corporation, a company she has owned and operated since 1989. Dr. Kurshan received her MS in Computer Science and her Ed.D. in Curriculum and Instruction with concentration in Educational Technology from Virginia Tech University and has had a nearly thirty-year career as both an academic and award-winning entrepreneur. She currently serves on the board of directors of two private organizations

We believe that Dr. Kurshan’s qualifications to serve on our Board include her extensive background and leadership experience for nearly thirty years in the field of higher education.

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Timothy J. Landon has served on our Board since January 2009. Since September 2013, Mr. Landon has served as the Chief Executive Officer of Aggrego, LLC, a venture capital-backed startup focused on building content and ad networks for mobile distribution in the United States, Western Europe, the Caribbean, Central America and Asia Pacific. Aggrego's investors are Wrapports, LLC and Digicel Group Limited. From June 2012 until September of 2013, Mr. Landon served as President of Wrapports Ventures, the venture capital and incubator division of Wrapports, LLC, which disrupts and transforms local media using technology. From 2008 to 2012, Mr. Landon served as Chief Executive Officer of Landon Company, where he focused on early stage angel investing and consulting for private equity, venture capital and large traditional and online media companies. Mr. Landon worked at Tribune Company for more than 20 years, and served in a variety of positions within the Tribune organization, including as President of Tribune Interactive, Inc. from March 2004 until February 2008, where he was responsible for overall interactive and classified advertising strategy, technology and operations for the Tribune Company, and had leadership roles in starting CareerBuilder.com, Classified Ventures (the holding company of apartments.com and cars.com), and other online businesses. In December 2008, the Tribune Company filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code.

We believe that Mr. Landon's qualifications to serve on our Board include his extensive experience in starting, building and managing internet-focused media businesses over the last seventeen years. He brings significant knowledge of online marketing and online business models, including knowledge based on his position as President of Tribune Interactive and his experience at CareerBuilder.com, which has direct relevance and applicability to our business.

Westley Moore has served has served on our Board since June 2013. Since 2014, Mr. Moore's principal occupation has been as the founder and CEO of BridgeEdU. He is also an author, public speaker and television personality through his wholly owned business entities. Within television, Mr. Moore has been the Executive Producer and host of the PBS miniseries on returning veterans "Coming Back with Wes Moore." During 2011, he hosted the television program "Beyond Belief" on the Oprah Winfrey Network and served as a news analyst for NBC. Prior to that, in 2010, he published a bestselling book, *The Other Wes Moore*. From 2007 to 2011, he was a securities broker with Citigroup. From 2006 to 2007, Mr. Moore worked at the U.S. Department of State as a White House Fellow to Secretary of State Condoleezza Rice. Previously, Mr. Moore served as a paratrooper and Captain in the U.S. Army from 2004 to 2006, which included a tour of combat duty in Afghanistan. Mr. Moore currently serves on the board of the Iraq and Afghanistan Veterans of America, the Johns Hopkins University Board of Trustees, and the Valley Forge Military Academy and College Board of Trustees. He is also a trustee of the Baltimore Community Foundation, a member of the Board of Overseers of The Network for Teaching Entrepreneurship, and a trustee of Phi Theta Kappa Foundation.

We believe that Mr. Moore's qualifications to serve on our Board include his experience in media and communications, as well as his policy and military experience.

Timothy T. Weglicki has served on our Board since August 2002, was appointed Vice-Chairperson of the Board in 2010, and was appointed Chairperson of the Board in 2013. Mr. Weglicki is a Founding Partner of ABS Capital Partners, a venture capital firm founded in 1993. Prior to co-founding ABS Capital Partners, from 1978 to 1993, Mr. Weglicki was an investment banker with Alex. Brown & Sons, where he founded and headed the Capital Markets Group from 1989 to 1993. Mr. Weglicki served on the board of directors and the compensation and the nominating and governance committees of Coventry Health Care, Inc. until its acquisition by merger in 2013 and is currently on the boards of directors of several of ABS Capital Partners' portfolio companies.

We believe that Mr. Weglicki's qualifications to serve on our Board include his significant experience and leadership of businesses in investment banking, capital markets and private equity as a Founding Partner of ABS Capital Partners, a director of other public companies and head of the Capital Markets Group at Alex. Brown & Sons.

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Required Vote and Board Recommendation

In order to be elected as a director, a nominee must be elected by a majority of the votes cast with respect to such nominee at the Annual Meeting. A majority of the votes cast means that the number of shares of common stock voted FOR a nominee must exceed 50% of the votes cast with respect to that nominee. Stockholders do not have the right to cumulate their votes in the election of directors. If an incumbent nominee in an uncontested election such as the election to be held at the Annual Meeting fails to be elected, the incumbent nominee will continue in office and the Board will consider whether to accept the nominee’s earlier submitted conditional resignation. If the resignation is not accepted the incumbent nominee may continue in office until a successor is elected.

THE BOARD RECOMMENDS A VOTE FOR ELECTION OF EACH OF THE EIGHT NOMINATED DIRECTORS.

2014 Director Compensation

Under our non-employee director compensation policy, which was established and is periodically revised following consultation with Towers Watson, directors receive an annual retainer of $40,000. The chairs of the Audit, Compensation, and Nominating and Corporate Governance Committees receive an additional annual retainer of $11,000, $8,500 and $5,500, respectively, the non-employee Chairperson of the Board receives an additional annual retainer of $30,000 and the non-employee Vice-Chairperson of the Board receives an additional annual retainer of $15,000. The Chairperson and the Vice-Chairperson are not entitled to receive any additional annual retainers for also serving as chair of any of the Board’s standing committees.

The annual retainers are payable in quarterly installments, and each director may, before the beginning of the applicable year, elect to receive his or her annual retainer in common stock having the same value as the portion of the annual retainer to be paid, calculated as of the close of business on the first business day of the year. In connection with our annual meeting of stockholders, our non-employee director compensation policy also provides for an annual grant to each director of restricted stock having a value of $55,000 on the grant date. The restricted stock grant vests on the earlier of the one-year anniversary of the date of grant or immediately prior to the next year’s annual meeting of stockholders.

We also reimburse all directors for travel and other necessary business expenses incurred in the performance of their services for us and extend coverage to them under the directors’ and officers’ indemnity insurance policies.

Some directors may also be asked to serve as a representative of our Board on the boards of our wholly-owned subsidiaries or in entities in which we have invested. A non-employee director who serves on the board of a wholly-owned subsidiary as a representative of our Board receives a payment of $2,500 ($3,000 for a director serving as chair) per in-person meeting, or $750 ($1,000 for a director serving as chair) for telephonic meetings, but with no more than one payment per day. Non-employee directors who serve on the board of entities in which we have invested are compensated by those companies consistent with their policies, provided that our Compensation Committee or full Board of Directors reviews the compensation arrangements.

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The following table sets forth information regarding compensation earned by directors during 2014:

Name[(1)]	**Fees Earned or Paid in Cash ($)**[(2)]	**Stock Awards ($)**[(3)]	**Total ($)**
Eric C. Andersen[(4)]	$ 40,000	$ 54,998	$94,998
J. Christopher Everett	$ 19,153	$ —	$19,153
Barbara G. Fast	$ 56,961	$ 54,998	$111,959
Jean C. Halle	$ 50,061	$ 54,998	$105,059
Barbara Kurshan	$ 15,561	$ 45,949	$61,510
Timothy J. Landon	$ 41,503	$ 54,998	$96,500
Westley Moore	$ 40,000	$ 54,998	$94,998
Timothy T. Weglicki	$ 57,683	$ 54,998	$112,681

(1) See the Summary Compensation Table in the “Compensation Tables and Disclosures” section of this Proxy Statement for disclosure related to Dr. Boston, who is one of our named executive officers (“NEOs”) as of December 31, 2014.

(2) Mr. Weglicki elected to receive his entire 2014 annual retainer in fully-vested shares of common stock. Mr. Landon, Ms. Halle and Mr. Everett each elected to receive a portion of his or her 2014 annual retainer in fully-vested shares of common stock. Mr. Everett’s annual retainer was prorated to reflect his service until the 2014 Annual Meeting of Stockholders. Dr. Kurshan’s annual retainer was prorated to reflect that she was appointed to serve as a director on August 12, 2014. For MG (Ret) Fast, amount includes $2,500 paid as compensation for her service as Chairperson of the Board of APEI’s subsidiary National Education Seminars, Inc., which operates as Hondros College of Nursing.

(3) Dr. Kurshan’s restricted stock award was prorated to reflect that she was appointed to serve as a director on August 12, 2014. The aggregate grant date fair value of the restricted stock award for Dr. Kurshan was $30.15, and the aggregate grant date fair value of the restricted stock awards for the other directors in 2014 was $35.12, in each case computed in accordance with FASB ASC Topic 718. Dr. Kurshan’s award was not granted until January 15, 2015.

(4) Mr. Andersen received an additional $25,000 as compensation for his service on the Board of Directors of NWHW Holdings, Inc., which was paid by NWHW Holdings, Inc.

As of December 31, 2014, there were no exercisable or unexercisable option awards held by our current non-employee directors. The aggregate number of unvested stock awards outstanding held as of that date by our current non-employee directors were as follows:

Name	**Stock Awards**
Eric C. Andersen	1,566
Barbara G. Fast	1,566
Jean C. Halle	1,566
Barbara Kurshan	—
Timothy J. Landon	1,566
Westley Moore	1,566
Timothy T. Weglicki	1,566

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EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

EXECUTIVE SUMMARY

This Compensation Discussion and Analysis describes our executive compensation program and decisions for 2014. This section details the compensation framework applied by the Compensation Committee and, in particular, our compensation philosophy and objectives, elements of compensation, compensation decisions and the link between executive pay and performance. The named executive officers, or NEOs, for 2014 are:

- Wallace E. Boston, Jr., our Chief Executive Officer and President
- Richard W. Sunderland, Jr., our Executive Vice President and Chief Financial Officer
- Karan Powell, our Executive Vice President and Provost of American Public University System
- Harry T. Wilkins, our Executive Vice President and Chief Development Officer of American Public Education, Inc. and Chief Executive Officer of our subsidiary, National Education Seminars, Inc., which we refer to as Hondros College of Nursing
- Sharon van Wyk, our former Executive Vice President and Chief Operations Officer, who resigned from her position in March 2015 in order to accept the position of President of The Princeton Review and Tutor.com

Building on a Strong Foundation

4 Number of times APUS has received an Effective Practice Award from the Online Learning Consortium – the most of any institution.

APEI's American Public University System (APUS) was founded to provide military and public service communities with access to affordable, quality academic programs, and in 2013 APEI acquired Hondros College of Nursing (HCON), which educates nurses at four Ohio campuses and online. Today, APUS serves over 111,000 students and is one of the largest accredited online providers of higher education in the United States, and HCON serves approximately 1,500 students. In early 2015, APUS was ranked in the top 10% among online undergraduate degree programs by *U.S. News & World Report*.

As we help our students prepare to advance their careers, APEI is committed to remaining successful amidst growing competition and the challenges of the current economic environment. We continue to focus on driving improvements in our core services — focusing on academic quality, student outcomes and the learning experience — not only to potential reach more students and improve our business results, but to enroll students with greater college readiness and help them achieve success.

ACADEMIC QUALITY AND VALUE

In 2014, APUS again was recognized with an Effective Practice Award from the Online Learning Consortium, which is a professional organization devoted to advancing quality in and expanding access to post-secondary online learning. This is the fourth effective practice award that APUS has received — the most any institution has received recognizing their contributions to improving the quality of online higher education.We remain committed to affordability — despite recently announcing a tuition increase for APUS undergraduates for the first time in 13 years, our combined tuition, fees and books after the tuition increase remain approximately 17% less for undergraduate students than the published average in-state tuition, fees and book costs at public universities, according to the College Board 2014 Trends in College Pricing. The increase in tuition was implemented primarily to support our continued investment in programs, systems and classroom innovation.

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COMMITMENT TO ONGOING RESEARCH INTO STUDENT SUCCESS

This year, APUS became an inaugural member of the John Gardner Institute's Gateways to Completion (G2C) program — a collaborative process designed to research and improve student success, especially in general education and other high-risk courses. In addition, APUS joined the first cohort of the Higher Learning Commission's Persistence Academy — a research-based collaboration of institutions designed to further improve persistence and completion of postsecondary students.

SATISFACTION AND REFERRALS

We continue to have high levels of student satisfaction, high referral rates and a high percentage of students returning for a second degree. In 2014, approximately 45% of our new students indicated that they were referred to APUS by others, and by the end of 2014 approximately 45% of our 2012 alumni had returned to APUS to pursue a second degree.

CONTINUED RECOGNITION

APUS maintained its position as a leading institution serving the U.S. military market, with Military Times ranking AMU as the number one school serving active duty military and the number nine school serving veterans. APUS has been named for the third consecutive year to U.S. News & World Report's annual qualitative ranking of top online degree programs. In 2015, APUS ranked #27 nationally out of 292 evaluated schools that offer online bachelor's degree programs, or in the top 10 percent overall, advancing seven places over its 2014 ranking.

GROWTH IN OUR NURSING SCHOOL

In 2014, HCON completed a move to a larger, more visible and accessible facility in Cleveland, Ohio, added new evening and weekend classes at both its Cleveland and Columbus campuses and prepared for a transition of its online classrooms to the Sakai Learning Management System, which is used by APUS. In 2014, compared to the prior year, HCON achieved enrollment growth of 11% and new student enrollment growth of 16%.

LOOKING AHEAD: FOCUS ON THE LEARNING EXPERIENCE AND DIVERSIFICATION

We remain firmly committed to ensuring that our active duty service members and veterans have the opportunity to pursue their higher educational goals with minimal or low out-of-pocket expense. At the same time, we know that various civilian communities also seek quality, affordable online degree programs. To reach these potential students and to further strengthen our education enterprise we will continue investing in our information technology platforms to further improve the student experience and set us apart from competition, and we plan to continue diversifying by launching new degree programs and entering new markets. We believe this strategy is critical to achieving our academic, operational and financial goals in the future.

CHALLENGING MARKET HEADWINDS CONTINUED IN 2014

9%	Percent increase, year-over-year, in net course registrations by students using Veteran's Administrations benefits.

We faced a number of challenges in 2014, including increased competition from both traditional and online universities, an uncertain regulatory environment, attracting students with greater college readiness, and changes to the military's Voluntary Education Program, which contributed to an overall decline in APUS enrollments. As a result, net course registrations for APUS declined 1% year-over-year for 2014. Despite these and other challenges, we believe our reputation in military-affiliated communities helped drive a 9% year-over-year increase in net course registrations by students using Veteran's Administrations benefits in 2014. Due to these challenges, among other reasons, our management recommended suspending our annual incentive plan in early 2014 and our NEOs did not receive any cash incentive payments in 2014.

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2014 Compensation Program Highlights

Our financial performance was directly reflected in the compensation of our top executives this year. Notably, at the recommendation of our management we voluntarily suspended our annual incentive plan, and none of our NEOs received any cash incentive payments in 2014.

We believe we have continued to make improvements in how we compensate our executives for their performance, and we continue to rigorously compare our programs to industry best practices.

The table below summarizes significant compensation decisions relative to our NEOs for fiscal year 2014:

Compensation Decisions and Changes to Compensation Program for 2014	
Suspended our Annual Incentive Plan to Reflect Difficult Financial Performance	At the recommendation of our management, our Compensation Committee suspended our annual incentive plan in recognition of what was expected to be a challenging year for financial returns.
Increased the percentage of equity awards tied to performance for the CEO and all of the named executive officers or NEOs	For 2014, we increased the use of performance-based shares in our overall equity mix from 30% to 35% of the value of an NEO's long-term incentive award in order to further link the compensation of our executives with performance. *The Compensation Committee approved a performance share mix increase to 40% for 2015*
Eliminated excise tax gross-ups	We executed amendments and restatements to existing employment agreements to eliminate from those agreements that had them the provisions providing for excise tax gross-ups in connection with a change of control.

COMPENSATION PROGRAM OVERVIEW

Compensation Program Philosophy and Objectives

Our compensation programs for our NEOs are designed to attract, incentivize, retain and reward the talent that we need to maintain and strengthen our position in higher education and to achieve our business objectives.

Elements of our Compensation Program	Philosophy
Variable Cash Compensation	We believe in using variable cash compensation to motivate and reward performance for our NEOs.
Focus on Corporate Goals	We strive to provide compensation that is directly related to the achievement of our corporate goals, which we measure through financial earnings, individual management objectives and free cash flow goals.
Carefully Monitor External Market Practices	We monitor market practices so that our programs reflect the realities of our rapidly evolving competitive market to ensure we are paying for performance. At the same time, we must also ensure we can attract the top talent necessary to drive results through our diversified business strategy.

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Executive Compensation Best Practices

Below we highlight certain executive compensation practices we employ in order to align executive compensation with stockholder interests. Also listed below are certain compensation practices we do not employ because we do not believe they would serve our stockholders' long-term interests.

What We Do	**How We Do It**
We Pay for Performance	We tie a significant portion of our executives' annual pay to objective performance metrics and continue to monitor our pay mix to ensure the performance-based portion is consistent with that of our peers. We review our pay and performance alignment compared to our peers to understand where our programs are working and where we can continue to make improvements.
We Target Pay Competitively	We seek to target compensation within a competitive range of the market median and only deliver greater compensation when warranted by actual superior performance within the median range. Conversely, we deliver lower compensation when performance results do not meet our threshold expectations.
We Enforce Executive Stock Ownership Guidelines	Each of our executives is expected to own shares of the Company's common stock with a value ranging from one to six times the executive's base salary, depending on position.
We Utilize Meaningful Vesting Conditions for Equity Awards	Equity awards, including performance-based awards, have three-year ratable vesting periods from the date of grant.
We Impose a "Clawback Policy"	We can recover any performance-based cash or equity award where, as a result of an accounting restatement, the performance goals were later determined not to have been achieved. In addition, we can recover equity awards made to an employee in cases where the Company has to prepare an accounting restatement due to the material noncompliance by the Company with financial reporting requirements and the restatement is the result of misconduct that resulted from the employee knowingly having engaged in that misconduct, the employee's gross negligence, or the employee knowingly or through gross negligence having failed to prevent misconduct.
We Utilize an Independent Compensation Consulting Firm	The Compensation Committee utilizes Towers Watson, an independent compensation consulting firm, to assist the Committee in determining compensation.
What We Don't Do	**How We Avoid It**
We Don't Permit Hedging	We prohibit our directors and employees, including our NEOs, from engaging in short sales, transactions in derivative securities (including put and call options), or other forms of hedging and monetization transactions, such as zero-cost collars, equity swaps, exchange funds and forward sale contracts, that allow the holder to limit or eliminate the risk of a decrease in the value of our securities.

We Don’t Offer Single-Trigger “Change of Control” Payments	We have employment agreements with our NEOs that, in the case of a “change of control,” only provide severance payments in connection with a termination of their employment.
We Don’t Provide Tax Gross-Up Provisions	We do not provide for tax gross-up payments for a change in control in existing employment agreements.

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COMPETITIVE COMPENSATION AND PEER GROUP REVIEW

50th	The Compensation Committee's general intent is to set each NEO's base salary near the 50th percentile of the survey data received from the Compensation Committee's independent consultant

Our executive compensation policies are designed to assist us in attracting and retaining qualified executives by providing competitive levels of compensation that are consistent with the executives' alternatives within the for-profit education industry and the broader market for executive talent. It is the Compensation Committee's general intent that each NEO's base salary should be set near the 50th percentile of the survey data received from the Compensation Committee's independent consultant. The Compensation Committee believes that the 50th percentile for base salary is appropriate to remain competitive with the companies with which the Company competes for executive talent. Consistent with the approach to base salary, the Compensation Committee believes that target annual incentives should be structured so that target total cash compensation (base salary plus annual incentives) approximates the 50th percentile of the survey data for achievement of target performance goals under the annual incentive plan. Each NEO has the opportunity to receive a stretch payment for superior performance if stretch performance goals are achieved under the plan. Conversely, the opportunity for below target or even no payment exists for below target or below threshold performance if performance goals are not achieved. The Compensation Committee believes that these opportunities for base salary and target annual incentive pay are in line with competitive market levels and are appropriate if our NEOs achieve the targeted level of performance.

For 2014, the Compensation Committee continued its prior engagement of Towers Watson as an independent consultant to the Compensation Committee. Towers Watson provided information on competitive levels of compensation that was used by the Compensation Committee in determining 2014 compensation, including information on base salary, annual incentives, equity awards and total compensation.

As part of the analysis of APEI's compensation program, Towers Watson provided data from the following published surveys as a primary source: *2013 Towers Watson CDB* General Industry Survey Report; *2013 Towers Watson Data Services* Top Management Survey; *2012-2013 College and University Professionals Association for Human Resources* Administrators in Higher Education Salary Survey. Because of the variance in size among the companies included in the databases for the published surveys, Towers Watson informed the Compensation Committee that, to the extent possible, it had assessed the published survey data in the context of APEI's projected fiscal year 2014 revenues, as revenue responsibility is typically one of the most reliable predictors of executive pay.

In addition to published survey data, Towers Watson also examined publicly-filed proxy statements of select industry-specific peers.

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Assessing Competitive Practice

The Compensation Committee identified, with the guidance and input of Towers Watson, a group of companies against which we compare compensation. These companies were selected because the Compensation Committee considered them to be similar to and competitive with us in the market for executive talent, and because they are in comparable or related businesses (e.g., focus on secondary education and online access). This group, which we refer to as our peer group, remained the same in 2014 as it had been in 2013 and 2012 and consisted of the following companies:

- Bridgepoint Education, Inc.
- Capella Education Company
- Grand Canyon Education, Inc.
- Lincoln Educational Services Corporation
- National American University Holdings, Inc.
- Strayer Education, Inc.
- Universal Technical Institute, Inc.

The review of the peer group only included comparative information for Dr. Boston and Mr. Sunderland, as the peer group information did not identify executives at comparable positions for Dr. Powell, Mr. Wilkins and Dr. van Wyk.

The comparative data provided by Towers Watson was used in connection with our determinations of base salaries, target annual incentive compensation and equity incentive awards as part of the 2014 compensation setting process, as described below. For those executives for whom both survey data and peer group data are available, the Compensation Committee uses the survey data for its primary comparisons because we believe, consistent with the advice of Towers Watson, that the survey data is more robust and provides a better comparison for the Company than the peer group data. This is in part because peer group data is more limited and typically cannot be size-adjusted to account for revenue responsibilities. Notwithstanding that the survey data is the primary source of comparative information, we believe the peer group is still important as a secondary review of the competitive market for executive talent.

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ELEMENTS OF COMPENSATION

The compensation program for our NEOs is comprised of three elements: base salary; annual incentive cash compensation; and long-term equity incentives.

Pay Element	How It Links To Performance
BASE SALARY • Regular, fixed element of compensation. • Reviewed annually. • Set near the 50th percentile of the survey data received from the Compensation Committee's independent consultant.	• Intended to be part of a total compensation package that is competitive. • Reflects each NEO's individual role and responsibility.
ANNUAL INCENTIVE CASH COMPENSATION • Provides cash incentives for achieving and surpassing corporate goals. • Offers the opportunity for NEOs to earn: annual payments for achievement of earnings targets; and annual payments for individual management objectives ("MBO"s). • Structured so that target total cash compensation (base salary plus annual incentives) approximates the 50th percentile of the survey data for achievement of target performance goals under the annual incentive plan.	• Provides compensation for annual performance. • Helps to focus executives on corporate financial, strategic and operational goals, which are expected to lead to increased stockholder value. • This focus is enhanced through an additional incentive that pays an additional amount to NEOs for superior performance, which is referred to as the stretch portion of the annual incentive plan.
LONG-TERM EQUITY INCENTIVES • Annual grants of equity awards comprising restricted stock and performance-based restricted stock units. • All awards vest over three years. • Performance-based restricted stock units tied to 2014 achievement of free cash flow. • Set to be consistent with the 50th percentile of the survey data received from the Compensation Committee's independent consultant.	• Provides compensation that is tied to longer-term performance. • Intended to align the interests of the NEOs with our stockholders. • Time-based vesting aids in the retention of NEOs. • Free cash flow performance measures align with a metric that is relevant to the achievement of our long-term strategic goals, including with respect to having available capital to pursue initiatives related to diversification.

2014 COMPENSATION DECISIONS

In setting base salary, annual incentive cash compensation and long-term equity incentives for 2014, we considered the compensation levels for our NEOs in 2013, the respective performances of each of our NEOs in 2013, and what we believed was required based on the marketplace for executive talent, including based on the information provided by Towers Watson. We also considered the results of the annual advisory vote on the compensation of named executive officers. In 2013, approximately 89% of the stockholder votes cast on this proposal were voted in favor of our executive compensation proposal, which was the most recent shareholder vote before we set our 2014 compensation. The Compensation Committee considered this in the context of the recommendation of various proxy advisory firms and as part of its decision to continue to increase the proportion of compensation that is performance-based. In 2014, approximately 97% of the stockholder votes cast on this proposal were voted in favor of our executive compensation proposal.

Base Salary

Base salary is an integral part of compensation for our NEOs and is generally set in January of each year, absent other factors, such as promotions. For 2014, the Compensation Committee approved increasing Dr. Boston's base salary by approximately 8.9%. This base salary placed Dr. Boston just below the 50th percentile of the survey data and below the 50th percentile of the peer group proxy data. The Compensation Committee determined that it was appropriate to increase Dr. Boston's salary to reflect his continued commitment to the Company, the Compensation Committee's assessment of the continued success of our business compared to other companies in our industry, including after taking into account federal government funding and actions, and the competitive review by Towers Watson. The committee believed that Dr. Boston's leadership was a key component of the Company's performance relative to that of other companies.

The base salaries for the remainder of the NEOs increased by approximately 33.3%, 12.0%, 3.1% and 2.2% for Mr. Sunderland, Dr. Powell, Mr. Wilkins and Dr. van Wyk, respectively. This increase placed Mr. Sunderland, who became an executive officer on January 1, 2014, at approximately the 35th percentile of the survey data and the lowest percentile of the peer group data. While the Compensation Committee expects to increase Mr. Sunderland's compensation over time, the Committee believes this was a significant and appropriate increase in the first year in which he was an executive officer. The remainder of the increases brought these executive officers within competitive range of the 50th percentile of the survey data. The Compensation Committee felt that the performance of each of the NEOs and the Company had been strong in the prior year and that base salary increases were warranted. Dr. Boston recommended the amounts of the increases for all of the NEOs other than himself, and the Committee concurred, determining that the levels Dr. Boston recommended, which were consistent with the 50th percentile of the survey data (except for Mr. Sunderland), were appropriate.

Annual Incentive Cash Compensation

We believe annual incentive pay furthers our compensation philosophy and objectives by focusing our NEOs on corporate financial, strategic and operational goals. The opportunity for annual incentive pay for our NEOs is expressed as a percentage of base salary as follows:

Position	Target Annual Incentive (as % of Base Salary)
President & CEO	60%
All Other NEOs	50%

These percentages for Dr. Boston, Mr. Wilkins, Dr. Powell and Dr. van Wyk reflected the minimum percentages set forth in their employment agreements. After considering the survey data information and the individual performance of the executives, the Compensation Committee believed, in its subjective, but informed, judgment, that these percentages should remain the same for 2014, including, with respect to Mr. Sunderland, because it was appropriate to provide the same structure for his compensation as was used for the other NEOs. Dr. Boston's annual incentive target is set at a higher percentage than those of the other NEOs, which is consistent with overall market practice and is in part a result of the negotiation of his employment agreement in 2004, at which time we agreed to provide him a larger annual incentive to reflect his greater ability as Chief Executive Officer to influence our business success as well as his greater responsibilities as the head of our Company.

Overall, we believe that the proportion of target annual incentive pay to target total cash compensation (base salary plus target annual incentive pay) for our NEOs should be a relatively high percentage. It is the Compensation Committee's general intent, as discussed above, that each NEO's base salary should be set near the 50th percentile of the survey data received from the Compensation Committee's independent consultant, and that target annual incentives should be structured so that target total cash compensation approximates the 50th percentile of the survey data for achievement of target performance goals under the annual incentive plan. We believe that positioning at the 50th percentile is appropriate for target total cash compensation because of the high level of performance that we believe is required from our executives in order for the Company to achieve our performance targets. We believe the high percentage of compensation tied to incentive pay increases the focus of our NEOs on achieving our performance goals.

We enhance this focus through a stretch incentive that pays an additional amount to our NEOs for superior performance, which we refer to as the stretch portion of the annual incentive plan. This additional amount, if achieved, provided an opportunity to Dr. Boston of an additional 40% of his base salary (for 100% of base salary in total maximum incentive potential), an opportunity to Mr. Sunderland, Mr. Wilkins and Dr. van Wyk of an additional 30% of each of their respective base salaries (for 80% of base salary in total maximum incentive potential) and an opportunity to Dr. Powell of an additional 20% of her base salary (for 70% of base salary in total maximum incentive potential). This stretch incentive would have resulted in maximum total cash compensation payments to our NEOs of amounts in line with the 75th percentile of the survey data for each of our NEOs, which the Compensation Committee believes is appropriate for exceptional performance.

The Compensation Committee intended that performance under the NEO's annual incentive awards would be based on achieving and surpassing financial performance goals and achievement of MBOs, so long as a threshold level of financial performance was also achieved. We believe that a split among goals is important in order to send a message to our employees that they should be focused on both earnings goals and personal goals that are largely derived from important strategic and operating plan goals, and we believe this split encourages a focus on multiple metrics of performance rather than focusing on one particular metric of performance to the exclusion of others that are also important to our results.

$0 Amount of annual incentive payouts for fiscal 2014.

Prior to finalizing any performance goals for the 2014 annual incentive plan, however, our management recommended that the annual incentive plan be suspended for 2014, including because of the expectation that 2014 would be a challenging year for financial performance for the Company. The Compensation Committee accepted this recommendation after considering a variety of factors, including the uncertainty and pressures of the government sequestration, declines in government funding for the military, and changes in the Voluntary Education Program. The Committee did not make any annual incentive plan awards in 2014.

Equity Incentives

We believe that a significant portion of our NEOs' total compensation should be in the form of equity awards in order to align the priorities of the NEOs with the interests of our stockholders. In 2014, the equity awards were split 65% as time-based restricted stock and 35% as performance-based restricted stock units. This reflects an increase from 30% of the portion of the award in 2013 that was allocated as performance-based restricted stock units and reflects the Compensation Committee's desire to focus more on performance-based awards and to incentivize executives for Company financial performance. Consistent with APEI's long-term policy of tying pay to performance, for 2015 the Committee increased to 40% the percentage of long-term equity incentives that are performance-based.

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The Committee continued to use free cash flow as the performance measure for the performance-based restricted stock unit awards in 2014, and will again use this measure in 2015. Free cash flow had been selected in 2013 after:

- consulting with Towers Watson;
- reviewing measures that are used by others in the Company's industry;
- evaluating metrics that are important to investors; and
- reflecting upon a desire to avoid using an earnings measure similar to what was used for the financial portion of the annual incentive plan.

Free cash flow, which is a non-GAAP measure, is defined as income from operations before income taxes *less* interest income (interest) *less* depreciation and amortization *less* capital expenditures *less* capitalized program development costs and other assets. The 2014 awards were structured as follows:

	Threshold	**Target**	**Stretch (Maximum)**
Free Cash Flow Goal	$42.3 million	$47.0 million	$51.7 million
Percentage of Award Earned	50% (of target)	100% (of target)	200% (of target)

For a level of free cash flow between these dollar amounts, the percentage of the award earned would be interpolated accordingly. For 2014, free cash flow was $58.0 million, which exceeded the stretch goal and resulted in 200% of the target awards being earned. The award earned was then further subject to time-based vesting, in order to continue to provide a retention element and to encourage executives to focus on the long-term performance of the Company.

Consistent with historical practice, the restricted stock awards and the performance-based restricted stock units vest in one-third equal annual installments on the first three anniversaries of the grant date, subject to achievement of performance metrics for the performance-based restricted stock units.

In determining the appropriate level of 2014 equity incentive grants for our NEOs, the Compensation Committee reviewed comparative survey information provided by Towers Watson. In calculating the equity incentive grants to our NEOs, the Compensation Committee considered the survey data and determined that awards that were consistent with the 50th percentile of the survey data would be appropriate to recognize performance and remain competitive with comparable companies. The award sizes were discussed at the same time the Compensation Committee met to set the other elements of compensation so that all elements of compensation were set taking into account the total compensation package.

OTHER COMPENSATION POLICIES AND PRACTICES

Employment Agreements and Post-Termination Compensation

We have entered into employment agreements with each of our NEOs. These agreements provide the executive with severance payments upon certain terminations, including termination without cause, termination by the executive for good reason in the event of a change of control, or if the executive's employment agreement is not assumed by a successor entity in a change of control. The agreements provide for certain payments in connection with a termination of the executives' employment within six months of a change in control of the Company. We believe that these agreements were necessary to attract some of our NEOs and help to retain our NEOs due to the prevalence of similar arrangements in the market in which we compete for executives.

In 2007, prior to the time that we were a public company, we entered into an amendment and restatement of our employment agreements with Dr. Boston and Mr. Wilkins to provide for additional severance payments for termination without cause or by the executives for good reason in connection with a change of control and to provide that if severance payments payable by us become subject to the excise tax on "excess parachute payments," we will reimburse them for the amount of such excise

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tax (and the income and excise taxes on such reimbursement). We agreed to provide Dr. Boston and Mr. Wilkins with these changes in anticipation of our initial public offering to reflect what at the time we concluded were prevalent practices in the marketplace in which we compete for executives, and because as a public company we wanted these officers to be able to focus on our operations and not be distracted by their personal situations in the event a change of control transaction arose and, in the case of Dr. Boston, to reflect his long-term commitment to us and our long-term commitment to him as our Chief Executive Officer. We further amended the employment agreements for Dr. Boston and Mr. Wilkins in December 2008 to provide for technical compliance with certain Department of the Treasury regulations. We entered into the employment agreement with Dr. van Wyk in August 2009 at the time she joined the Company. We entered into the employment agreement with Dr. Powell in 2011 in connection with her appointment as our Provost.

In 2013, the Compensation Committee received an assessment from Towers Watson on the terms contained in the employment agreements and comparisons to market practice and the peer group. The Compensation Committee then negotiated amendments to the employment agreements in 2014, including eliminating any reimbursement for excise taxes from the employment agreements, and also authorized negotiating an employment agreement with Mr. Sunderland on substantially the same terms as the agreements with our other NEOs. The Committee determined it was appropriate to have an employment agreement with Mr. Sunderland in an effort to treat him similarly to other executives, to retain him and to obtain his agreement to be subject to post-employment non-competition and non-solicitation terms with which he otherwise would not have had to comply. The amendments to Dr. Boston’s and Mr. Wilkins’ employment agreements were entered into in April 2014. The amendments to Dr. Powell’s and Dr. van Wyk’s employment agreements and the new employment agreement with Mr. Sunderland were entered into in August 2014.

For additional information regarding these agreements, including a quantification of benefits that would be received by these officers had termination occurred on December 31, 2014, see the section titled “Potential Payments upon Termination or Change in Control” below.

Non-Qualified Deferred Compensation

In 2013, we adopted a new non-qualified deferred compensation plan in which our executive officers are permitted to participate. In making the determination to adopt the plan, we took into account that the Internal Revenue Code limits the amount of matching contributions that we can contribute to our traditional 401(k) plan for the benefit of our executives. The new deferred compensation plan provides that we will make an annual matching contribution to plan participants in an amount equal to the difference between the matching contribution that the participant would have received under our 401(k) plan if those limitations under the Internal Revenue Code did not apply and the matching contribution that the employee actually received under our 401(k) plan. The balances in the plan are only available for investment in investment options that are also available under our 401(k) plan. We believe that it is fair to provide this plan to our executives because absent the limitations under the Internal Revenue Code, they would have otherwise received these amounts. The plan also permits us, but does not require us to, make additional, discretionary contributions. We did not make any discretionary contributions in 2014.

Effect of Accounting and Tax Treatment on Compensation Decisions

Section 162(m) of the Internal Revenue Code of 1986, as amended, generally imposes a $1 million limit on the amount that a public company may deduct for compensation paid to a company’s CEO or any of the company’s three other most highly compensated executive officers (other than the CFO) who are employed as of the end of the year. This limitation does not apply to compensation that meets the requirements under Section 162(m) for “qualifying performance-based” compensation (i.e., compensation paid only if the individual’s performance meets pre-established objective goals based on performance criteria approved by stockholders) that is established by a Compensation Committee that consists only of “outside directors” as defined for purposes of Section 162(m). All members of our Compensation Committee qualify as “outside directors”. We currently expect to consider the qualification of our annual incentive plan compensation as performance-based compensation within the meaning of the Internal Revenue Code, but that is only one factor among many considered by the Committee.

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Role of Executives in Executive Compensation Decisions

Historically, our Chief Executive Officer has recommended to the Compensation Committee each element of compensation for all executive officers other than himself, and the Compensation Committee determines the target level of compensation for each executive officer.

The amount of each element of compensation for our Chief Executive Officer is determined by the Compensation Committee. Our Chief Executive Officer does not participate in deliberations relating to his own compensation. None of our other executive officers participates in any deliberations related to the setting of executive compensation with the exception of Peter Gibbons, our Senior Vice President, Chief Administrative Officer, who provides support to the Committee and facilitates the requests for information received from the independent consultant.

COMPENSATION COMMITTEE REPORT

The Compensation Committee reviewed and discussed the above Compensation Discussion and Analysis with the Company's management. Based on its review and discussions with the Company's management, the Compensation Committee recommended that the Compensation Discussion and Analysis be included in the Company's Proxy Statement and in the Company's Annual Report on Form 10-K (including by incorporation to the Proxy Statement).

Compensation Committee (April 20, 2015)

MG (Ret) Barbara G. Fast, Chairperson

Eric C. Andersen

Westley Moore

COMPENSATION TABLES AND DISCLOSURES

Summary Compensation Table

Name and Principal Position	Year	Salary	Stock Awards[1]	Non-Equity Incentive	All Other	Total

				Plan Compensation[2]	Compensation[3]	
Wallace E. Boston, Jr.	2014	$610,000	$1,245,167	—	$ 26,679	$1,881,846
President and Chief	2013	$560,000	$1,210,529	$ 210,000	$ 23,617	$2,004,146
Executive Officer	2012	$539,231	$1,258,690	$ 496,300	$ 26,175	$2,320,395
Richard W. Sunderland, Jr.						
Executive Vice President, Chief Financial Officer	2014	$300,000	$452,222	—	$ 13,125	$765,347
Karan Powell	2014	$280,000	$157,209	—	$ 12,829	$450,038
Executive Vice President,	2013	$250,000	$156,798	$ 78,125	$ 16,765	$501,688
Provost	2012	$236,488	$136,480	$ 158,400	$ 15,018	$546,386
Sharon van Wyk	2014	$332,000	$254,286	—	$ 14,900	$601,186
Former Executive Vice	2013	$325,000	$264,800	$ 101,563	$ 22,052	$713,415
President, Chief Operations Officer	2012	$314,631	$255,853	$ 224,438	$ 22,798	$817,719
Harry T. Wilkins[4]	2014	$335,000	$256,511	—	$ 16,290	$607,801
Executive Vice President,	2013	$325,000	$264,800	$ 101,563	$ 16,980	$708,342
Chief Development Officer	2012	$314,533	$255,853	$ 252,000	$ 20,915	$843,301

(1) Amounts reflect the aggregate grant date fair value, computed in accordance with FASB ASC Topic 718, of restricted stock awards and restricted stock units, excluding estimates of forfeiture. A discussion of the relevant assumptions used in calculating these equity awards can be found in Notes 1 and 7 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2014. For this purpose, performance-based restricted stock units are

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valued assuming achievement at target, which was the probable outcome determined for accounting purposes at the time of grant. The target and maximum grant date values of performance share awards for 2014 are, as follows:

Name	**Grant Date Value at Target Performance**	**Grant Date Value at Maximum Performance**
Wallace E. Boston, Jr.	$ 435,797	$ 871,595
Richard W. Sunderland, Jr.	$ 80,385	$ 160,770
Karan Powell	$ 55,014	$ 110,029
Sharon van Wyk	$ 89,020	$ 178,040
Harry T. Wilkins	$ 89,777	$ 179,553

(2) Amounts represent annual incentive payments paid pursuant to our annual incentive compensation plan based upon the achievement of certain performance goals established by our Compensation Committee.

(3) Amounts include, but are not limited to, 401(k) contribution matches made by us and non-qualified deferred compensation plan continuation matches made by us in respect of 2014, as follows:

Name	**401(k) Match**	**Non-Qualified Deferred Compensation Plan Matching Contribution**
Wallace E. Boston, Jr.	$ 10,400	$ 14,015
Richard W. Sunderland, Jr.	$ 10,400	$ 2,725
Karan Powell	$ 10,400	$ 2,064
Sharon van Wyk	$ 10,400	$ 4,500
Harry T. Wilkins	$ 10,400	$ 3,469

(4) In 2014 Mr. Wilkins received an additional $25,000 as compensation for his service on the Board of Directors of NWHW Holdings, Inc., which was paid by NWHW Holdings, Inc.

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2014 Grants of Plan-Based Awards

The following table sets forth information with respect to grants of plan-based awards to our NEOs during 2014:

Name	Award Type	Grant Date	Estimated Future Payouts Under Equity Incentive Plan Awards[1] Threshold	Target	Maximum	All Other Stock Awards: Number of Stock or Units[2]	Grant Date Fair Value of Stock Awards[3]
Wallace E. Boston, Jr.	Restricted Stock	1/20/2014				18,184	$ 809,370
	Performance RSUs	1/20/2014	4,896	9,791	19,582		$ 435,797
Richard W. Sunderland, Jr.	Restricted Stock	1/20/2014				8,354	$ 371,837
	Performance RSUs	1/20/2014	903	1,806	3,612		$ 80,385
Karan Powell	Restricted Stock	1/20/2014				2,296	$ 102,195
	Performance RSUs	1/20/2014	618	1,236	2,472		$ 55,014
Sharon van Wyk	Restricted Stock	1/20/2014				3,713	$ 165,266
	Performance RSUs	1/20/2014	1,000	2,000	4,000		$ 89,020
Harry T. Wilkins	Restricted Stock	1/20/2014				3,746	$ 166,734
	Performance RSUs	1/20/2014	1,009	2,017	4,034		$ 89,777

(1) These columns show the range of restricted stock units that could be earned based on 2014 performance pursuant to the performance-based restricted stock units granted in 2014. Restricted stock units earned vest over a three-year period. For a discussion of the performance goals established by the Compensation Committee for these awards, see the section titled "2014 Compensation Decisions — Equity Incentives" in the Compensation Discussion and Analysis.

(2) This column shows the number of shares of restricted stock granted, which vest ratably over three years.

(3) Amounts reflect the grant date fair value, computed in accordance with FASB ASC Topic 718.

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Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table

Employment Agreements

The amounts disclosed in the tables above are in part a result of the terms of the NEOs' employment agreements.

Dr. Boston's Employment Agreement. In June 2004, we entered into an employment agreement with Dr. Boston to serve as our president and Chief Executive Officer with an initial term of three years starting from June 21, 2004 and ending June 21, 2007, which was subsequently amended to provide for renewal until March 31, 2018 and automatically thereafter for additional one-year terms unless we give written notice of our intent not to renew at least 30 days prior to the renewal date. In December 2008, his employment agreement was amended to provide for technical compliance with certain U.S. Department of Treasury regulations. In April 2014, his agreement was amended and restated, in part to eliminate Dr. Boston's entitlement to tax gross-up payments in connection with a change in control. Pursuant to his amended and restated agreement, Dr. Boston's base salary was set at $610,000 per year, subject to annual review and adjustment by our Compensation Committee. Under the agreement, Dr. Boston's base salary may be reduced at any time as part of a general salary reduction to all employees with annual salaries in excess of $150,000, provided, however, that any reduction shall be no more than the lesser of the median percentage salary reduction applied to such employees or 20%. Dr. Boston's employment agreement provides that he is entitled to participate in our annual incentive plan, under which he is eligible for an annual bonus of up to 60% of his base salary then in effect, and up to an additional 40% of his base salary as then in effect based upon the achievement of certain performance goals or certain "stretch" performance goals, respectively, as determined by the Compensation Committee.

In addition to a base salary and annual bonus, Dr. Boston is entitled to receive such other benefits approved by our Compensation Committee and made available to our other senior executives and to participate in plans and receive bonuses, incentive compensation and fringe benefits as we may grant or establish from time to time. Furthermore, under Dr. Boston's employment agreement, we are required to pay or reimburse him for customary and reasonable moving expenses he incurs in connection with any subsequent relocation of our executive offices. Dr. Boston has agreed not to compete with us nor solicit our employees for alternative employment during the term of his agreement and for a period of two years after termination for any reason.

Dr. Boston's base salary for 2014 and annual incentive compensation plan award for 2014 are set forth in the tables above.

Mr. Wilkins's Employment Agreement. Upon his hiring in February 2007, we entered into an employment agreement with Mr. Wilkins to serve as our executive vice president and chief financial officer, which agreement was amended and restated on October 10, 2007. In December 2008, his employment agreement was amended to provide for technical compliance with certain U.S. Department of Treasury regulations. In April 2014, his agreement was amended and restated, in part to eliminate Mr. Wilkins's entitlement tax gross-up payments in connection with a change in control and also to reflect Mr. Wilkins's current role as Executive Vice President and Chief Development Officer of APEI and Chief Executive Officer of National Education Seminars, Inc., which we refer to as Hondros College of Nursing. As amended and restated, the agreement has a term commencing January 29, 2007 and ending March 31, 2017 and will automatically renew for additional one-year terms unless we give written notice of our intent not to renew at least 30 days prior to the renewal date. Pursuant to his agreement, Mr. Wilkins's base salary is set at $335,000 per year, subject to annual review and adjustment by our Compensation Committee. Under the agreement, Mr. Wilkins's base salary may be reduced at any time as part of a general salary reduction to all employees with annual salaries in excess of $150,000, provided, however, that any reduction shall be no more than the lesser of the median percentage salary reduction applied to such employees or 20%. Pursuant to his employment agreement, Mr. Wilkins is entitled to participate in our annual incentive plan, under which he is eligible for an annual bonus of up to 50% of his base salary then in effect, and up to an additional 30% of his base salary as then in effect based upon the achievement of certain performance goals or certain "stretch" performance goals, respectively, as determined by the Compensation Committee.

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In addition to a base salary and annual bonus, Mr. Wilkins is entitled to receive such other benefits approved by our Compensation Committee and made available to our other senior executives and to participate in plans and receive bonuses, incentive compensation and fringe benefits as we may grant or establish from time to time. Furthermore, under Mr. Wilkins's employment agreement, we are required to pay or reimburse him for customary and reasonable moving expenses he incurs in connection with any subsequent relocation of our executive offices. In his employment agreement, Mr. Wilkins has agreed not to compete with us nor solicit our employees for alternative employment during the term of his agreement and for a period of eighteen months after termination for any reason.

Mr. Wilkins's base salary for 2014 and annual incentive compensation plan award for 2014 are set forth in the tables above.

Mr. Sunderland's, Dr. Powell's and Dr. van Wyk's Employment Agreements. We have entered into an employment agreement with each of Mr. Sunderland and Dr. Powell and, before her departure, with Dr. van Wyk, which have similar provisions to the provisions of Dr. Boston's agreement discussed above, except with respect to their positions, amounts relating to their base salary and annual bonus, and length and scope of restrictive covenants. We entered into the employment agreement with Dr. van Wyk to serve as Executive Vice President and Chief Operations Officer beginning August 3, 2009. We entered into the employment agreement with Dr. Powell to serve as Executive Vice President and Provost on November 4, 2011 in connection with her promotion to that position. In August 2014, we entered into the employment agreement with Mr. Sunderland to serve as Executive Vice President and Chief Financial Officer and Dr. Powell's and Dr. van Wyk's employment agreements were amended and restated.

Under their employment agreements, Mr. Sunderland's and Dr. Powell's terms of employment each run until March 31, 2017 and will automatically renew for additional one-year terms unless we give written notice of our intent not to renew at least 30 days prior to the renewal date. Pursuant to his agreement, Mr. Sunderland's initial annual salary is $300,000, and he is eligible for an annual bonus of up to 50% of his base salary then in effect and up to an additional 30% of his base salary as then in effect based upon the achievement of certain performance goals or certain "stretch" performance goals, respectively, as determined by the Compensation Committee. Pursuant to her agreement, Dr. Powell's annual salary is $280,000, and she is eligible for an annual bonus of up to 50% of her base salary then in effect and up to an additional 20% of her base salary as then in effect based upon the achievement of certain performance goals or certain "stretch" performance goals, respectively, as determined by the Compensation Committee. While Dr. van Wyk's agreement terminated in connection with her departure from the Company on March 13, 2015, prior to such time and pursuant to her agreement, Dr. van Wyk's annual salary was $332,000, and she was eligible for an annual bonus of up to 50% of her base salary then in effect and up to an additional 30% of her base salary as then in effect based upon the achievement of certain performance goals or certain "stretch" performance goals, respectively, as determined by the Compensation Committee.

Mr. Sunderland's, Dr. Powell's and Dr. van Wyk's base salaries for 2014 and annual incentive compensation plan awards for 2014 are set forth in the tables above.

In addition, each of the above employment agreements provides for payments upon certain terminations of the executive's employment. For a description of these termination provisions, whether or not following a change in control, and a quantification of benefits that would be received by these executives see the section titled "Potential Payments upon Termination or Change in Control" below.

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2014 Outstanding Equity Awards at Fiscal Year-End

The following table sets forth information with respect to the outstanding equity awards at December 31, 2014 for our NEOs:

				Stock Awards	
Name	**Number of Securities Underlying Unexercised Options (#) Exercisable**	**Options Exercise Price ($)**	**Options Expiration Date**	**Number of Shares or Units of Stock That Have Not Vested[(1)]**	**Market Value of Shares or Units of Stock That Have Not Vested ($)[(2)]**
Wallace E. Boston, Jr.	56,000 58,000	$34.80 $37.52	1/4/2017 1/3/2018	70,548	$2,601,105
Richard W. Sunderland, Jr.				13,958	$514,631
	9,118 4,625	$3.29 $37.19	7/13/2016 1/1/2016		
Karan Powell					

	INVESTMENT ACTIVITIES				
Purchase of property, plant and equipment		**(421)**	(469)	**(733)**	(895)
Business acquisitions and purchase of investments, net of cash and time deposits acquired		**(12)**	(2)	**(14)**	(40)

Net proceeds from disposal of businesses, investments and other assets	**50**	9	**57**	207
Other	**2**	12	**(47)**	12
Cash used for investment activities in continuing operations	**(381)**	(450)	**(737)**	(716)
Cash from investment activities in discontinued operations	**-**	5	**-**	5
Cash used for investment activities	**(381)**	(445)	**(737)**	(711)
Effect of exchange rate changes on cash and time deposits	**3**	2	**4**	5
Increase (Decrease) in cash and time deposits	**12**	(21)	**(31)**	1
Cash and time deposits - beginning of period	**186**	203	**229**	181
Cash and time deposits - end of period	**198**	182	**198**	182

The accompanying notes are an integral part of the interim consolidated financial statements.

ALCAN INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2007
(unaudited)
(in millions of US$, except per share amounts)

1. ACCOUNTING POLICIES

Basis of Presentation

The unaudited interim consolidated financial statements are based upon accounting policies and methods of their application consistent with those used and described in the Company's annual consolidated financial statements as contained in the most recent Annual Report on Form 10-K (Form 10-K), except as described below in notes 2 and 4. The 2006 year-end balance sheet data was derived from audited annual consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (US GAAP). The unaudited interim consolidated financial statements do not include all of the financial statement disclosures included in the annual consolidated financial statements prepared in accordance with US GAAP and therefore should be read in conjunction with the Company's most recent Form 10-K.

In the opinion of management of the Company, the unaudited interim consolidated financial statements reflect all adjustments, which consist only of normal and recurring adjustments, necessary to present fairly the financial position and the results of operations and cash flows in accordance with US GAAP. The results reported in these unaudited interim consolidated financial statements are not necessarily indicative of the results that may be expected for the entire year.

2. ACCOUNTING CHANGES

FIN 48 - Accounting for Uncertainty in Income Taxes

On January 1, 2007, the Company adopted the provisions of the Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN 48). Under FIN 48, the Company may recognize the tax benefit from a tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and expanded income tax disclosures.

On January 1, 2007, the Company recorded a $28 net increase in the liability for unrecognized tax benefits. This net increase in liabilities resulted in a decrease to the January 1, 2007 balance of Retained earnings of $21, a net decrease in Deferred tax liabilities of $8 and a reduction of $1 in equity-accounted investments included in Deferred charges and other assets. See note 7 - Income taxes.

SFAS No. 156 - Accounting for Servicing of Financial Assets

On January 1, 2007, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 156, Accounting for Servicing of Financial Assets. This statement, which is an amendment to SFAS No. 140, requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable and permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. The Company will recognize servicing assets or liabilities at fair value at inception but will not remeasure separately recognized servicing assets and liabilities at fair value. The adoption of this standard did not impact the Company’s financial statements.

3. RECENTLY ISSUED ACCOUNTING STANDARDS

SFAS No. 157 - Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, to increase consistency and comparability in fair value measurements and to expand their disclosures. The new standard includes a definition of fair value as well as a framework for measuring fair value. The standard is effective for fiscal periods beginning after November 15, 2007 and should be applied prospectively, except for certain financial instruments where it must be applied retrospectively as a cumulative-effect adjustment to the balance of opening retained earnings in the year in which this statement is initially applied. The Company is currently evaluating the impact of this standard on its financial statements.

SFAS No. 159 - The Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115. This statement permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The standard is effective for fiscal periods beginning after November 15, 2007 and should be applied prospectively with the effect of the remeasurement to fair value at adoption recorded as a cumulative-effect adjustment to the opening balance of retained earnings. The Company is currently evaluating the impact of this standard on its financial statements.

4. CHANGE IN FUNCTIONAL CURRENCY OF THE EUROPEAN PRIMARY METAL GROUP

Effective January 1, 2007, the smelting businesses of the European Primary Metal group located in the UK, France, and Cameroon adopted the US dollar as their functional currency. The currency of the primary economic environment for these businesses in these countries became the US dollar. This change was triggered by the acquisition and subsequent integration of Pechiney, the Novelis Spin-off, a European legal reorganization, as well as reorganization of the European Primary Metal group.

5. EARNINGS PER SHARE - BASIC AND DILUTED

Basic and diluted earnings per share are based on the weighted average number of shares outstanding during the period. The treasury stock method for calculating the dilutive impact of stock options is used. The following table outlines the calculation of basic and diluted earnings per share on income from continuing operations.

	Second Quarter		Six Months	
Periods ended June 30	**2007**	2006	**2007**	2006
Numerator:				
Income from continuing operations	**438**	454	**1,028**	908
Less: dividends on preference shares	**(3)**	(3)	**(6)**	(5)
Income from continuing operations attributable to common shareholders	**435**	451	**1,022**	903
Denominator (number of common shares in millions):				

Weighted average of outstanding shares	**369**	375	**368**	374
Effect of dilutive stock options	**2**	2	**2**	2
Adjusted weighted average of outstanding shares	**371**	377	**370**	376
Earnings per common share - basic	**1.18**	1.21	**2.78**	2.42
Earnings per common share - diluted	**1.17**	1.20	**2.77**	2.41

5. EARNINGS PER SHARE - BASIC AND DILUTED (cont'd)
In the second quarter and six months ended June 30, 2007, there were no options to purchase common shares (2006: 402,561 options at a weighted average grant price of CAN$56.34 per share were outstanding in the second quarter and six months ended June 30, 2006) that were outstanding during the periods and that were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average price of the common shares.

As at June 30, 2007, there were 370,975,741 (2006: 376,070,782) common shares outstanding.

6. RESTRUCTURING PROGRAMS

2007 Restructuring Activities

The schedule provided below shows details of the charges by operating segment:

Charges recorded in the statement of income

Quarter ended June 30, 2007	Severance Costs	Asset Impairment Charges	Other	Total
Bauxite and Alumina	**1**	**-**	**-**	**1**
Primary Metal	**4**	**-**	**1**	**5**
Engineered Products	**-**	**-**	**1**	**1**
Packaging	**15**	**3**	**-**	**18**
Other	**1**	**-**	**-**	**1**
Total	**21**	**3**	**2**	**26**

Six months ended June 30, 2007	Severance Costs	Asset Impairment Charges	Other	Total
Bauxite and Alumina	**2**	**-**	**-**	**2**
Primary Metal	**11**	**-**	**1**	**12**
Engineered Products	**-**	**-**	**2**	**2**
Packaging	**17**	**4**	**-**	**21**
Other	**1**	**-**	**-**	**1**
Total	**31**	**4**	**3**	**38**

For the second quarter and six months ended June 30, 2007, $1 and $3 of the severance costs and other charges above are excluded from the measurement of the profitability of the Company's operating segments (Business Group Profit), as they relate to corporate initiatives as discussed in note 18 - Information by Operating Segment.

The components of the 2007 restructuring charges were as follows:

Bauxite and Alumina

The Company announced in 2006 that it had signed a new collective labour agreement with its Quebec employees represented by the Canadian Auto Workers union. As part of this agreement, the Company has offered early retirement incentives to employees and recorded severance charges of $1 in the second quarter of 2007 for employees who have accepted. The Company expects to incur additional severance charges of $1 as a result of this offer.

The Company announced in 2005 that its subsidiary, Société Générale de Recherches et d'Exploitations Minières (Sogerem), had begun an information and consultation process with its employee representatives and local partners due to the exhaustion of mining resources in the Tarn region of France. Production at its fluorspar mining operations came to a close during the first half of 2006. The consultation process is now ended. In the first quarter of 2007, the Company recorded additional severance costs of $1. No further charges are expected to be incurred.

6. RESTRUCTURING PROGRAMS (cont'd)

Primary Metal

The Company announced in 2006 that it had begun consultations with unions and employee representatives for a proposed sale of selected assets at the Company's Affimet aluminum recycling plant in Compiègne (France). The consultation process is now ended. In the first quarter of 2007, the Company recorded additional severance costs of $5. The divestiture was completed in the second quarter of 2007, as discussed in note 11 - Sales and Acquisitions of Businesses and Investments.

In 2005, the Company recorded restructuring charges related to the closure of its aluminum smelter in Lannemezan (France). The closure process for Lannemezan began in June 2006 and is expected to be completed, at the latest, during the course of 2008. In the first quarter of 2007, the Company recorded additional severance costs of $1. In the second quarter of 2007, the Company recorded additional severance costs and other restructuring charges of $1 each. The Company expects to incur an additional $7 of restructuring charges related to the closure of the smelter.

The Company recorded additional severance costs of $1 and $3 for other minor restructuring programs pursued in the first and second quarters of 2007 in this operating segment.

Engineered Products

The Company announced in 2006 that it had begun consultations with unions and employee representatives for a proposed closure of the Workington hard alloy extrusion plant. Production from Workington will be consolidated at Alcan's facilities in Issoire and Montreuil-Juigné (France). In the first quarter of 2007, the Company recorded additional other restructuring charges of $1. In the second quarter of 2007, the Company recorded additional other restructuring charges of $1. Workington production is now ceased. The Company expects to incur additional charges of $11 related to this activity.

Packaging

In the second quarter of 2007, along with the Company's continuous effort to manage ongoing costs and margins, certain selected restructuring activities were announced, mainly in its Food Europe and Tobacco Businesses. In relation to these activities, the Company incurred severance costs of $12 and expects further costs of $2.

The Company launched in 2006 a restructuring program in the Global Beauty Packaging sector aimed at streamlining processes and reaching an improved competitive position. In the first quarter of 2007, the Company recorded severance costs of $2. In the second quarter of 2007, the Company recorded additional severance costs of $3. The Company expects to incur additional charges of $4 related to this activity.

The Company announced in 2005 the restructuring of certain businesses, notably Global Beauty Packaging and Food Packaging Europe, as part of the continuing drive to reshape its portfolio, counter increasing competitive pressures in Western countries and improve margins. In the first quarter of 2007, the Company recorded additional asset impairment charges of $1. In the second quarter of 2007, the Company recorded asset impairment charges of $3. The Company expects to incur additional charges of $1 related to this activity.

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6. RESTRUCTURING PROGRAMS (cont'd)

2006 Restructuring Activities

The schedule provided below shows details of the charges by operating segment:

Charges recorded in the statement of income

Quarter ended June 30, 2006	**Severance Costs**	**Asset Impairment Provisions**	**Other**	**Total**
Bauxite and Alumina	1	11	-	12
Primary Metal	14	23	7	44
Engineered Products	9	-	1	10
Packaging	23	1	3	27
Other	1	-	-	1
Total	48	35	11	94
Six months ended June 30, 2006				
Bauxite and Alumina	1	11	2	14
Primary Metal	15	23	8	46
Engineered Products	10	-	1	11
Packaging	25	6	5	36
Other	1	-	-	1
Total	52	40	16	108

For the second quarter and six months ended June 30, 2006, $16 and $22, respectively, of the severance costs and other charges above are excluded from the measurement of the profitability of the Company's operating segments (Business Group Profit), as they relate to major corporate initiatives as discussed in note 18 - Information by Operating Segment.

The significant components of the second quarter and six months ended June 30, 2006 restructuring charges were as follows:

<u>Bauxite and Alumina</u>

In 2006, the Company announced the reorganization of its global specialty aluminas business entailing the gradual, yet permanent shut-down of the Company's Specialty-Calcined Alumina plant (UPCA) in Jonquière, Quebec, by the end of the year. In relation to this activity, the Company recorded restructuring charges of $12 comprising $1 of severance costs and $11 of asset impairment charges during the second quarter of 2006. No further charges were incurred.

In relation to the proposed closure of mining operations in the Tarn region of France announced in 2005 by Sogerem, the Company recorded additional other restructuring charges of $2 in the first quarter of 2006. Refer to the components of the 2007 restructuring charges discussed above for more details in relation to this activity.

<u>Primary Metal</u>

In relation to the proposed sale of selected assets at the Company's Affimet aluminum recycling plant in Compiègne (France) announced in 2006, the Company recorded restructuring charges of $44 comprising $14 of severance costs,

$7 of other costs and $23 of asset impairment charges during the second quarter of 2006. Refer to the components of the 2007 restructuring charges discussed above for more details in relation to this activity.

In the first quarter of 2006, the Company recorded other restructuring charges of $1 and severance costs of $1 related to other minor restructuring programs in this operating segment.

6. RESTRUCTURING PROGRAMS (cont'd)

Engineered Products

In relation to the Workington closure announced in 2006, the Company recorded severance costs of $9 during the second quarter of 2006. Refer to the components of the 2007 restructuring charges discussed above for more details in relation to this activity.

Other minor restructuring charges were incurred in this operating segment. In the first quarter of 2006, the Company recorded severance costs of $1 and in the second quarter of 2006, the Company recorded additional other restructuring charges of $1.

Packaging

In 2006, the Company announced that it had begun consultations with unions and employee representatives for a proposed closure of the Midsomer Norton food flexibles packaging plant. The plant had been adversely affected by a declining demand in the UK market and high raw material costs. The Company recorded restructuring charges of $17 comprising $16 of severance costs and $1 of asset impairment charges during the second quarter of 2006.

In relation to pursuing plans to restructure certain businesses announced in 2005, notably Global Beauty Packaging and Food Packaging Europe, the Company recorded additional restructuring charges of $9 in the first quarter of 2006. This charge was comprised of severance costs of $2, asset impairment charges of $5 and other charges of $2. In the second quarter of 2006, the Company recorded additional severance costs of $5 and other restructuring charges of $3. Refer to the components of the 2007 restructuring charges discussed above for more details in relation to this activity.

In addition, the Company also recorded severance costs of $2 during the second quarter of 2006 related to the closure of Alcan Packaging Mohammedia's cookware activity.

The schedules provided below show details of the provision balances and related cash payments for the significant restructuring activities:

Provision roll-forward

Quarter ended June 30, 2007	**Severance Costs**	**Asset Impairment Charges***	**Other**	**Total**
Provision balance as at March 31, 2007	**163**	**-**	**57**	**220**
Charges recorded in the statement of income	**21**	**3**	**2**	**26**
Cash payments - net	**(30)**	**-**	**(7)**	**(37)**
Non-cash items	**5**	**(3)**	**-**	**2**
Provision balance as at June 30, 2007	**159**	**-**	**52**	**211**

Quarter ended June 30, 2006	**Severance Costs**	**Asset Impairment Charges***	**Other**	**Total**
Provision balance as at March 31, 2006	217	-	54	271

Charges recorded in the statement of income	48	35	11	94
Cash payments - net	(46)	-	(9)	(55)
Non-cash items	3	(35)	2	(30)
Provision balance as at June 30, 2006	222	-	58	280

6. RESTRUCTURING PROGRAMS (cont'd)

Six months ended June 30, 2007	**Severance Costs**	**Asset Impairment Charges***	**Other**	**Total**
Provision balance as at December 31, 2006	**199**	**-**	**61**	**260**
Charges recorded in the statement of income	**31**	**4**	**3**	**38**
Cash payments - net	**(78)**	**-**	**(12)**	**(90)**
Non-cash items	**7**	**(4)**	**-**	**3**
Provision balance as at June 30, 2007	**159**	**-**	**52**	**211**

Six months ended June 30, 2006	**Severance Costs**	**Asset Impairment Charges***	**Other**	**Total**
Provision balance as at December 31, 2005	243	-	57	300
Charges recorded in the statement of income	52	40	16	108
Cash payments - net	(83)	-	(17)	(100)
Non-cash items	10	(40)	2	(28)
Provision balance as at June 30, 2006	222	-	58	280

*Fair value of assets was determined using discounted future cash flows.

7. INCOME TAXES

	Second Quarter		Six Months	
Periods ended June 30	**2007**	2006	**2007**	2006
Current	**192**	112	**405**	237
Deferred	**(26)**	83	**41**	227
	166	195	**446**	464

The composite of the applicable statutory corporate income tax rates in Canada is 33% (2006: 33%).

The Company's 2007 second quarter and year to date effective tax rate increased due to balance sheet translation losses resulting from the continued strengthening of the Canadian dollar, offset by the favourable impact related to the recognition of future tax benefits in France which were not previously recognized. In the second quarter of 2007, the Company reversed $462 of valuation allowance related to deferred income tax assets of French subsidiaries when it became evident that the realization of these assets was more likely than not due to current forecasts of sustained improved operating results. An amount of $144 was recorded as a credit to the income tax provision and $318 was applied to reduce Goodwill as it related to tax benefits acquired in a business combination.

As a result of the implementation of FIN 48, the amount of unrecognized tax benefits at January 1, 2007 is $193 of which $84 would impact the Company's effective tax rate, if recognized. Also included in the amount of unrecognized tax benefits is $44 that, if recognized, would be allocated to reduce goodwill and $44 for which the Company would obtain an offset in other taxing jurisdictions. There were no material changes in the amounts above during the second quarter and six months ended June 30, 2007.

It is expected that the amount of unrecognized tax benefits will change in the next 12 months, however we do not expect the change to have a significant impact on the results of operations or the financial position of the Company.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits as part of the income tax provision. As of January 1, 2007, the Company had recorded a net liability of $10 for interest and penalties.

7. INCOME TAXES (cont'd)

Canadian federal income tax returns are closed through 2001 (except for potential transfer pricing adjustments) and Canadian provincial income tax returns are closed through 1995. The process to obtain corollary adjustments with the US competent authority for the 1996-1999 transfer pricing adjustments to income is underway. The Canadian federal statute of limitations remains open for the year 2002 and onward with years 2002 and 2003 currently under examination by the Canada Revenue Agency. Foreign jurisdictions have statutes of limitations generally ranging from 2 to 5 years. Years still open to examination by foreign tax authorities in major jurisdictions include US (2004 onward), Germany (2001 onward), UK (2004 onward), Switzerland (2004 onward), Australia (2002 onward) and France (1989 onward).

8. SALES OF RECEIVABLES

The Company has entered into programs with certain financial institutions to sell certain trade receivables. Effective April 2, 2007, the Company terminated one such program to sell to a third party an undivided interest up to $125 (€95 million) of selected trade receivables without recourse.

9. OTHER EXPENSES (INCOME) - NET

	Second Quarter		Six Months	
Periods ended June 30	**2007**	2006	**2007**	2006
Asset impairment charges not included in restructuring programs	**15**	1	**15**	5
Loss (Gain) on disposal of businesses and investments - net	**50**	(4)	**46**	(4)
Provision for (Recoveries of) legal claims	**-**	8	**-**	(54)
Environmental provisions	**-**	7	**-**	9
Interest revenue	**(9)**	(7)	**(19)**	(15)
Exchange losses - net	**54**	65	**71**	83
Derivative gains - net	**(6)**	(46)	**(22)**	(44)
Advisory and legal fees	**21**	-	**21**	-
Other	**30**	(22)	**40**	(9)
	155	2	**152**	(29)

Following a hostile takeover offer in May 2007, the Company incurred $21 in the second quarter of 2007 for advisory and legal fees in order to develop alternatives. See note 20 - Subsequent Events.

On January 19, 2006, the Company sold claims related to the Enron bankruptcy to a financial institution for combined proceeds of $62, recorded in Provision for (Recoveries of) legal claims.

10. INVENTORIES

	June 30, 2007	December 31, 2006
Aluminum operating segments		
Aluminum	**977**	1,060
Raw materials	**903**	835
Other supplies	**557**	495
	2,437	2,390
Packaging operating segments		
Raw materials and other supplies	**324**	311
Work in progress	**165**	155
Finished goods	**332**	330
	821	796
	3,258	3,186

11. SALES AND ACQUISITIONS OF BUSINESSES AND INVESTMENTS

Investment

On April 30, 2007, the Company signed a Heads of Agreement with Saudi Arabian mining company Ma'aden to develop a proposed US$7-billion integrated aluminum "mine-to-metal" project. The Company would hold a 49% stake in the project and recorded an initial investment of $18 in the second quarter of 2007.

Sales

On April 27, 2007, the Company concluded the sale of selected assets at the Company's Affimet aluminum recycling plant in Compiègne (France). In relation to this, the Company received proceeds of $26 and recorded a loss on disposal of $12 in the second quarter of 2007.

On May 31, 2007, the Company reached an agreement in principle with UK-based Klesch & Company Limited (Klesch) regarding the sale of its Vlissingen smelter in the Netherlands. Alcan had an 85% interest in the smelter. The Company recorded charges of $42 included as a loss on disposal of businesses and investments within Other expenses (income) - net in the second quarter of 2007. The sale was concluded on July 2, 2007, for net proceeds of $29.

On June 26, 2007, the Company concluded the sale of its Satma subsidiary, located in Goncelin (France), to ALMECO Spa for net proceeds of $4 and the Company recorded a loss on disposal of $1 in the second quarter and $2 in the six months ended June 30, 2007.

12. LONG-TERM DEBT

As at June 30, 2007, the Company has the ability, through its long-term credit facilities, to refinance its commercial paper borrowings on a long-term basis. However, the Company's intention is to repay these commercial paper borrowings during the third quarter of 2007 and has classified them as Short-term borrowings at June 30, 2007. As at December 31, 2006, the Company had both the intention and the ability, through its long-term credit facilities, to refinance its commercial paper borrowings on a long-term basis and had classified them as Debt not maturing within one year. Furthermore, all commercial paper debt repayments were included in the year 2011 when the multi-currency, five year, committed global credit facility matures. Based on foreign exchange rates in effect at June 30, 2007, debt repayment requirements over the next five years amount to $69 in 2007, $484 in 2008, $25 in 2009, $18 in 2010 and $416 in 2011.

During the first quarter of 2007, the Company entered into an interest rate derivative to swap interest payments on $100 of its long-term debt from fixed to floating rate (relating to the 4.875% Global notes due in 2012). The fair market value of this derivative was $(1) as at June 30, 2007. During the second quarter of 2007, the Company entered into interest rate derivatives to swap interest payments on an additional $200 of the same long-term debt. The fair market value of these derivatives was $(5) as at June 30, 2007. These derivatives have been designated and are effective as fair value hedges of the underlying fixed rate debt.

Since June 16, 2006, the Company has had in place a two-tranche, multi-currency, committed global credit facility with a syndicate of international banks. This facility is comprised of a $2,000 5-year tranche, maturing in June 2011, and a $1,000 364-day tranche, extendable by two years at the Company's option. In the second quarter of 2007, the Company extended the $1,000 364-day tranche. The facility is available for general corporate purposes and is primarily used to support the commercial paper programs.

13. STOCK OPTIONS AND OTHER STOCK-BASED COMPENSATION

Total Stock-Based Compensation Cost

Total pre-tax stock based compensation expense is $76 and $93 for the second quarter and six months ended June 30, 2007, respectively (2006: $21 and $61). The amounts include other stock-based compensation expense of $67 and $82 for the second quarter and six months ended June 30, 2007 (2006: $10 and $25) and stock option expense of $9 and $11 for the second quarter and six months ended June 30, 2007 (2006: $11 and $36). Total pre-tax stock based compensation expense for the second quarter and six months ended June 30, 2007 includes $3 and $5 of compensation expense related to retired and retirement eligible employees (2006: $nil and $11).

As of June 30, 2007, virtually all of the stock options were vested. As such, all related stock option expense has been recognized for all currently outstanding stock options. The Company expects to continue to incur additional stock-based compensation expense for its outstanding awards, other than stock options, until such time that these awards are settled, which will depend on the change in control date. As a result of the Rio Tinto offer, as discussed in note 20 - Subsequent Events, the Company expects to record the remaining compensation expense for such awards over an accelerated requisite service period.

14. COMPREHENSIVE INCOME

	Second Quarter		Six Months	
Periods ended June 30	**2007**	2006	**2007**	2006
Net income	**438**	455	**1,029**	908
Other comprehensive income:				
Net change in deferred translation adjustments	**55**	239	**108**	396
Net change in excess of market value over book value of "available-for-sale" securities	**1**	-	**1**	-
Net change in unreleased gains and losses on derivatives, net of tax of $(30) and $(54) respectively, for the quarter and six months ended June 30, 2007 (2006: $6 and $49):				
Net change from periodic revaluations	**8**	(65)	(3)	(188)
Net amount reclassified to income	**53**	57	**110**	98
Net change in minimum pension liability (net of tax of $8 and $9, respectively, for the quarter and six months ended June 30, 2006)	**-**	(13)	**-**	(18)
Net change in unfunded status of pension and other				

postretirement plans, net of tax of $(15) and $(20), respectively for the quarter and six months ended June 30, 2007	**33**	-	**42**	-
	150	218	**258**	288
Comprehensive income	**588**	673	**1,287**	1,196

	June 30, 2007	December 31, 2006
Accumulated other comprehensive income (loss)		
Deferred translation adjustments	**1,125**	1,017
Unrealized gain on "available-for-sale" securities	**6**	5
Unfunded status of pensions and other postretirement plans	**(991)**	(1,033)
Unreleased loss on derivatives	**(105)**	(212)
Accumulated other comprehensive income (loss)	**35**	(223)

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15. COMMITMENTS AND CONTINGENCIES

On January 22, 2007, Alcan filed its leave to appeal application with the British Columbia (BC) Court of Appeal regarding the BC Utilities Commission December 29, 2006 decision to reject the amended and restated Long-Term Energy Purchase Agreement between Alcan and BC Hydro. This appeal was withdrawn on April 2, 2007. On March 28, 2007, the Supreme Court of BC in a judgment concluded that there are no restrictions on the Company's use or sale of Kemano power in the legislation or agreements with the Province of BC.

The Company has guaranteed the repayment of indebtedness by third parties or the indemnification of third parties for a total amount of approximately $438. Alcan believes that none of these guarantees is likely to be invoked. These guarantees relate primarily to debt held by equity-accounted Joint Ventures, employee housing loans, obligations relating to businesses sold and potential environmental remediation at former Alcan sites.

Alcan, in the course of its operations, is subject to environmental and other claims, lawsuits and contingencies. The Company is involved in proceedings arising out of laws regulating the discharge of materials into the environment or laws seeking to protect the environment, for which it has made accruals, in respect of 21 existing and former Alcan sites and third party sites. Accruals have been made in specific instances where it is probable that liabilities will be incurred and where such liabilities can be reasonably estimated.

According to agreements entered into by the Company as part of Novelis Spin-off, the Company has transferred to Novelis certain environmental contingencies.

Alcan has agreed to indemnify Novelis and each of its Directors, officers and employees against liabilities relating to:

- liabilities of the Company other than those of an entity forming part of Novelis or otherwise assumed by Novelis pursuant to its separation agreement with Novelis;
- any liability of the Company or its Subsidiaries, other than Novelis, retained by Alcan under the separation agreement; and
- any breach by the Company of its separation agreement with Novelis or any of its ancillary agreements with Novelis.

Although there is a possibility that liabilities may arise in other instances for which no accruals have been made, the Company does not believe that any losses in excess of accrued amounts would be sufficient to significantly impair its operations, have a material adverse effect on its financial position or liquidity, or materially and adversely affect its results of operations for any particular reporting period, absent unusual circumstances.

16. SUPPLEMENTARY INFORMATION

	Second Quarter		Six Months	
Periods ended June 30	**2007**	2006	**2007**	2006
Income Statement				
Interest on long-term debt	**74**	84	**148**	168
Capitalized interest	**(24)**	(20)	**(47)**	(34)

June 30, 2007

		December 31, 2006
Balance Sheet		
Payables and accrued liabilities include the following:		
Trade payables	**2,094**	2,163
Other accrued liabilities	**1,785**	1,700
Derivatives	**655**	740
Income and other taxes	**224**	119
Accrued employment costs	**708**	708
	5,466	5,430

17. POST-RETIREMENT BENEFITS

Alcan and its subsidiaries have established retirement benefit plans in the principal countries where they operate. The pension obligation relates mostly to funded defined benefit pension plans in Canada, UK, US, Switzerland, the Netherlands and Australia and to unfunded defined benefit pension plans mainly in Germany and France, or lump sum retirement indemnities in France. Pension benefits are generally based on the employee's service and highest average eligible compensation before retirement, and are periodically adjusted for cost of living increases, either by collective agreement such as in Canada, statutory requirement such as in UK, France and Germany, or Company practice when there are surpluses determined on a funding basis, such as in Canada, Switzerland and the Netherlands.

Most Funded Pension Plans are administered by a Pension Committee or Board of Trustees composed of plan members designated by the Company and employees. Each Committee or Board adopts its own investment policy which generally favours diversification and active management of plan assets through selection of specialized managers. Investments are generally limited to publicly-traded stocks and high rated debt securities, excluding securities in Alcan, and include only small amounts in other categories, except for the Swiss plan, whose target allocation is evenly distributed between equity, bonds and real estate.

Components of Net Periodic Benefit Cost

	Pension Benefits				**Other Benefits**			
	Second Quarter		Six Months		Second Quarter		Six Months	
Periods ended June 30	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006
Current service cost	**53**	51	**103**	100	**4**	4	**8**	8
Interest cost	**150**	140	**294**	278	**15**	14	**31**	28
Expected return on assets	**(172)**	(153)	**(337)**	(304)	**-**	-	**-**	-
Amortization:								
Actuarial losses	**22**	29	**43**	56	**4**	4	**8**	8
Prior service cost	**18**	18	**35**	36	**1**	-	**1**	-
Net periodic benefit cost	**71**	85	**138**	166	**24**	22	**48**	44

The expected long-term rate of return on plan assets is 6.9% in 2007 (6.9% in 2006).

Employer Contributions

Alcan previously disclosed in its financial statements for the year ended December 31, 2006, that it expected to contribute $289 in aggregate to its funded pension plans in 2007. The contributions are expected to be fully comprised of cash. As at June 30, 2007, $134 has been contributed, and the Company expects to contribute an additional $136 over the remainder of the year. The Company expected to pay in 2007 $64 of unfunded pension benefits and lump sum indemnities from operating cash flows. As at June 30, 2007, $32 has been paid, and the Company expects to pay an additional $33 over the remainder of the year.

18. INFORMATION BY OPERATING SEGMENT

The following presents selected information by operating segment, viewed on a stand-alone basis. The operating management structure is comprised of four operating segments or business groups: Bauxite and Alumina; Primary Metal; Engineered Products and Packaging. The Company's measure of the profitability of its operating segments is referred to as business group profit (BGP). BGP comprises earnings before interest, income taxes, minority interests, depreciation and amortization and excludes certain items, such as corporate costs, restructuring costs (relating to major corporate-wide acquisitions or initiatives), impairment and other special charges, pension actuarial gains, losses and other adjustments, and unrealized gains and losses on derivatives that are not under the control of the business groups or are not considered in the measurement of their profitability. These items are generally managed by the Company's corporate head office, which focuses on strategy development and oversees governance, policy, legal, compliance, human resources and finance matters. The unrealized change in fair market value of derivatives is removed from individual BGP and is shown on a separate line in the reconciliation to income from continuing operations. This presentation provides a more accurate portrayal of underlying business group results and is in line with the Company's portfolio approach to risk management. Transactions between operating segments are conducted on an arm's-length basis and reflect market prices.

18. INFORMATION BY OPERATING SEGMENT (cont'd)

Thus, earnings from the Bauxite and Alumina as well as from the Primary Metal groups represent mainly profit on alumina or metal produced by the Company, whether sold to third parties or used in the Company's fabricating and packaging operations. Earnings from the Engineered Products and Packaging groups represent only the fabricating profit on their respective products.

The accounting principles used to prepare the information by operating segment are the same as those used to prepare the consolidated financial statements of the Company, except for the following two items:

(1) The operating segments include the Company's proportionate share of joint ventures (including joint ventures accounted for using the equity method) and certain other equity-accounted investments as they are managed within each operating segment, with the adjustments for these investments shown on a separate line in the reconciliation to Income from continuing operations; and

(2) Pension costs for the operating segments are based on the normal current service cost with all actuarial gains, losses and other adjustments being included in Intersegment and other.

The operating segments are described below.

<u>Bauxite and Alumina</u>

Headquartered in Montreal (Canada), this business group comprises Alcan's worldwide activities related to bauxite mining and refining into smelter-grade and specialty aluminas, owning, operating or having interests in six bauxite mines and deposits in five countries, five smelter-grade alumina plants in four countries and six specialty alumina plants in three countries and providing engineering and technology services.

<u>Primary Metal</u>

Also headquartered in Montreal, this business group comprises smelting operations, power generation, production of primary value-added ingot, manufacturing of smelter anodes, smelter cathode blocks and aluminum fluoride, smelter technology and equipment sales, engineering services and trading operations for aluminum, operating or having interests in 21 smelters in ten countries, 12 power facilities in four countries and 12 technology and equipment sales centers and engineering operations in ten countries.

<u>Engineered Products</u>

Headquartered in Paris (France), this business group produces engineered and fabricated aluminum products including rolled, extruded and cast aluminum products, engineered shaped products and structures, including cable, wire, rod, as well as composite materials such as aluminum-plastic, fibre reinforced plastic and foam-plastic in 54 plants located in 12 countries. Also included in this business group are 33 service centres in 11 countries and 33 sales offices in 28 countries and regions.

<u>Packaging</u>

Also headquartered in Paris, this business group consists of the Company's worldwide food, pharmaceutical and medical, beauty and personal care and tobacco packaging businesses, operating 129 plants in 31 countries. This business group produces packaging from a number of different materials, including plastic, aluminum, paper, paper board and glass.

18. INFORMATION BY OPERATING SEGMENT (cont'd)

Intersegment and other

This classification includes the deferral or realization of profits on intersegment sales of aluminum and alumina, corporate office costs as well as other non-operating items.

	Second Quarter		Six Months	
Periods ended June 30	**2007**	2006	**2007**	2006
Sales and operating revenues - Intersegment				
Bauxite and Alumina	**576**	460	**1,152**	930
Primary Metal	**492**	656	**1,043**	1,227
Engineered Products	**21**	50	**46**	94
Packaging	**-**	1	**1**	1
Other	**(1,089)**	(1,167)	**(2,242)**	(2,252)
	-	-	**-**	-

	Second Quarter		Six Months	
Periods ended June 30	**2007**	2006	**2007**	2006
Sales and operating revenues - Third Parties				
Bauxite and Alumina	**549**	482	**1,021**	795
Primary Metal	**2,427**	2,260	**4,772**	4,271
Engineered Products	**2,067**	1,868	**4,135**	3,547
Packaging	**1,572**	1,511	**3,107**	3,012
Adjustments for equity-accounted joint ventures and certain investments	**(35)**	(25)	**(52)**	11
Other	**25**	7	**42**	17
	6,605	6,103	**13,025**	11,653

	Second Quarter		Six Months	
Periods ended June 30	**2007**	2006	**2007**	2006
Business Group Profit (BGP)				
Bauxite and Alumina	**204**	126	**379**	255
Primary Metal	**744**	774	**1,588**	1,532
Engineered Products	**149**	144	**323**	298
Packaging	**126**	134	**266**	280
Adjustments for equity-accounted joint ventures and certain investments	**(75)**	(86)	**(122)**	(157)
Adjustments for mark-to-market of derivatives	**(7)**	7	**(22)**	21
Depreciation and amortization	**(269)**	(258)	**(533)**	(509)
Intersegment, corporate offices and other	**(229)**	(159)	**(318)**	(266)

Equity income	**24**	37	**36**	65
Interest	**(61)**	(69)	**(121)**	(145)
Income taxes	**(166)**	(195)	**(446)**	(464)
Minority interests	**(2)**	(1)	**(2)**	(2)
Income from continuing operations	**438**	454	**1,028**	908

Risk Concentration

The Company's consolidated sales and operating revenues for the second quarter and six months ended June 30, 2007 include $695 and $1,372, respectively (2006: $724 and $1,347) arising from transactions with one customer. These sales and operating revenues, principally made by the Primary Metal Group, represent 11% (2006: 12%) of consolidated sales and operating revenues for both the second quarter and six months ended June 30, 2007.

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19. PRIOR YEAR AMOUNTS

Certain prior year amounts have been reclassified to conform with current period presentation.

20. SUBSEQUENT EVENTS

On July 12, 2007, Alcan entered into a support agreement with Rio Tinto plc (Rio Tinto) and Rio Tinto Canada Holding Inc. (Rio Tinto Canada), a wholly-owned indirect subsidiary of Rio Tinto. Pursuant to the support agreement, Rio Tinto Canada has agreed to make a cash tender offer to acquire all of Alcan's outstanding common shares for $101 per common share. The board of directors of Alcan has unanimously recommended that Alcan shareholders should accept the offer. The offer is subject to a number of conditions including valid acceptances of not less than 66 percent of Alcan shares on a fully diluted basis and the approval of Rio Tinto shareholders. The board of directors of Rio Tinto has approved and will recommend the transaction to its shareholders. The offer will also be subject to certain customary conditions including receipt of necessary regulatory and antitrust approvals, including in the United States, Canada, the European Union and Australia, and the absence of material adverse changes or effects. The offer is expected to close in the fourth quarter of 2007.

Subject to the terms and conditions of the support agreement, Alcan's board of directors has the right to withdraw, modify or change its support of the offer if Alcan receives a superior proposal (as defined in the support agreement) prior to the expiration of the offer. However, Rio Tinto Canada has the right to match any such superior proposal received by Alcan and, in certain circumstances, if the offer is not consummated, Rio Tinto Canada would have the right to receive a payment of $1,049 from Alcan. In other circumstances, related to the required shareholder votes for the Rio Tinto group, an equivalent payment from Rio Tinto may be required.

The Company concurrently announced that Rio Tinto and Alcan had agreed to divest Alcan's packaging business. The Company is currently evaluating its strategies for the planned divestiture.

On August 7, 2007, the Government of Quebec announced that it had accepted the conclusions of the board of directors of Alcan with respect to the proposed acquisition and confirmed that the Rio Tinto Canada offer respects the terms of the Continuity Agreement between Alcan and the Government of Quebec, signed in 2006. Alcan had made an undertaking that it would maintain its head office and principal place of business in Quebec and it would ensure that, in the event of a change of control, the acquirer would maintain the same level and quality of commitments in Quebec to socio-economic programs and to regional development as then existed at Alcan.

On July 18, 2007 the Company announced it had reached an agreement with Hindalco Industries Limited, India for the sale of its 45% interest in Utkal Alumina International Limited (Utkal). The Company had announced its intention to sell its interest in Utkal on April 12, 2007. The Company expects completion of the sale during the third quarter of 2007.

On July 26, 2007, the Company's board of directors approved the redemption of its redeemable non-retractable preference shares at a price of CAN$25.00 per share. The transaction is expected to be completed on September 3, 2007.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

(In millions of US$, except per common share amounts, aluminum prices and as otherwise stated)

This Management's Discussion and Analysis (MD&A) includes some measures for which no meaning is prescribed by generally accepted accounting principles (GAAP). Refer to the section "Definitions" for an explanation of these measures.

Overview

The Company reported second quarter income from continuing operations of $438 or $1.18 per common share versus $454 or $1.21 per common share a year earlier and $590 or $1.60 per common share in the first quarter of 2007. Income from continuing operations decreased by $16 year-over-year reflecting an unfavourable variance in foreign currency balance sheet translation effects, the negative impact of a weaker US dollar on operating costs, increased energy, raw materials and operating costs as well as an unfavourable non-cash mark-to-market adjustment on derivatives. These effects more than offset higher aluminum realizations, better pricing and mix in the Engineered Products and Bauxite & Alumina business segments, a favourable variance in Other Specified Items, increased volumes across most businesses, the contribution from the cathode producer Carbone Savoie acquisition and higher technology and smelter equipment sales. The decrease of $152 in income from continuing operations from the first quarter of 2007 reflected an unfavourable variance in foreign currency balance sheet translation effects, the negative impact of a weaker US dollar on operating costs, higher alumina costs, lower market premia, lower contribution from power generation, as well as higher share-based compensation expense related to the increase in share price during the quarter. These were partially offset by higher aluminum volumes, improved pricing and product mix mainly in Bauxite & Alumina, a favourable variance in Other Specified Items, higher aluminum prices and technology and smelter equipment sales. The terms "Other Specified Items" (OSIs) and "Foreign Currency Balance Sheet Translation" are defined under "Definitions" at the end of the MD&A.

Income from continuing operations for the second quarter of 2007 included a primarily non-cash, after-tax loss of $193 or $0.52 per common share for the effects of foreign currency balance sheet translation, compared to an after-tax loss of $100 or $0.27 per common share in the year-ago quarter and an after-tax loss of $19 or $0.05 per common share in the first quarter. The foreign currency balance sheet translation losses in the second quarter of 2007 were largely due to the strengthening of the Canadian dollar versus the US dollar, which went from 86 cents at the end of the first quarter to 94 cents at the end of the second quarter. Foreign currency balance sheet translation charges for the second quarter of 2006 reflect the largely non-cash impact of the strengthening Canadian dollar on the Company's deferred income taxes.

Also included in income from continuing operations for the second quarter was an after-tax gain for OSIs of $28 or $0.08 per common share compared to an after-tax charge of $2 or $nil per common share in the year-ago quarter and an after-tax charge of $9 or $0.02 per common share in the first quarter of 2007. A detailed OSIs schedule is provided on the next page.

	Second Quarter		First Quarter
	2007	2006	2007
Included in income from continuing operations are:			
Foreign currency balance sheet translation	**(193)**	(100)	(19)
Other Specified Items (OSIs)	**28**	(2)	(9)
Income from continuing operations	**438**	454	590
Income from discontinued operations	**-**	1	1
Net income	**438**	455	591
Basic earnings per common share *($ per common share)*			
Income from continuing operations	**1.18**	1.21	1.60
Net income	**1.18**	1.21	1.60
Average number of common shares outstanding (millions)	**369.0**	375.1	367.1

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	Second Quarter		First Quarter
	2007	2006	2007
Sales and operating revenues	**6,605**	6,103	6,420
Shipment volumes *(kt)*			
Ingot products *	**760**	765	744
Aluminum used in engineered products & packaging	**342**	341	342
Total aluminum volume	**1,102**	1,106	1,086
Aluminum pricing data *($ per tonne)*			
Ingot product realizations *	**2,866**	2,709	2,835
Average LME 3-month price (one-month lag)	**2,808**	2,661	2,760

** The bulk of Alcan's ingot product sales are based on the LME 3-month price with a one-month lag plus a local market premium and any applicable product premium.*

Sales and operating revenues of $6,605 were up $502 compared to the year-ago quarter mainly reflecting higher aluminum prices as well as favourable pricing, product mix and volumes across most businesses. Compared to the first quarter, sales and operating revenues increased by $185 mainly as a result of higher aluminum volumes, improved pricing and product mix across most businesses, higher aluminum prices and technology and smelter equipment sales, partially offset by lower market premia and contribution from power generation.

The average realized price on sales of ingot products during the second quarter was up $157 per tonne from the year-ago quarter and up $31 per tonne from the first quarter. The increases over both the year-ago and sequential quarters mainly reflected the impact of higher LME aluminum prices offset by lower market premia.

Other Specified Items	**28**	

The most significant items included in OSIs in the second quarter of 2007 were favourable tax adjustments of $150 mainly related to the recognition of future tax benefits in France, partially offset by losses on disposals of assets, businesses and investments of $30 primarily in connection with the sale of the Company’s Vlissingen smelter in the Netherlands, share-based compensation expense of $27 resulting from the appreciation in the share price subsequent to the May 7, 2007 offer from Alcoa, charges of $14 principally related to previously announced restructuring in respect of packaging businesses, advisory and legal fees of $14 related to the Company’s efforts following the May 7, 2007 Alcoa offer to develop a full set of highest value alternatives consistent with the best interests of Alcan shareholders, as well as other charges of $25 mainly related to a correction of a net working capital overstatement (non-cash) of $18 at a Packaging business in Spain. The most significant items included in OSIs in the second quarter of 2006 were after-tax charges totaling $66 associated mainly with previously announced restructuring initiatives across all business groups, largely offset by tax adjustments of $63 mainly related to a deferred tax benefit arising from a reduction in the Canadian Federal tax rates enacted in June 2006. The most significant items included in OSIs in the first quarter of 2007 were after-tax restructuring charges of $7 which included costs related to the Company’s

Affimet aluminum recycling plant in Compiègne, France.

Included in income from continuing operations for the second quarter of 2007 were non-cash mark-to-market charges on derivatives of $0.02 per common share compared to gains of $0.03 per common share a year earlier and charges of $0.02 per common share in the first quarter.

Also included in income from continuing operations for the second quarter of 2007 were non-cash pre-tax expenses of $76 for share-based compensation as compared to $21 in the year-ago quarter and $17 in the first quarter of 2007. As of June 30, 2007, virtually all of the stock options were vested. As such, all related stock option expense has been recognized for all currently outstanding stock options. The Company expects to continue to incur additional stock-based compensation expense for its outstanding awards, other than stock options, until such time that these awards are settled, which will depend on the change in control date. As a result of the Rio Tinto offer, the Company expects to record the remaining compensation expense for such awards over an accelerated requisite service period.

Net Income

Including results from discontinued operations, the Company reported net income of $438 or $1.18 per common share in the second quarter of 2007, compared to $455 or $1.21 per common share a year earlier and $591 or $1.60 per common share in the first quarter of 2007.

Operating Segment Review

The term "Business Group Profit" (BGP) is defined under "Definitions" at the end of the MD&A.

	Second Quarter		First Quarter
	2007	2006	2007
Business Group Profit (BGP)			
Bauxite and Alumina	**204**	126	175
Primary Metal	**744**	774	844
Engineered Products	**149**	144	174
Packaging	**126**	134	140
Subtotal	**1,223**	1,178	1,333
Equity accounted joint venture eliminations	**(75)**	(86)	(47)
Change in fair market value of derivatives	**(7)**	7	(15)
	1,141	1,099	1,271
Corporate Items			
Intersegment, corporate offices and other	**(229)**	(159)	(89)
Depreciation & amortization	**(269)**	(258)	(264)
Interest	**(61)**	(69)	(60)
Income taxes	**(166)**	(195)	(280)
Equity income	**24**	37	12
Minority interests	**(2)**	(1)	-

Income from continuing operations	**438**	454	590

Bauxite and Alumina: BGP for the second quarter was a record $204, an increase of $78 compared to the year-ago quarter. Excluding OSIs and foreign currency balance sheet translation effects, the year-over-year increase in BGP was $86 or 60%. This improvement mainly reflected higher LME-linked contract prices for alumina (given the normal one-quarter lag), higher technology-related profits as well as improved sales mix, partially offset by exchange losses due to the strengthening Australian and Canadian dollars, higher raw material costs and the residual impact from the national strike in Guinea during the first quarter of 2007. On a sequential basis, BGP for the group was $29 above the previous quarter. Excluding OSIs and foreign currency balance sheet translation effects, BGP increased by $50 or 28%, reflecting a favorable change in sales mix, lower operating costs, lower adverse impact from the Guinean national strike during the first quarter of 2007 and higher volumes, partially offset by higher raw material costs and exchange losses due to the strengthening Australian and Canadian dollars. To date, the total impact of the national strike in Guinea commencing in the first quarter across B&A was $36, of which $15 impacted the second quarter. Results for the third quarter of 2007 are expected to be slightly higher than the second quarter as a result of higher shipments (partly related to Gove expansion capacity beginning to come on-stream) and higher bauxite profits.

Primary Metal: BGP for the second quarter was $744, a decrease of $30 as compared to the year-ago quarter. Excluding OSIs and foreign currency balance sheet translation effects, the year-over-year decrease in BGP was $26 or 3%. The decline mainly reflected higher input costs (alumina, electricity and carbon-related raw material costs), the adverse effect of the weaker US dollar, higher operating costs, as well as lower market premia, partially offset by higher LME metal prices, volumes and contribution from the cathode producer Carbone Savoie. On a sequential quarter basis, BGP decreased by $100. Excluding OSIs and foreign currency balance sheet translation effects, BGP decreased by $76 or 9%, reflecting higher input costs (alumina, electricity and carbon-related raw material costs), the adverse effect of the weaker US dollar, lower contributions from power generation and lower market premia. These unfavorable impacts were partially offset by higher volumes, higher LME and higher contribution from technology and smelter equipment sales. As a result of lost contribution from the divestiture of the Vlissingen smelter in the Netherlands, and assuming current forward prices for aluminum and forward exchange rates, results for the third quarter are expected to be somewhat lower than the second quarter.

Engineered Products: BGP for the second quarter was $149. Excluding OSIs and foreign currency balance sheet translation effects, operating results were $162, or $7 higher than a year earlier. Results for the second quarter of 2006 included significant metal timing benefits, a consequence of the rapid rise in LME prices in earlier quarters. Adjusting for these non-cash accounting benefits, the operating performance of the group improved by approximately 20 percent year over year on the back of strong results from the Cable, Composites and Aerospace businesses. On a sequential quarter basis, BGP was $25 lower than in the first quarter of the year. Excluding OSIs and foreign currency balance sheet translation effects, operating results were $16 lower principally due to the absence of beneficial metal timing effects. Adjusting for these non-cash accounting benefits, the performance of the group was equivalent to the record level of the first quarter, a reflection of the generally firm business conditions evident through the first half of the year. Operating results for the third quarter are expected to be lower due to the usual summer holiday closures in Europe.

Packaging: BGP in the second quarter of $126 was down $8 or 6% from the prior-year quarter. Excluding the impact of OSIs, foreign currency balance sheet translation effects and lost contributions from divested businesses, BGP was $165, an improvement of $12 or 8%. The year-on-year improvement was mainly due to operational savings and restructuring measures, a stronger euro compared to the US dollar and volume growth initiatives. On a sequential quarter basis, BGP decreased by $14 or 10%. Excluding the impact of OSIs and foreign currency balance sheet translation effects, BGP increased by $20 or 14% as a result of stronger volumes and cost saving measures. Operating BGP in the third quarter of 2007 is expected to be similar as normal seasonal volume softening is offset by ongoing progress in growth and operational efficiencies.

Corporate Items

The Intersegment, corporate offices and other expense category includes corporate head office costs as well as other non-operating items and the elimination of profits on intersegment sales of aluminum and alumina. The increase of $70 compared to the second quarter of 2006 as well as the increase of $140 over the prior quarter mainly reflect higher share-based compensation expense, the loss on the sale of the Company’s Vlissingen smelter in the Netherlands and advisory fees resulting from the Company’s efforts during the quarter to develop a full set of highest value alternatives consistent with the best interests of Alcan shareholders following the May 7, 2007 Alcoa offer.

Depreciation and amortization expenses were $11 higher than in the year-ago quarter primarily reflecting increased depreciation at the Gove alumina refinery in Australia. Depreciation and amortization expenses were comparable to the prior quarter.

Interest expense, net of capitalized interest, was $8 lower than in the year-ago quarter and comparable to the prior quarter. The year-over-year decline mainly reflected a higher level of capitalized interest and reduced debt levels. In the second quarter of 2007, capitalized interest was $24 compared to $20 a year ago and $23 in the first quarter, all largely related to the Gove expansion.

The Company's effective tax rate on income from continuing operations was 29% in the second quarter and 31% year to date. Foreign currency balance sheet translation losses due to the strengthening of the Canadian dollar increased the effective tax rate in the second quarter, largely offset by the recognition of future tax benefits in France which were not previously recognized. These tax benefits, which are included in OSIs, were recognized in the second quarter when their realization met the relevant tests for likelihood of recovery.

Share Repurchase Program

Cumulatively since the program inception, Alcan purchased 9,831,200 common shares at an average price of $47.42 per share for a total cost of $466. This represents 52% of the total number of shares approved for repurchase.

Liquidity and Capital Resources

	Second Quarter		First Quarter
	2007	2006	2007
Cash flow from operating activities in continuing operations	**738**	771	582
Dividends	**(73)**	(58)	(75)
Capital expenditures	**(421)**	(469)	(312)
Free cash flow from continuing operations	**244**	244	195

Operating Activities

In the second quarter of 2007, cash flow from operating activities in continuing operations of $738 decreased by $33 compared to the year-ago quarter and increased by $156 compared to the first quarter. The increase over the prior quarter principally reflects seasonally typical favourable movements in payables and deferred items which more than offset lower net income. After dividends of $73 and capital expenditures of $421, free cash flow from continuing operations was $244 for the second quarter of 2007. In the year-ago quarter, after dividends of $58 and capital expenditures of $469, free cash flow from continuing operations was also $244. In the prior quarter, after dividends of $75 and capital expenditures of $312, free cash flow from continuing operations was $195. The term “Free cash flow from continuing operations” is defined under "Definitions" at the end of the MD&A.

Financing Activities

	June 30		March 31
Debt as a Percentage of Invested Capital	**2007**	2006	2007
Debt			
Short-term borrowings	**704**	349	579
Debt maturing within one year	**69**	105	32
Debt not maturing within one year	**4,578**	5,570	5,169
Total debt	**5,351**	6,024	5,780
Minority interests	**74**	65	71
Equity			
Redeemable non-retractable preference shares	**160**	160	160
Common shareholders' equity	**12,223**	10,750	11,565
Total invested capital	**17,808**	16,999	17,576
Debt as a percent of invested capital (%)	**30%**	35%	33%

The term “Debt as a percentage of invested capital” is defined under "Definitions" at the end of the MD&A.

Debt as a percentage of invested capital as at June 30, 2007 was 30%, down from 33% at the end of the first quarter due to lower debt and higher equity.

During the first quarter of 2007, the Company entered into an interest rate derivative to swap interest payments on $100 of its long-term debt from fixed to floating rate (relating to the 4.875% Global notes due in 2012). During the second quarter of 2007, the Company entered into interest rate derivatives to swap interest payments on an additional $200 of the same long-term debt.

On July 26, 2007, Alcan’s board of directors approved the redemption of the Company's redeemable non-retractable preference shares at a price of CAN$25.00 per share. The transaction is expected to be completed on September 3, 2007.

The Company has entered into programs with certain financial institutions to sell certain trade receivables. Effective April 2, 2007, the Company terminated one such program to sell to a third party an undivided interest up to $125 (€95 million) of selected trade receivables without recourse.

Liquidity

Since June 16, 2006, the Company has had in place a two-tranche, multi-currency, committed global credit facility with a syndicate of international banks. This facility is comprised of a $2,000 5-year tranche, maturing in June 2011, and a $1,000 364-day tranche, extendable by two years at the Company's option. During the second quarter of 2007, the Company extended the $1,000 364-day tranche. The facility is available for general corporate purposes and is primarily used to support the commercial paper programs.

In addition to its existing $3-billion commercial paper program in Canada, the Company has two commercial paper programs, one in France of € 1 billion and another in the US of $2 billion. The Company guarantees the commercial paper issued under these two programs. The Company also has a commercial paper program in the US with Alcan Corporation as the issuer. At any point in time, the total combined issuance limit for all three programs cannot exceed $3 billion.

As at June 30, 2007, the Company had the ability, through its long-term credit facilities, to refinance its commercial paper borrowings on a long-term basis. However, the Company's intention is to repay these commercial paper borrowings during the third quarter of 2007 and has classified them as Short-term borrowings at June 30, 2007. As at December 31, 2006, the Company had both the intention and the ability, through its long-term credit facilities, to refinance its commercial paper borrowings on a long-term basis and had classified them as Debt not maturing within one year. Furthermore, all commercial paper debt repayments were included in the year 2011 when the multi-currency, five year, committed global credit facility matures.

As at August 1, 2007, Alcan had $448 of commercial paper outstanding. Based on the Company's forecasts, the Company believes that cash from continuing operations together with available credit facilities will be more than sufficient to meet the cash requirements of operations, planned capital expenditures, dividends and any short-term debt refinancing requirements. In addition, the Company believes that its ability to access global capital markets provides any additional liquidity that may be required to meet unforeseen events. Alcan's long-term debt rating remains unchanged at BBB+ / Baa1 with short-term debt rated A2 / P2 by S&P's and Moody's respectively. Credit rating agencies apply their own criteria and may change the ratings at any time.

Investment Activities

In the second quarter of 2007, cash used for investment activities in continuing operations was $381 compared to $450 in the year-ago quarter. Both the current and year-ago quarter balances mainly reflect capital expenditures of $421 and $469, respectively. Excluding capital expenditures on the Gove expansion, capital spending was 106% and 100% of depreciation and amortization expense for the second quarter of 2007 and prior-year quarter, respectively.

Investments

On April 30, 2007, Alcan signed a Heads of Agreement with Saudi Arabian mining company Ma'aden to develop a proposed $7-billion integrated aluminum "mine-to-metal" project including bauxite mining, alumina refining, power generation and aluminum smelting. Alcan would hold a 49% stake in the project and would provide technology and operating management support, with Ma'aden holding the balance of 51%. As one of the world's largest vertically integrated projects of its kind, the initial operations would feature a power plant delivering 1,400 megawatts; a 90 million tonne bauxite reserve located in Az Zabirah in northern Saudi Arabia representing a potential 30 years of mining; an alumina refinery with a capacity of 1.6 million tonnes per year; an aluminum smelter with a capacity of 720 thousand tonnes per year, and would leverage Saudi Arabia's port facilities and infrastructure. First metal would be expected during the first quarter of 2011, and first alumina a year later.

Divestments

On April 27, 2007, the Company concluded the sale of selected assets at the Company's Affimet aluminum recycling plant in Compiègne, France. In relation to this, the Company recorded a loss on disposal of $12 in the second quarter of 2007.

On May 31, 2007, the Company reached an agreement in principle regarding the sale of its Vlissingen smelter in the Netherlands in which Alcan had an 85% interest. The Company recorded charges of $42, included as a loss on disposal of businesses and investments within Other expenses (income) - net, during the second quarter of 2007.

On June 26, 2007, the Company concluded the sale of its Satma subsidiary. Satma, located in Goncelin, France, manufactures and sells capacitor foil for the electronic industry as well as anodized strip for the lighting and decoration markets.

On July 18, 2007, Alcan agreed to sell its 45% interest in Utkal Alumina International Limited (Utkal) to Hindalco Industries Limited, India. The Utkal joint venture was established in 1992 and involves the development of a new bauxite mine and alumina refinery in the Indian state of Orissa (Utkal Project). The Company had announced its intention to sell its interest in Utkal on April 12, 2007. The Company expects completion of the sale during the third quarter of 2007.

Contractual Obligations

The Company has future obligations under various contracts relating to debt payments including those with associated interest rate swap agreements, capital and operating leases, long-term purchase arrangements, pensions and other post-employment benefits, and guarantees. The table below provides a summary of these contractual obligations (based on undiscounted future cash flows) as at June 30, 2007. There are no material off-balance sheet arrangements.

Contractual Obligations
As at June 30, 2007

		Payments due by Period			
	Total	2007	2008-2009	2010-2011	2012 and thereafter
Long-term debt (1)	**4,647**	69	509	434	3,635
Interest payments (1)	**3,451**	132	500	459	2,360
Capital lease obligations	**29**	4	8	3	14
Operating leases	**637**	58	197	155	227
Purchase obligations	**5,713**	1,111	1,328	952	2,322
Unfunded pension plans (2)	**2,478**	33	140	142	2,163
Other post-employment benefits (2)	**2,805**	33	145	160	2,467
Funded pension plans (2),(3)	**(3)**	136	558	577	(3)
Guarantees (4)	**438**	58	289	3	88
Total		**1,634**	**3,674**	**2,885**	

(1) *Interest payments are calculated using the interest rate in effect, including the impact of interest rate swap agreements on $900 of fixed rate long-term debt and the outstanding debt balance as at June 30, 2007. All commercial paper borrowings and interest payments thereon have been excluded because these borrowings are now classified in short-term borrowings.*

(2) *Refer to note 17, Post-Retirement Benefits, of the accompanying unaudited interim consolidated financial statements.*

(3) *Pension funding generally includes the contribution required to finance the annual service cost, except where the plan is largely overfunded, and amortization of unfunded liabilities over periods of 15 years, with larger payments made over the initial period where required by pension legislation. Contributions depend on actual returns on pension assets and on deviations from other economic and demographic actuarial assumptions. Based on management's long-term expected return on assets, annual contributions for years after 2011 are projected to be in the same range as in prior years and to grow in relation with payroll.*

(4) *Refer to note 15, Commitments and Contingencies, of the accompanying unaudited interim consolidated financial statements.*

Alcoa and Rio Tinto Offers

On May 7, 2007, Alcan received from Alcoa notice of intent to file an unsolicited offer to acquire all of the outstanding shares of Alcan for US$58.60 in cash and 0.4108 of a share of Alcoa common stock for each outstanding common share of Alcan.

On May 22, 2007, Alcan’s Board of Directors unanimously recommended shareholders reject Alcoa Inc.'s unsolicited offer to acquire Alcan. The Board determined that the offer was inadequate in multiple respects and was contrary to the best interests of Alcan's shareholders. Yves Fortier, Chairman of Alcan's Board of Directors, stated, "Alcan's Board of Directors has thoroughly evaluated Alcoa's offer and concluded that it fails to meet the best interests of Alcan shareholders. It does not adequately reflect the value of Alcan's extremely attractive assets, strategic capabilities and growth prospects, does not offer an appropriate premium for control of Alcan, and is highly conditional and uncertain. Furthermore, it is clear to us that Alcan and Alcoa have fundamentally different approaches and track records in creating shareholder value. We are convinced that the proposed Alcoa-led acquisition of Alcan is not the right choice for our shareholders."

On July 12, 2007, Alcan entered into a support agreement with Rio Tinto plc (Rio Tinto) and Rio Tinto Canada Holding Inc. (Rio Tinto Canada), a wholly-owned indirect subsidiary of Rio Tinto. Pursuant to the support agreement, Rio Tinto Canada has agreed to make a cash tender offer to acquire all of Alcan's outstanding common shares for $101 per common share. The offer represents a total equity consideration for Alcan of approximately $38.1 billion. The combined aluminium product group, to be named Rio Tinto Alcan, will be a new global leader in the aluminium industry with large, long life, low cost assets worldwide. The combined Group's access to significant bauxite reserves, competitive alumina refining, low cost hydro power, leading smelter technology, and a deep and diverse talent pool provides an excellent position to capitalize on the favourable demand fundamentals of the aluminium industry. Rio Tinto Alcan will also have a strong portfolio of growth projects.

The board of directors of Alcan has unanimously recommended that Alcan shareholders should accept the offer. The offer is subject to a number of conditions including valid acceptances of not less than 66 percent of Alcan shares on a fully diluted basis and the approval of Rio Tinto shareholders. The board of directors of Rio Tinto has approved the transaction and will recommend the transaction to its shareholders. The offer will also be subject to certain customary conditions including receipt of necessary regulatory and antitrust approvals in the United States, Canada, the European Union and Australia, and the absence of material adverse changes or effects. The offer is expected to close in the fourth quarter of 2007.

Subject to the terms and conditions of the support agreement, Alcan's board of directors has the right to withdraw, modify or change its support of the offer if Alcan receives a superior proposal (as defined in the support agreement) prior to the expiration of the offer. However, Rio Tinto Canada has the right to match any such superior proposal received by Alcan and, in certain circumstances, if the offer is not consummated, Rio Tinto Canada would have the right to receive a payment of $1,049 from Alcan. In other circumstances, related to the required shareholder votes for the Rio Tinto group, an equivalent payment from Rio Tinto may be required.

The Company concurrently announced that Rio Tinto and Alcan had agreed to divest Alcan's packaging business. The Company is currently evaluating its strategies for the planned divestiture.

On August 7, 2007, the Government of Quebec announced that it had accepted the conclusions of the board of directors of Alcan with respect to the proposed acquisition and confirmed that the Rio Tinto Canada offer respects the terms of the Continuity Agreement between Alcan and the Government of Quebec, signed in 2006. Alcan had made an undertaking that it would maintain its head office and principal place of business in Quebec and it would ensure that, in the event of a change of control, the acquirer would maintain the same level and quality of commitments in Quebec to socio-economic programs and to regional development as then existed at Alcan.

Transaction Costs

Following a hostile takeover offer by Alcoa on May 7, 2007, the Company incurred pre-tax charges of $21 in the second quarter of 2007 for advisory and legal fees in order to develop a full set of highest value alternatives consistent with the best interests of Alcan shareholders. In accordance with the terms of the agreements entered into with the Company’s investment and legal advisors, the Company expects to pay an additional amount of approximately $145 in advisory fees.

Share-Based Compensation and Other Change of Control Costs

Upon a change of control of Alcan, based on a share price of $101 per share as described in the Rio Tinto offer, a maximum of $232 pre-tax would be payable under the Company's Total Shareholder Return Performance Plan, Restricted Share Unit Plan and Stock Price Appreciation Unit Plan. Approximately $121 has been accrued as of June 30, 2007 in Selling, administrative and general expenses. The Company is currently examining the manner of settlement of its stock option plans. In the event of a change of control and termination of certain executives, change of control agreements provide for severance entitlements of a maximum of $38 pre-tax.

Credit Rating and Liquidity

Following the Alcoa announcement on May 7, 2007, both S&P and Moody's placed Alcan's credit rating under review with negative implications. S&P has maintained the negative outlook while Moody's revised the outlook and placed Alcan's rating under review for possible upgrade on July 12, following announcement of the Rio Tinto offer.

Alcan's $3,000 two-tranche, multi-currency committed global credit facility may no longer be available 90 days following the consummation of a change of control transaction. Accordingly, alternative liquidity sources would need to be put in place to finance Alcan's activities.

Selected Annual Information

Selected financial data for each of the Company's three most recently completed financial years is as follows:

		31 December	
	2006	**2005**	**2004**
Sales and operating revenues	23,641	20,320	24,948
Income from continuing operations	1,786	155	243
Net income	1,786	129	258
Total assets	28,939	26,638	33,341
Total long-term debt	5,512	6,067	6,914
($ per common share)			
Income from continuing operations - basic	4.75	0.40	0.64
Income from continuing operations - diluted	4.74	0.40	0.64
Net income - basic	4.75	0.33	0.69
Net income - diluted	4.74	0.33	0.69
Dividends	0.70	0.60	0.60

Selected Quarterly Information

Selected unaudited financial data for each of the Company's eight most recently completed quarters is as follows:

	Q2-07	**Q1-07**	**Q4-06**	**Q3-06**	**Q2-06**	**Q1-06**	**Q4-05**	**Q3-05**
Sales and operating revenues	6,605	6,420	6,219	5,769	6,103	5,550	5,049	4,887
Income (Loss) from continuing operations	438	590	418	460	454	454	(333)	72
Net income (Loss)	438	591	422	456	455	453	(361)	81
($ per common share)								
Income (Loss) from continuing operations - basic	1.18	1.60	1.12	1.21	1.21	1.21	(0.91)	0.19
Income (Loss) from continuing operations - diluted	1.17	1.59	1.12	1.21	1.20	1.20	(0.91)	0.19
Net income (Loss) - basic	1.18	1.60	1.13	1.20	1.21	1.21	(0.98)	0.21
Net income (Loss) - diluted	1.17	1.59	1.13	1.20	1.20	1.20	(0.98)	0.21

Commitments and Contingencies

The Company's commitments and contingencies are described in note 15 - Commitments and Contingencies, of the accompanying unaudited interim consolidated financial statements.

Related Party Transactions

The only related party transactions are those with the joint ventures accounted for under the equity method. These transactions are undertaken on an arm’s length, negotiated basis. For more details, refer to note 11 - Related Party Transactions, of the consolidated financial statements in the most recent Annual Report on Form 10-K.

Accounting Policies

The preparation of financial statements in conformity with United States GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates are associated with the critical accounting policies relating to post-retirement benefits; environmental liabilities; property, plant and equipment; goodwill; income taxes; and business combinations. These critical accounting policies are those that are both most important to the portrayal of the Company’s financial condition and results and require management’s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

The Company's critical accounting policies are more fully described in note 2 - Summary of Significant Accounting Policies, of the audited consolidated financial statements and in the MD&A, contained in the most recent Annual Report on Form 10-K.

On January 1, 2007, the Company adopted the provisions of the Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN 48). The adoption of this standard resulted in the Company recording a $28 net increase in the liability for unrecognized tax benefits on January 1, 2007. This net increase in liabilities resulted in a decrease to the January 1, 2007 balance of Retained earnings of $21, a net decrease in Deferred tax liabilities of $8 and a reduction of $1 in equity-accounted investments included in Deferred charges and other assets. For more details, refer to note 2 - Accounting Changes and note 7 - Income Taxes, of the accompanying unaudited interim consolidated financial statements.

Cautionary Statement

Statements made in this Form 10-Q which describe the Company's or management's objectives, projections, estimates, expectations or predictions of the future may be "forward-looking statements" within the meaning of securities laws which can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "will," "should," "estimates," “plans,” "anticipates" or the negative thereof or other variations thereon. All statements that address the Company's expectations or projections about the future including statements about the Company's growth, cost reduction goals, operations, reorganization plans, expenditures and financial results are forward-looking statements. Such statements may be based on the Company’s own research and analysis. The Company cautions that, by their nature, forward-looking statements involve risk and uncertainty and that the Company's actual actions or results could differ materially from those expressed or implied in such forward-looking statements or could affect the extent to which a particular projection is realized. Reference should be made to the Company’s most recent Annual Report on Form 10-K for a list of factors that could cause such differences.

Important factors which could cause such differences include: changes in global supply and demand conditions for aluminum and other products; cyclical demand and pricing within the principal markets for the company's products; changes in the relative value of various currencies; fluctuations in the supply of and prices for power in the areas in which the company maintains production facilities; changes in aluminum ingot prices and changes in raw material costs and availability; competition in highly competitive markets; changes in prevailing interest rates and equity market returns related to pension plan investments; economic, regulatory and political factors within the countries in which the company operates or sells its products; the risk of significant losses from trading operations, including losses due to market and credit risks associated with derivatives; changes in government regulations, particularly those affecting environmental, health or safety compliance; risks related to the use of hazardous materials in manufacturing processes; delay and cost risks related to significant capital projects; the consequences of transferring most of the aluminum rolled products businesses operated by the company to Novelis Inc.; relationships with, and financial and operating conditions of, customers and suppliers; willingness of customers to accept substitution by competing products; major changes in technology that affect the company’s competitiveness; potential catastrophic damage, increased insurance and security costs and general uncertainties associated with the increased threat of terrorism or war; the effect of international trade disputes on the company’s ability to import materials, export its products and compete internationally; the effect of integrating acquired businesses and the ability to attain expected benefits; potential discovery of unanticipated commitments or other liabilities associated with the acquisition and integration or disposition of businesses; and other factors affecting the company's operations including, but not limited to, litigation, labour relations and negotiations and fiscal regimes.

The Company undertakes no obligation to release publicly the results of any future revisions it may make to forward-looking statements to reflect events or circumstances after the date of this quarterly report or to reflect the occurrence of unanticipated events. Furthermore, the Company undertakes no obligation, in relation to future quarterly earnings disclosures, to release publicly any information on an interim basis prior to the final earnings disclosure.

Definitions

“$” all amounts are in US dollars.

“Business Group Profit” (BGP) comprises earnings before interest, income taxes, minority interests, depreciation and amortization and excludes certain items, such as corporate costs, restructuring costs (relating to major corporate-wide acquisitions or initiatives), impairment and other special charges, pension actuarial gains, losses and other adjustments, and unrealized gains and losses on derivatives, that are not under the control of the Business Groups or are not considered in the measurement of their profitability. These items are generally managed by the Company's corporate head office, which focuses on strategy development and oversees governance, policy, legal, compliance, human resources and finance matters. Financial information for individual business groups includes the results of certain joint ventures and other investments accounted for using the equity method on a proportionately consolidated basis, which is consistent with the way the business groups are managed. However, the BGP of these joint ventures and equity-accounted investments is removed from total BGP for the company and the net after-tax results are reported as equity income. The unrealized change in the fair market value of derivatives has been removed from individual business group results and is shown on a separate line within total BGP. This presentation provides a more accurate portrayal of underlying business group results and is in line with the company's portfolio approach to risk management.

"Debt as a percentage of invested capital" does not have a uniform definition. Because other issuers may calculate debt as a percentage of invested capital differently, Alcan's calculation may not be comparable to other companies' calculations. The figure is calculated by dividing borrowings by total invested capital. Total invested capital is equal to the sum of borrowings and equity, including minority interests. The Company believes that debt as a percentage of invested capital can be a useful measure of its financial leverage as it indicates the extent to which it is financed by debt holders. The measure is widely used by the investment community and credit rating agencies to assess the relative amounts of capital put at risk by debt holders and equity investors.

"Derivatives" including forward contracts, swaps and options are financial instruments used by the Company to manage the specific risks arising from fluctuations in exchange rates, interest rates, aluminum prices and other commodity prices. Mark-to-market gains and losses on derivatives will be offset over time by gains and losses on the underlying exposures.

“Foreign currency balance sheet translation” effects largely arise from translating monetary items (principally deferred income taxes and long-term liabilities) denominated in Canadian and Australian dollars into US dollars for reporting purposes. Although these effects are primarily non-cash in nature, they can have a significant impact on the Company’s net income.

“Free cash flow from continuing operations” consists of cash from operating activities in continuing operations less capital expenditures and dividends. Management believes that free cash flow, for which there is no comparable GAAP measure, is relevant to investors as it provides an indication of the cash generated internally that is available for investment opportunities and debt service.

“GAAP” refers to United States Generally Accepted Accounting Principles.

“LME” refers to the London Metal Exchange.

“Other Specified Items” (OSIs) include, for example: restructuring and synergy charges; asset impairment charges; gains and losses on non-routine sales of assets, businesses or investments; unusual gains and losses from legal claims and environmental matters; gains and losses on the redemption of debt; income tax reassessments related to prior years and the effects of changes in income tax rates; and other items that, in Alcan’s view, do not typify normal operating activities.

All tonnages are stated in metric tonnes, equivalent to 2,204.6 pounds.

All figures are unaudited.

Additional information on Alcan is available on the Company's website at www.alcan.com and the Company's regulatory filings can be viewed on the Canadian Securities Administrators' site at www.sedar.com and on the US Securities and Exchange Commission's site at www.sec.gov. All website addresses contained in this report are textual references and information from referenced websites is not incorporated by reference into this report. The number of common shares outstanding as at August 1, 2007 is 372,961,222.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

(*in millions of US$, except LME prices*)

Changes in interest rates, foreign exchange rates and the market price of aluminum are among the factors that can impact the Company's cash flow. See risk factors described in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Interest Rates

The impact of a 10% increase in interest rates on the Company's variable rate debt outstanding and on the fixed rate debt that has been converted to variable rate debt through interest rate swaps at June 30, 2007 and 2006, net of its cash and time deposits, would be to reduce annual net income by $6 and $5, respectively for the variable rate debt including $3 and $nil, respectively for the fixed rate debt converted to variable rate debt through interest rate swaps. The fixed rate debt is expected to be outstanding until maturity as the Company does not intend to refinance its fixed rate debt prior to maturity. Transactions in interest rate financial instruments for which there is no underlying interest rate exposure to the Company are prohibited. For accounting policies for interest rate swaps used to hedge interest costs on certain debt, see note 2 - Summary of Significant Accounting Policies of the Company's most recent Annual Report on Form 10-K.

Currency Legend:

AUD	Australian Dollar	ISK	Iceland Kronur
BRL	Brazilian Real	JPY	Japanese Yen
CAD	Canadian Dollar	MXN	Mexican Peso
CHF	Swiss Franc	NOK	Norwegian Krone
CZK	Czech Koruna	NZD	New Zealand Dollar
DKK	Denmark Kroner	SKK	Slovak Koruna
EUR	Euros	USD	US Dollar
GBP	UK Pound		

Currency Derivatives

The schedule below presents fair value information and contract terms relevant to determining future cash flows categorized by expected maturity dates of the Company's currency derivatives (principally forward contracts) outstanding as at June 30, 2007.

	2007	2008	2009 to 2012 and thereafter	Total Nominal Amount	Fair Value
	(in US$ millions, except average contract rates)				
FORWARD CONTRACTS					

To buy USD against the foreign currency

GBP	Nominal amount	15	-	-	15	-
	Average contract rate	*0.502*	-	-		
CAD	Nominal amount	3	-	-	3	-
	Average contract rate	*1.165*	-	-		
CHF	Nominal amount	-	-	1*	1	-
	Average contract rate	-	-	*1.166**		
MXN	Nominal amount	3	1	-	4	-
	Average contract rate	*11.049*	*11.290*	-		
JPY	Nominal amount	9	-	-	9	1
	Average contract rate	*113.698*	-	-		
NZD	Nominal amount	2	-	-	2	-
	Average contract rate	*1.365*	-	-		

		2007	2008	2009 to 2012 and thereafter	Total Nominal Amount	Fair Value
		(in US$ millions, except average contract rates)				
FORWARD CONTRACTS (cont'd)						
SKK	Nominal amount	4	-	-	4	-
	Average contract rate	*26.583*	-	-		
To sell USD against the foreign currency						
GBP	Nominal amount	1	-	-	1	-
	Average contract rate	*0.499*	-	-		
BRL	Nominal amount	23	-	-	23	7
	Average contract rate	*2.726*	-	-		
CHF	Nominal amount	17	9	-	26	-
	Average contract rate	*1.228*	*1.197*	-		
CZK	Nominal amount	5	-	-	5	-
	Average contract rate	*20.220*	-	-		
CAD	Nominal amount	9	-	-	9	1
	Average contract rate	*1.131*	-	-		
To buy EUR against the foreign currency						
USD	Nominal amount	133	-	-	133	-
	Average contract rate	*1.345*	-	-		
GBP	Nominal amount	1	-	-	1	-
	Average contract rate	*0.677*	-	-		
JPY	Nominal amount	21	-	-	21	1
	Average contract rate	*155.534*	-	-		

		2009	2010	2011	2012 and thereafter
To buy USD against the foreign currency					
*CHF	Nominal amount	1	-	-	-
	Average contract rate	*1.166*	-	-	-

		2007	2008	2009 to 2012 and thereafter	Total Nominal Amount	Fair Value
		(in US$ millions, except average contract rates)				
FORWARD CONTRACTS (cont'd)						
To sell EUR against the foreign currency						
USD	Nominal amount	327	13	5**	345	(1)
	Average contract rate	*1.350*	*1.113*	*1.359***		
CHF	Nominal amount	20	4	-	24	(1)
	Average contract rate	*1.633*	*1.506*	-		
GBP	Nominal amount	2	-	-	2	-
	Average contract rate	*0.675*	-	-		
To sell GBP against the foreign currency						
CHF	Nominal amount	1	-	-	1	-
	Average contract rate	*2.449*	-	-		
To sell AUD against the foreign currency						
CHF	Nominal amount	1	-	-	1	-
	Average contract rate	*0.969*	-	-		
To sell JPY against the foreign currency						
CHF	Nominal amount	3	-	-	3	-
	Average contract rate	*98.109*	-	-		

		2009	2010	2011	2012 and thereafter
To sell EUR against the foreign currency					
**USD	Nominal amount	1	1	1	2

Average contract rate	*1.333*	*1.349*	*1.360*	*1.381*

The schedule below presents fair value information and contract terms relevant to determining future cash flows categorized by expected maturity dates of the Company's currency derivatives (principally forward and option contracts) outstanding as at June 30, 2006.

		2006	2007	2008 to 2011 and thereafter	Total Nominal Amount	Fair Value
		(in US$ millions, except average contract rates)				
FORWARD CONTRACTS						
To buy USD against the foreign currency						
GBP	Nominal amount	6	-	-	6	-
	Average contract rate	*0.549*	-	-		
CHF	Nominal amount	4	-	-	4	-
	Average contract rate	*1.218*	-	-		
JPY	Nominal amount	19	-	-	19	1
	Average contract rate	*109.2*	-	-		
MXN	Nominal amount	14	4	1***	19	-
	Average contract rate	*11.20*	*10.97*	*11.29****		
DKK	Nominal amount	5	-	-	5	-
	Average contract rate	*5.912*	-	-		
Other	Nominal amount	3	-	-	3	-
To sell USD against the foreign currency						
GBP	Nominal amount	22	-	-	22	-
	Average contract rate	*0.535*	-	-		
AUD	Nominal amount	89	-	-	89	2
	Average contract rate	*1.381*	-	-		
BRL	Nominal amount	23	45	-	68	7
	Average contract rate	*2.514*	*2.669*	-		
ISK	Nominal amount	9	-	-	9	-
	Average contract rate	*74.26*	-	-		

CZK	Nominal amount	1	-	-	1	-
	Average contract rate	*22.31*	-	-		
Other	Nominal amount	1	-	-	1	-
To buy EUR against the foreign currency						
USD	Nominal amount	655	21	-	676	38
	Average contract rate	*1.204*	*1.201*	-		
GBP	Nominal amount	34	1	-	35	-
	Average contract rate	*0.691*	*0.694*	-		
CAD	Nominal amount	4	2	-	6	-
	Average contract rate	*1.462*	1.525	-		

		2006	2007	2008 to 2011 and thereafter	Total Nominal Amount	Fair Value
		(in US$ millions, except average contract rates)				
FORWARD CONTRACTS (cont'd)						
To sell EUR against the foreign currency						
USD	Nominal amount	662	24	16****	702	(34)
	Average contract rate	*1.216*	*1.223*	*1.174*****		
GBP	Nominal amount	22	-	-	22	-
	Average contract rate	*0.688*	-	-		
CHF	Nominal amount	33	5	4*****	42	-
	Average contract rate	*1.550*	*1.522*	*1.506******		
NOK	Nominal amount	5	-	-	5	-
	Average contract rate	*7.946*	-	-		
CAD	Nominal amount	1	-	-	1	-
	Average contract rate	*1.422*	-	-		

		2008	2009	2010	2011 and thereafter
To buy USD against the foreign currency					
***MXN	Nominal amount	1	-	-	-
	Average contract rate	*11.29*	-	-	-
To sell EUR against the foreign currency					
****USD	Nominal amount	12	1	1	2
	Average contract rate	*1.113*	*1.333*	*1.349*	*1.374*
*****CHF	Nominal amount	4	-	-	-
	Average contract rate	*1.506*	-	-	-

Any negative impact of currency movements on the currency contracts that the Company has taken out to hedge identifiable foreign currency commitments to buy or sell goods and services would be offset by an equal and opposite favourable exchange impact on the commitments being hedged. Transactions in currency-related financial instruments for which there is no underlying foreign currency exchange rate exposure to the Company are prohibited, except for a small trading portfolio not exceeding $50. For accounting policies relating to currency contracts, see note 2 - Summary of Significant Accounting Policies of the Financial Statements of the Company's most recent Annual Report on Form 10-K.

Derivative Commodity Contracts

The effect of a reduction of 10% in aluminum prices on the Company's aluminum forward and option contracts outstanding at June 30, 2007 would be to increase net income over the period ending December 31, 2008 by approximately $42 ($39 in 2007 and $3 in 2008). The $42 increase reflects a 10% reduction from the June 30, 2007, three-month LME aluminum closing price of $2,725 per tonne and assumes an equal 10% drop has occurred throughout the aluminum forward price curve existing as at June 30, 2007. As of June 30, 2006, such sensitivity would have increased net income over the period ending December 31, 2007 by approximately $111 ($55 in 2006 and $56 in 2007).

The Company's aluminum forward contract positions, producing the above results, are entered into to hedge anticipated future sales of metal. Consequently, any negative impact of movements in the price of aluminum on the forward contracts would be offset by an equal and opposite impact on the sales being hedged. The effect of a reduction of 10% in aluminum prices on the Company's anticipated sales and purchases of aluminum is excluded from the sensitivity analysis above.

Transactions in metal-related financial instruments for which there is no underlying metal price exposure to the Company are prohibited, except for a small trading portfolio of metal forwards not exceeding 25,000 tonnes.

Item 4. Controls and Procedures

a) Evaluation of Disclosure Controls and Procedures

As at June 30, 2007, an evaluation was carried out under the supervision and with the participation of the Company’s management, including the Chief Executive Officer and Chief Financial Officer (respectively, the Company’s principal executive and financial officers), of the effectiveness of the design and operation of Alcan’s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, Alcan’s Chief Executive Officer and Chief Financial Officer concluded that these disclosure controls and procedures were effective as of June 30, 2007.

b) Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. The Company will provide management’s assessment of the effectiveness of the Company’s internal control over financial reporting in the Company’s Annual Report on Form 10-K for 2007.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Williams Land Fill, New Jersey. In June 2006, Alcan Global Pharmaceutical Packaging Inc. ("AGPP") was advised by the New Jersey Department of Environmental Protection ("NJDEP") that it was investigating the recovery of natural resource damages from AGPP in relation to the land fill site. In March 2007, the NJDEP issued a settlement demand for 3.2 acres of undeveloped land in the same watershed. On 25 June 2007, the NJDEP filed suit. Settlement negotiations are ongoing.

Items 1A., 3. and 5.

The registrant has nothing to report under these items.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Unregistered Sales of Equity Securities

In the second quarter of 2007, the Company issued 631,025 Common Shares to former holders of Pechiney options that resided outside the United States and Canada upon the exercise of such options. The aggregate proceeds of the exercise of the options were approximately $25.8 million. These proceeds were used for general corporate purposes. These Common Shares were not registered under the *Securities Act of 1933*, as amended in reliance on regulation S. The dates of sale and amounts of Common Shares are set forth below:

Dates	Number of Shares	Dates	Number of Shares	Dates	Number of Shares
4 April 2007	21,073	3 May 2007	9,891	5 June 2007	10,206
5 April 2007	1,198	4 May 2007	8,259	6 June 2007	8,589
10 April 2007	478	7 May 2007	18,182	8 June 2007	918
11 April 2007	1,595	9 May 2007	77,205	12 June 2007	2,436
13 April 2007	2,592	14 May 2007	37,341	14 June 2007	7,168
17 April 2007	1,116	15 May 2007	28,601	15 June 2007	10,456
18 April 2007	2,215	16 May 2007	7,440	18 June 2007	61,791
19 April 2007	2,592	18 May 2007	26,817	19 June 2007	12,677
23 April 2007	3,607	22 May 2007	25,570	22 June 2007	12,902
25 April 2007	10,966	28 May 2007	15,530	26 June 2007	8,160
26 April 2007	30,502	30 May 2007	24,750	27 June 2007	3,233
27 April 2007	19,230	31 May 2007	20,476	28 June 2007	8,417
30 April 2007	47,245	1 June 2007	6,706		
2 May 2007	11,399	4 June 2007	21,496		

Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of Shareholders of Alcan was held on April 26, 2007. At the Annual Meeting:

Election of Directors

- On a vote by ballot, each of the following 13 nominees were elected as a Director of the Company.

Nominee	Votes For	% Votes For	Votes Withheld	% Votes Withheld
Roland Berger	220,873,035	99.55	995,379	0.45
L. Denis Desautels	210,740,776	94.98	11,127,638	5.02
Richard B. Evans	221,578,412	99.87	290,002	0.13
L. Yves Fortier	207,681,594	93.61	14,186,820	6.39
Jeffrey E. Garten	221,662,065	99.91	206,349	0.09
Jean-Paul Jacamon	220,802,523	99.52	1,065,891	0.48
Yves Mansion	215,644,013	97.19	6,224,401	2.81
Christine Morin-Postel	219,568,101	98.96	2,300,313	1.04
Heather Munroe-Blum	221,496,089	99.83	372,325	0.17
H. Onno Ruding	221,631,732	99.89	236,682	0.11
Gerhard Schulmeyer	209,909,163	94.61	11,959,251	5.39
Paul M. Tellier	221,637,807	99.90	230,607	0.10
Milton K. Wong	221,743,136	99.94	125,278	0.06

Appointment of Auditors

- On a vote by ballot, PricewaterhouseCoopers LLP were appointed as auditors of the Company.

Votes For	% Votes For	Votes Withheld	% Votes Withheld
220,378,630	99.3	1,489,784	0.7

Resolution approving amendments to Alcan Executive Share Option Plan

- On a vote by ballot, the amendments to the Alcan Executive Share Option Plan were approved.

Votes For	% Votes For	Votes Against	% Votes Against
176,609,377	83.3	35,354,212	16.7

Item 6. Exhibits

(31.1) Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under Securities Exchange Act of 1934.

(31.2) Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under Securities Exchange Act of 1934.

(32.1) Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(32.2) Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURE

Pursuant to the requirements of the *Securities Exchange Act of 1934*, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: August 9, 2007
ALCAN INC.

By: /s/ Cesidio Ricci
Cesidio Ricci
Vice President and Controller
(A Duly Authorized Officer)

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EXHIBIT INDEX

Exhibit Number	Description
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