

Chief executive's message



An extraordinary year

2008 was a year of stark contrasts. Our business performed exceptionally well in the first nine months before being hit hard by a steep decline in commodity markets in the fourth quarter. But despite the biggest global financial crisis in generations, the quality of our business shone through and we succeeded in maintaining strong cash flow and earnings.

This encouraging financial performance was unfortunately overshadowed by a very damaging year on the safety front. There were 18 fatalities in the businesses managed by Rio Tinto, including ten people killed in a helicopter crash in Peru. Twelve of the 18 deaths occurred at new projects in developing countries and 14 of the 18 were employees of contractors.

A major review of contractor management is now under way and in 2009 there will be renewed emphasis on the implementation of Group standards and systems for safety and on the expectations and training for leaders. We have also redoubled our work on preventing low probability, high consequence incidents. On a more positive safety note, 2008 saw a welcome reduction in the frequency of lost time injuries and also of the rate of all injuries.

Market conditions in the fourth quarter of 2008 combined to send the spot prices of many commodities down to levels last seen in 2006. The unprecedented downturn and continuing near term uncertainty reflect a more negative global macroeconomic setting.

We have always said we are in a cyclical industry and our strategy is geared to this fact. Rio Tinto is a resilient business, with

low cost, long life assets that enable us to build value throughout the cycle. No less important to the Group's success is the quality of our people, who have demonstrated great skill, flexibility and drive in meeting the exceptional challenges which confronted us in 2008.

During the year, we continued to invest in new production capacity, while re-examining the timing of big capital projects to ensure that planned production levels are carefully aligned with projections of demand.

Looking to our future, the transaction we announced with Chinalco in February 2009 makes great financial and strategic sense. It is intended to position Rio Tinto to lead the resources industry into the next decade and beyond by ensuring the continuity of our strategy with the added benefit of Chinalco's valuable relationships, resources and capabilities.

How we manage for value

We are a low cost producer of the key commodities that support the industrialisation of developing countries like China. In 2007 (the most recent year for which full comparative industry data is available), 93 per cent of our iron ore production, 95 per cent of our copper and 87 per cent of our aluminium production were positioned in the lower half of the cost curve.

In the current market conditions we are implementing a comprehensive package of tough but necessary measures which take into account the short term impact on the demand for our products. These initiatives are aimed at preserving value for shareholders by conserving cash flow and reducing levels of debt.

There will be 14,000 staff reductions globally – made up of 8,500 contractors and 5,500 employees. Controllable operating costs are to be cut by at least US\$2.5 billion per annum by 2010 and net debt will be reduced by US\$10 billion by the end of 2009. We intend to cut our capital expenditure to about US\$4 billion in 2009, from US\$8.5 billion in 2008, which will of course affect many projects. In addition, more assets will be divested than those already earmarked for sale.

All projects and near term capital expenditure will be continuously reassessed in light of demand from China, the prevailing outlook for commodity prices and the falling costs of construction. In short, our aim is to make sure our businesses remain robust during a period of relatively low prices.

We have, for example, deferred a final decision on the US\$2.5 billion modernisation

of the Kitimat aluminium smelter in Canada. Instead, we plan to spend a further US\$300 million to continue the initial stages of the project; this is in addition to US\$200 million committed last July.

Rio Tinto Alcan has announced an 11 per cent cutback in aluminium production, equivalent to 450,000 tonnes of metal per year. This is being accompanied by a decrease in alumina production of close to six per cent.

The fundamentals of the aluminium industry nevertheless remain strong. Higher energy costs are raising the aluminium cost curve, particularly in China, to the advantage of lower cost producers like Rio Tinto Alcan. I am therefore confident that our aluminium operations will continue to play a vital role in helping Rio Tinto meet its commitment to creating value.

Our iron ore operations are performing well and we expect robust demand in the medium to long term. In the short term, however, a drop in demand has led to a ten per cent reduction in our iron ore shipments and to a scaling back of our immediate production forecasts. Iron Ore Company of Canada is cutting production in 2009 and expenditure at the Simandou iron ore project in Guinea is being reduced.

Our review of short term capital spending has also led us to slow exploration and evaluation at the La Granja copper project in Peru.

Meanwhile, in Australia, the Argyle diamond underground project, Northparkes Mines (copper), Kestrel coal and HISMelt® have all trimmed back their expansion activities or temporarily ceased further investment.

But the story is not only one of capital expenditure cuts and slowdowns. We are taking advantage of this period to look for further opportunities to add value to projects by redirecting our project design focus, looking at the best, rather than the fastest, solutions. Creating this breathing space gives us the time for further study to reduce capital costs, minimise our environmental impact, enhance our social contribution and shorten development timetables.

A stable financial position

The way we manage for value means our financial position remains stable. In 2008 we reduced our net debt by US\$6.5 billion. Our next major repayment will become due in October 2009 and we have available to us unused credit facilities of US\$8.1 billion, whilst our interest costs are at a very competitive rate of around 3.5 per cent.

In early 2009, we sold, for very good prices, our Corumbá iron ore mine in Brazil and two potash development projects in

Argentina and Canada.

All the previously announced divestment processes are under way and our primary objective continues to be obtaining appropriate value, in spite of some delays in the timing of the divestments.

Market conditions

The recent turbulence in the world's financial markets and the dramatic drop in the demand for our products have resulted in a massive, synchronised global slowdown.

China's growth trajectory dipped much more than expected in the fourth quarter of 2008. This may lead to a pick up in 2009 in the cumulative demand for most of the metals and minerals we produce. However, we hope to see some recovery in China's gross domestic product in the second half of this year.

In the West, anxiety in financial markets has meant falling asset values, volatile exchange rates and depressed commodity prices. The net result has been a substantial downturn in OECD economies.

Meanwhile, in China, monetary policy to dampen inflation is being loosened in order to maintain a growth rate that remains the envy of the world. The China urbanisation story and its beneficial effect on future metal markets still holds true, despite the recent economic turmoil. Fifteen years ago, only 25 per cent of the Chinese population was living in cities. Today, urban dwellers account for about 40 per cent of the total and that proportion is expected to reach 60 per cent by 2025. In other words, there will be hundreds of millions of people who will require new homes, schools, factories, offices, roads and other infrastructure.

Take aluminium, for example. In China today, consumption of the metal is about nine kilograms per capita. In Taiwan and South Korea it is about 20 kilograms. So if China were simply to attain a similar level of consumption, it would consume an additional 13-15 million tonnes of aluminium a year – the equivalent of 38 per cent of today's total world demand.

Mining is a long term industry and we still expect global demand for Rio Tinto's key products – including seaborne iron ore, copper and aluminium – to double in the next 15 to 20 years. That growth will be sustained in large part by China, along with India and other emerging markets.

So, the long term outlook for Rio Tinto remains positive. In the meantime, the Group has positioned itself to deal with the economic slowdown and to take advantage of the rebound when it happens.

Looking to future growth

Rio Tinto has a broad portfolio of projects

and our growth rate is not dependent on any one project. More than 80 per cent of our growth plans are derived from brownfield developments in established business environments. Generally, 85 per cent of our earnings come from businesses located in OECD countries.

In Madagascar, construction of the US\$1 billion QMM mineral sands operation was substantially completed on time in 2008. It represents the largest foreign investment in the country and forms part of a regional development plan supported by the World Bank. The first production of ilmenite from the plant is due to be shipped to Canada in March for processing into titanium dioxide slag. This high quality resource in Madagascar is expected to be in production for 40 years.

We are confident we can manage the risks associated with investments such as these. We are experienced operators in frontier regions, with a good reputation in sustainable development and community relations.

In the midst of the current difficulties, we are keeping our eyes on the longer term prize. Our Mine of the Future™ technology and innovation project in Western Australia remains a top priority whatever the market conditions. It is one of the world's biggest private sector trials of robotics and it will transform the efficiency and safety of the way we mine.

It consists of a fleet of mining equipment that loads and hauls ore automatically. An important step towards reality was taken in 2008 with the activation for testing of the first Autonomous Haulage System at the West Angelas mine in the Pilbara.

We have promising exploration prospects in nickel, bauxite, diamonds, ilmenite and lithium borates, plus potential expansion of iron ore resources in the Pilbara and at Simandou in Guinea.

At the heart of our long term value story is the strength of our project pipeline and our commitment to improving mining technology. Our portfolio of projects allows us to target strong production growth over the long term with the flexibility to decelerate – as we have done – when there is a pause in demand.

A new reality

We will have a difficult global economy for perhaps the next two years, during which we will have to navigate with cost cutting and debt reduction. All of our actions over the past few months are focused on communicating this reality.

That said, looking beyond the current global financial crisis, there remains good

reason to be fairly optimistic about the medium and longer term. I am confident we have the right strategy for these difficult times. Indeed it is a strategy that will serve us well whatever the future may bring.

Having travelled widely round the Group in 2008, I have seen for myself the skills, energy and unwavering commitment of our workforce. I very much regret the necessity of having to make many of these valuable people redundant and to cut back on our project development work.

Those employees who remain will make us a stronger company, a company that is able to shift more rapidly back to a higher gear when the upturn comes. It is they who make us strong and competitive, adding value for shareholders every day. I thank all of them for their outstanding contribution as we press on into another eventful year.



Tom Albanese Chief executive