Group financial performance

The Group uses a number of key performance indicators (KPIs) to monitor financial performance. These are described on page 23.

KPI	2008 US$m	2007 US$m	2006 US$m	2005 US$m	2004 US$m
Underlying earnings	**10,303**	7,443	7,338	4,955	2,272
Net debt	**38,672**	45,191	2,437	1,313	3,809
Capital expenditure	The Group's capital projects are listed on pages 29 and 30 of the *Annual report*				
Total shareholder return ('TSR')	**(71.3)%**	91.8%	7.6%	78.4%	3.0%

Acquisition of Alcan

During 2007, the Group acquired 100 per cent of the issued share capital of Alcan Inc. Alcan's results have been included for the entire year ended 31 December 2008 whereas in 2007 Alcan's results were included from 24 October 2007. This has had a significant effect on comparability of the two periods.

Net earnings and underlying earnings

Both net earnings and underlying earnings deal with amounts attributable to equity shareholders of Rio Tinto. However, IFRS requires that the profit for the period reported in the income statement should also include earnings attributable to outside shareholders in subsidiaries. The profit for the period is reconciled to net earnings and to underlying earnings as follows:

	2008 US$m	2007 US$m	2006 US$m
Profit for the year from continuing operations	**5,436**	7,746	7,867
Loss after tax from discontinued operations	**(827)**	–	–
Profit for the year	**4,609**	7,746	7,867
Attributable to outside equity shareholders	**(933)**	(434)	(429)
Attributable to equity shareholders of Rio Tinto (net earnings)	**3,676**	7,312	7,438
Exclusions from underlying earnings (page 37)	**6,627**	131	(100)
Underlying earnings attributable to shareholders of Rio Tinto	**10,303**	7,443	7,338

2008 financial performance compared with 2007

2008 underlying earnings of US$10,303 million were US$2,860 million above and US$3,636 million below the comparable measures for 2007. The principal factors explaining the movements are set out in the table below.

Changes in underlying earnings and net earnings 2007–2008		Underlying earnings US$m	Net earnings US$m
2007 Underlying earnings and net earnings		7,443	7,312
Effect of changes in:			
Prices	4,983		
Exchange rates	299		
Volumes	233		
General inflation	(336)		
Energy	(219)		
Other cash costs	(882)		
Exploration and evaluation costs (net of disposals of exploration properties)	(47)		
Interest/tax/other	(1,171)		
Total change in underlying earnings		2,860	2,860
Profits on disposal of interests in businesses			1,469
Impairment (charges) less reversals			(8,293)
Exchange differences and gains/losses on derivatives			653
Other, including divestment and takeover defence costs			(325)
2008 Underlying earnings and net earnings		**10,303**	**3,676**

The effect of price movements on all major commodities was to increase earnings by US$4,983 million compared with 2007. Prices for the Group's major traded products remained strong for the first nine months of the year in an environment of favourable economic conditions and strong demand. However, these favourable market conditions came to an end at the end of the third quarter of 2008, as significant financial turbulence led to sharp declines in the rate of global demand for commodities and in the price of most of the Group's principal products. The table below shows average prices for 2008 and 2007 and the 2008 year end price for the principal commodities for which the Group receives payments based on spot market pricing:

Commodity	Year end price 2008	Average price 2008	Average price 2007
Copper (USc/lb)	131.6	319.5	323.7
Aluminium (USc/lb)	66.0	117.7	119.8
Gold (US$/oz)	865	872	691
Molybdenum (US$/lb)	9.5	30.8	29.9

Rio Tinto negotiated strong benchmark pricing levels for its iron ore production, with effect from 1 April 2008. Agreements were reached with major iron ore customers for a 96.5 per cent increase for lump ore and 79.88 per cent increase for fines for the 2008 contract year, representing an 85.7 per cent weighted average increase. Since the beginning of the third quarter of 2008, the spot price for iron ore has suffered a decline similar to the commodities listed above. However Rio Tinto's exposure to this decline was ameliorated by its long term contract portfolio.

Contract prices for the seaborne thermal and coking coal markets reflected strong demand and tight supply.

Aluminium inventories were written down by US$185 million at the year end to reflect realisable values.

There was a sharp appreciation of the US dollar in late 2008 relative to the currencies in which Rio Tinto incurs the majority of its costs. However, the effect on average exchange rates for the year was not significant compared with 2007. In 2008, the Australian and Canadian dollars strengthened in the first half of the year and then weakened sharply in the second half such that the average exchange rate for both currencies for 2008 was within one per cent of the prior year. The effect of all currency movements was to increase underlying earnings relative to 2007 by US$299 million.

Higher sales volumes from iron ore growth projects, coking and thermal coal and the inclusion of a full year of Alcan's operations were partly offset by lower copper and gold volumes at Escondida, Kennecott Utah Copper, Grasberg and Northparkes. The overall impact of all volume movements was an increase of US$233 million relative to 2007.

The Group continued to invest further in the future development of the business with an increased charge to underlying earnings of US$530 million from exploration and evaluation costs. In line with Rio Tinto's policy, the US$483 million gain on disposal of the Kintyre undeveloped property has been recognised within underlying earnings. The net impact on underlying earnings from the change in exploration and evaluation costs was a decrease of US$47 million compared with 2007. Increased energy costs reduced underlying earnings by US$219 million. Higher freight, contractor, maintenance and input costs were experienced throughout the Group, notably in the Energy & Minerals and Copper & Diamonds product groups, as industry supply constraints persisted.

The effective tax rate on underlying earnings, excluding equity accounted units, was 31.6 per cent compared with a rate of 25.7 per cent in 2007. The increase compared with 2007 relates to the absence of the 2007 Canadian tax rate benefit, the adverse impact in 2008 of foreign exchange movements, particularly the revaluation of Canadian dollar denominated tax balances, and increased expenditure in 2008 on growth projects on which no tax relief is recognised.

The Group interest charge was US$765 million higher than in 2007, mainly reflecting a full year of increased net debt following the acquisition of Alcan. The debt under the Alcan acquisition facilities continues to incur an interest rate of 30 to 40 basis points over US$ LIBOR.

2007 financial performance compared with 2006

Net earnings of US$7,312 million in 2007 were US$126 million below 2006, a decrease of two per cent. Underlying earnings of US$7,443 million were US$105 million above 2006, an increase of one per cent. Underlying earnings per share increased by five per cent in 2007 reflecting the lower number of shares resulting from the share buyback programme in the first half of the year. The principal factors explaining the changes in net earnings and underlying earnings are shown in the table on the next page.

Changes in underlying earnings and net earnings 2006–2007

		Underlying earnings US$m	Net earnings US$
2006 Underlying earnings		7,338	7,438
Effect of changes in:			
Prices	1,364		
Exchange rates	(403)		
Volumes	516		
General inflation	(218)		
Cash costs	(442)		
Non cash costs	(201)		
Exploration, evaluation and technology costs (net of disposals of exploration properties)	(309)		
Tax/other	(202)		
Total change in underlying earnings		105	105
Impairment (charges) less reversals			(157)
Exchange differences and gains/losses on derivatives			176
Other, including non recurring consequences of Alcan acquisition			(250)
2007 underlying earnings and net earnings		**7,443**	**7,312**

The effect of price movements on all major commodities was to increase earnings by US$1,364 million. Prices for the major products remained strong throughout the year and were higher overall than those experienced in 2006: average copper prices were six per cent higher whilst average aluminium prices were three per cent higher. The strength of the global iron ore market was reflected in the 9.5 per cent increase in the benchmark price, mainly effective from 1 April 2007. The seaborne thermal and coking coal markets were also strong and strengthened further in the second half.

Molybdenum prices averaged US$30/lb throughout 2007, an increase of 20 per cent compared with the prior year.

There was significant movement in the US dollar in 2007 relative to the currencies in which Rio Tinto incurs the majority of its costs. The Australian dollar was 11 per cent stronger, the Canadian dollar was six per cent stronger and the South African rand four per cent weaker. The effect of all currency movements was to decrease underlying earnings relative to 2006 by US$403 million.

Higher sales volumes predominantly from growth projects increased underlying earnings by US$516 million compared with 2006. The ramp up of new projects in iron ore (including the Yandicoogina and brownfields expansions), higher volumes of copper in concentrate at Escondida from improved grades, higher refined copper sales from the Kennecott Utah Copper smelter operating at close to capacity and higher diamond grades at Diavik were the main contributors.

The Group continued to invest further in the future development of the business with an increased charge to underlying earnings of US$309 million from exploration, evaluation and technology costs. Higher freight and demurrage costs and increased energy costs reduced underlying earnings by US$163 million and US$82 million, respectively. Significant shipping congestion at the port of Newcastle affected coal sales with a resulting impact on costs at Rio Tinto Coal Australia, through higher demurrage and a higher unit cost of sale. General inflation and mining inflation increased costs by US$218 million and US$140 million respectively as higher contractor, maintenance and input costs were experienced throughout the Group, notably in the iron ore and copper operations, as industry supply constraints persisted.

An increase in non cash costs reduced 2007 earnings by US$201 million compared with 2006, following the completion of several large capital investment projects.

The effective tax rate on underlying earnings, excluding equity accounted units, was 25.7 per cent compared with 24.2 per cent in 2006. The tax charge in 2007 was reduced by US$392 million as a result of the impact of the reduction in the Canadian tax rate enacted in December 2007 on deferred tax provisions. The 2006 tax rate benefited from US$335 million of US Alternative Minimum Tax credits, which were recognised on the balance sheet as a result of improved prospects for recovery of these from future taxable earnings from the Group's US operations, as well as the utilisation of US$140 million of previously unrecognised tax assets.

Alcan's contribution to underlying earnings for the nine weeks to 31 December 2007 was US$424 million, including a benefit relating to the change in the Canadian tax rate as described above. Exploration divestments increased 2007 underlying earnings by US$139 million relative to 2006. A higher interest charge from an increase in net debt following the Alcan acquisition reduced earnings by US$248 million relative to 2006. These variances and the tax variances referred to above are included within the US$202 million adverse variance for 'Tax/other'.

Exclusions from underlying earnings 2006-2008

Earnings contributions from Group businesses and business segments are based on underlying earnings. Amounts excluded from net earnings in arriving at underlying earnings are summarised in the discussion of year on year results below.

Performance

Exclusions from underlying earnings 2006-2008

	2008 US$m	2007 US$m	2006 US$m
Profit less losses on disposal of interests in businesses	**1,470**	1	3
Impairment charges less reversals	**(7,579)**	(113)	44
Impairment of discontinued operations	**(827)**	–	–
Exchange gains/(losses) on external debt and intragroup balances	**960**	156	(14)
Gains/(losses) on currency and interest rate derivatives not qualifying for hedge accounting	**(22)**	34	30
Losses on commodity derivatives not qualifying for hedge accounting	**(95)**	–	–
Other exclusions	**(534)**	(209)	37
Total excluded in arriving at underlying earnings	**(6,627)**	(131)	100

Profit on disposal relates to the disposal of the Cortez gold mine and the Greens Creek silver/zinc/lead mine. These disposals were part of the previously announced divestment programme.

During 2008 the Group incurred advisory and other costs related to the rejection by the board of the pre-conditional takeover proposal from BHP Billiton which was withdrawn in November. These costs totalled US$270 million (net of tax) in 2008 and have been excluded from underlying earnings. Other charges excluded from underlying earnings comprise costs relating to non recurring acquisitions, disposals and similar corporate projects.

Of the Group's total post tax impairment charge of US$8.4 billion (which includes US$0.8 million in respect of discontinued operations) US$$7.9 billion relates to the Group's aluminium businesses including the Packaging unit.

The acquisition price of Alcan anticipated significant growth in smelter and refinery capacity, but following the recent significant weakening in economic and market circumstances, many of these growth projects have been deferred. These deferrals, together with the weak economic environment and increases in input costs, have resulted in the impairment charge. The deferral of some of these projects will be reviewed in light of the strategic partnership with Chinalco announced on 12 February 2009.

In measuring the amount of the impairment, the Group compared the carrying value of the upstream aluminium business with its value in use, assessed using discounted cash flow techniques. This follows the requirements of the accounting standards as, in the Group's view, the upstream aluminium business' fair value less cost to sell is lower than its value in use. For the purposes of the annual goodwill impairment test, goodwill was allocated to a group of cash generating units that includes both Alcan and the aluminium activities previously owned by Rio Tinto which are now managed as a single business.

The impairment charge does not trigger the covenant under the Alcan acquisition facilities, which requires that the ratio of net debt to underlying EBITDA be no greater than 4.5 times.

Exchange gains on external debt and intragroup balances of US$960 million relates to a gain of US$1.9 billion on Australian dollar intragroup liabilities, held by Group entities with a US dollar functional currency offset by a loss of US$1.7 billion on external US dollar debt held by an entity with an Australian dollar functional currency. The weakening of the Australian dollar against the US dollar, particularly towards the end of the year, led to these significant movements. The tax on exchange gains and losses includes a benefit of US$254 million through recovery of tax relating to the prior years. It also includes tax relief for losses on US dollar denominated debt. The pre-tax loss is offset by gains on intragroup balances which are largely not subject to tax.

An impairment of discontinued operations of US$827 million relating to Packaging has been recognised outside of underlying earnings. As required by IFRS 5 – Non-current Assets Held-for-Sale and Discontinued Operations, the amount of this impairment was determined by reference to the Group's best estimate of expected proceeds to be realised on the sale of Packaging, less an estimate of remaining costs to sell. The Packaging business has been valued based upon an assessment of its fair value, which is required because this business is presented as an Asset Held for Sale in the Group balance sheet. Engineered Products has also been valued based upon an assessment of its fair value, as the Group's intention is to sell this group of businesses.

In 2007 an impairment charge of US$328 million after tax was recognised at Argyle following a decline in value as a result of large increases in the estimated capital costs of the underground project. This was partly offset by the reversal of the residues of the impairments of Tarong Coal and Palabora.

Other exclusions from underlying earnings in 2007, a charge of US$209 million, mainly comprised non recurring consequences of the Alcan acquisition, including integration costs. Of this total, US$146 million resulted from the sale of Alcan inventories that were revalued based on selling prices at the date of acquisition.

Group financial results by product group 2006–2008

	2008	2007	2006
Iron Ore	**6,017**	2,664	2,265
Aluminium	**1,184**	1,097	746
Copper & Diamonds	**1,758**	3,751	3,737
Energy & Minerals	**2,887**	687	899
Other operations	**(52)**	15	33
Other items	**(337)**	(526)	(241)
Exploration and evaluation	**(124)**	20	(84)
Net interest	**(1,030)**	(265)	(17)
Group underlying earnings	**10,303**	7,443	7,338
Exclusion from underlying earnings	**(6,627)**	(131)	100
Net earnings	**3,676**	7,312	7,438