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address by

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Lessons from the GFC – The Customer is Key

Thankyou Mitch [Hooke], for your kind introduction; Good morning ladies and gentlemen

Before I begin, I would like to acknowledge the traditional owners of this land, the Ngunnawal people.

Today I want to go back to the basics. In times like these it's important to remind ourselves that where there are very few certainties, it's what we can do for the customer that counts. While we in the global resources industry deal with vast projects, and issues that appear to have a geo-political sweep sometimes, the fact is that we are in commerce, not politics. Our job is to make profits, not win votes. And making profits is very simple if you have customers and they like what you can do for them. So, fundamentally, this industry is no different from any other and that's the prism through which we need to focus.

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Lately, we've heard a lot of nonsense about the resources industry and its customers. We've heard all sorts of things about how customers, customer representatives, or entities in any way related to customers, might leverage pricing. We've heard how joint marketing structures might give rise to uncommercial advantage, how information might flow to customers, how customer interests might infect our executives, how we shouldn't get too close to them, and so on, and so on. It's all about threats, fears, frights and, taken as a whole, negatives.

You'd think that we in Australia had some sort of problem with customers. I have to tell you, that's not what we in the resources industry generally think. If the last six months has re-taught me any fundamental lessons about business, it is that when the customer disappears then I know I am in deep trouble. I don't know anybody in this industry who has a problem with customers. – our problem is how to get more of them and do more for them when we find them!

That has always been the reality in this business. More than perhaps any other sector in the global economy, the resources sector is renowned for its close and innovative relationships with customers, many of these relationships formalised through shared investments. If ever there was a period in resources where trade and investment were disconnected from the customer, I'd like to know when it was. On the contrary, the golden ages in this industry have always reflected deep and lasting relationships forged with customers and I believe that if we are constrained from forging those relationships and intensifying them in future it will be to our own regrettable and lasting cost.

So I thought today, I'd return to the basics and look at this crisis from the only point that really counts – which is the ability of our industry to identify the needs of our customers, respond to them and to work with them over time to build our businesses and deliver a fair return on capital to our shareholders.

I'll start with the term "recognition" as a general metaphor for what we see both now and in the future when we think about our customers, particularly as they are impacted by this crisis. I'll then move to a more focused theme of "responsiveness", which has to do with the shorter term reactions the crisis has forced us to make as a consequence of changes we see with our customers. Finally, and I'll dwell on this for longer, there is the broader theme of alignment with customers , and especially the importance of strengthening our alignment with customers as we move from the crisis and plan for growth over the longer term.

Recognition

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Rio Tinto recognised the awakening of China, and the gradual emergence of Chinese customers, early. Indeed, when I was a young executive my immediate predecessor in this role, Chris Renwick, was then involved in one of our Group's first visits to China - well before the era of ping pong diplomacy with the West. We sustained and multiplied those initial contacts, which ultimately spawned the Channar joint venture agreement in the Pilbara, China's first major offshore investment in the 1980s. The significance of Rio's role in attracting a Chinese SOE to invest in the Pilbara was recognised as a breakthrough at the time, attracting the patronage of the then PM, Bob Hawke, and his Chinese counterpart, General Secretary Hu Yaobang.

The investment reflected the long-term time horizons of China as a customer, focussing on supply in decades ahead, and of Rio the producer determined to focus China on the Pilbara early, locking in trade with investment, before there was a chance that Chinese customers might stray. Ultimately this was an extremely positive development for Australia.

Rio Tinto's lengthy history in dealing with China underpins our long-term confidence in that market, and provides us with the confidence to maintain our expansion plans in the Pilbara and elsewhere.

Our long-term confidence remains, despite the short-term shocks of the recent past. For instance, the extraordinary volatility we saw in November last year, when Australian iron-ore exports fell to 19.42 million tonnes from 26.4 million tonnes, was almost matched this March when iron-ore exports rose 19.6 per cent on a month by month basis.

Will it be a "V" shaped recovery, or a "W"? We think it's too early to say. The signs are unclear. What is unshakeable, however, is our belief that China, and India and the other emerging economies, will be the key engines to any return to world growth and commodity demand growth. This represents an outstanding opportunity for Rio Tinto and Australia.

Signs of improvement are present in recent data on China, and if such improvements continue with additional recovery in exports and housing, then we can call it a sustained recovery.

What we have seen so far includes:

- Faster- than-expected growth in credit after the Chinese authorities dropped restrictions on loans in November last year
- Increased sales of automobiles and residential property – sales of China's domestically-made vehicle set a record high of 1.15 million units in April, up 25% from a year earlier
- Investment in factories and property climbing 30.5% in the four months to April end from a year earlier.

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India's longer-term outlook is very robust as its industrialisation accelerates, leading to increased demand for most metals and minerals. This outlook is further supported by a new class of consumers, and a growing working age population.

While India has not been immune from the global economic crisis, it has fared better. It is structurally better positioned that some other economies due to lower household and external debt, lower dependence on exports, higher investment rates, and its demographics. With the elections now out of the way, and the Congress party back in power winning a larger than expected number of seats, we may see more focus on the immediate needs of recovery there. Indeed, there is a very valid comparison to be made with China in one significant respect - they are the two economies that can boast both a substantial iron ore production ability as well as an iron ore consumption capacity.

To sum up, the current downturn has underlined the importance of these new powerhouse economies and our relationships with them, especially as we rely on them to pull us into a viable recovery and sustain that recovery thereafter. But the current downturn also underlines how much we depend on these new customers. For its part, the Japanese experience gives us a salutary lesson.

As China was emerging as a customer in the 1980s and 1990s, Japan, meanwhile, was maturing as a customer, and perhaps through our own inability to change the way our businesses were run, our industry made the mistake of taking them for granted. Despite the role of Japanese customers in providing the long-term contracts on which the Australian resource industry financed itself, the Australian producers' inability to resolve their industrial relations issues through the 1970s and 1980s severely impacted their reliability of supply. Japanese customers subsequently went off to Brazil to hedge their bets by underwriting the expansion of production there – subsidising the freight on what should have been an uneconomic distance to transport the ore.

Later, Japanese customers were naturally concerned when Rio acquired a majority stake in North Limited, and with it Robe River and a number of other valuable businesses. There was a serious concern among Japanese customers, who were also joint venture partners in Robe, that Rio would exploit newfound market strength to impact supply and demand in its favour, against the customer. The natural opportunity to work together through the joint venture machinery in the Robe joint venture assuaged those concerns and an increase in volume to Japan through Robe took place. The outcome was to expand Australia's output without any undue threats to prices or returns on investment.

In one situation, we failed to satisfy our customer, who went elsewhere to our cost. In the other, we understood our customers' concerns, we worked closely with them with the help of the minority interest representation in our joint venture agreements, we maintained security of supply through sound work practices, and we increased volumes to our mutual benefit.

Responsiveness

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I'd like now to talk about the extraordinary market conditions of the last few months and how we have worked with our customers to get through it.

First, I'll talk about Rio Tinto corporately; then move to Rio Tinto Iron Ore.

Irrespective of the global financial crisis, Rio Tinto has the need to reduce debt – the economic deterioration hastened the desire to do so – quickly and prudently. To maintain the integrity of our customer relationships and our business in a highly capital intensive sector, we need a strong balance sheet. Working towards this has meant reducing global employee numbers as well as significantly reducing expenditure. We have re-assessed, deferred and even abandoned some developments underway. In some case the driver was reduced demand, in others we had to take account of the new pressures on cash flow, and delay good projects that could be picked up later as customer demand recovers.

Capital expenditure across Rio was reduced this year from US$9 billion to $4 billion, and possibly less next year depending on market conditions. In addition, we widened our list of possible divestments and have made some progress in the face of severely impaired funding conditions.

Now, let's talk about iron-ore. Most of the industry will have its war stories about what happened when we collectively went over a cliff in the December quarter of 2008. Rio Tinto's response in iron-ore was to take an early interpretation of what we were seeing and act upon it decisively -, urgently revising shipping schedules, and adjusting production and sales forecasts. We placed some assets on care and maintenance. We looked for some "silver linings" and found them by re-configuring projects around new time frames produced by the crisis – this also allowed us to take advantage of reduced input costs.

Our response has enabled us to:

- Keep our major growth projects ticking over so we can bring them back to full development when the recovery is sustained
- Shift our production plans quickly to respond to immediate movements in customer demand
- Ensure that prices clear the market, and respond to shifting conditions.

I might add that flexible and dedicated rail and port infrastructure has allowed us to calibrate our supply system to short, continually changing demand conditions during the crisis. We can only imagine what extra impacts would have occurred if we had been required to additionally manage third party complexities on our integrated system.

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We were ready to expand again, the instant we contracted. I'll explain this: few people appreciate that China produces more than 300 million tonnes of its own iron-ore each year, almost half its considerable requirements. The crisis has enabled more efficiently produced tonnes from outside China to displace higher cost, lower grade tonnes produced within China. Implied Chinese domestic concentrate production is currently down 140 million tonnes from June 2008 levels at current spot prices of US$60 per tonne.

Absent the crisis, we predicted this development as China modernised over time, and were planning for it in our expansion thinking. But the crisis has brought it on much earlier – in that sense it has provided Rio Tinto, and Australia, with tremendous opportunity we must be careful to maximise. The crisis is accelerating global trade responses from an outward-looking China – and the Australian industry is the beneficiary.

The Rio Tinto Iron Ore experience is instructive for Rio Tinto as a whole: Rio Tinto has a fundamentally positive medium term view of its markets and the future needs of its customers. Moreover, we have the assets, reserves and resources, infrastructure and capabilities to respond to a resumption of customer demand growth. As their demand for basic resources grows, we grow with them.

So, what does my world look like today? I can tell you that we are aiming to be as close to our customers as we can be. We are going flat out right now – but safety remains our first priority. Our expansion plans to 320 million tonnes are "at the ready". The project is at an advanced engineering and review stage and can be readied for approval at short notice should markets together with our capacity for reinvestment improve.

The Iron Ore group still has a significant amount of capital expenditure funds allocated to it (in fact $2 billion this year, half of the Group total). We are using this capital to ensure we retain our growth options for recovery. With Rio Tinto's 40 year mine plan we cannot allow the short run vagaries of the market determine all of our activity – that means that we retain an active mine automation program, and active expansion and exploration programs to find new reserves and resources to add to our base.

It is one thing to be the pioneer developer of the great Pilbara iron-ore province – it is another to keep it going efficiently, remaining well-placed to respond quickly and systematically to the needs of our customers.

Alignment

I want now to conclude this address where I started – which is to deal with the relationship between the resource industry and its customers and the challenge for global producers to be well aligned with their customers and their needs.

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Customer alignment is a world apart from pricing. Common ground in terms of prices will always be temporary and reflect merely the best possible for the parties at a particular time. Rather, real customer alignment means working within an agreed set of principles and institutions that drive towards sensible outcomes. These principles will evolve over time, but they must do so in a way that ensures ongoing alignment between customers and suppliers.

Historically, Rio Tinto, BHPB, the North-West Shelf participants, for example, have all been involved with customer partnerships. Every phase of development of Australia's iron ore industry has been built on these relationships. In Rio Tinto's case, Japanese trading houses, acting as steel mill customer representatives, were involved in many of the early joint ventures. Rio's major Japanese joint venture in the Pilbara is with the Robe joint venture, which in turn provides Japanese investors and customer representatives with exposure to Rio's rail and port system, together with some its mining operations. Rio is also proud to have pioneered the participation of China, through the Channar joint venture.

If we look further afield, we see the same pattern in other countries where the resource industry has prospered.

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The development of the massive Escondida copper mine, in Chile, was based on investment from customer countries and customer representatives. The global LNG industry has grown on the back of deep customer relationships.

You would all be aware that BHPB, as well, has downstream joint venture partners across all of its Pilbara operations, including JVs with Chinese State-owned enterprises. For instance, all of the Chinese partners in the highly successful Wheelarra Joint Venture are either Chinese State-owned or have major State ownership.

This is precisely as it should be – history shows us that when customers, customer representatives or companies with strong networks to customers are involved in major resource developments, the resulting trade with those customers grows and prospers.

Indeed, one of the strategic attractions of the proposed Chinalco transaction is exactly that it involves Rio's and Australia's now major market for iron-ore, potentially deepening relationships with customers through Chinalco's networks.

One of the concerns raised, for instance, is that any tie up with a major Chinese corporation and Rio might see Chinese interests moving to develop deposits offshore over deposits in Australia, courtesy of the global reach of the partnership with Rio.

But in fact the reverse is the case. The assets proposed for the iron-ore joint ventures are located in the Pilbara – more than proportionate volume growth can be expected out of them and this will accrue to both Rio and Australia. In this sense, the Chinalco deal will replicate the pioneering Channar joint venture, and skew trade towards Australia on account of the investment here.

The other concern of course, is with control or “influence”. Here I think we need to get a grip and look to the history of our industry and the commercial culture that dominates it. In Rio Tinto Iron Ore and elsewhere in the Rio Tinto group, there are more than 40 joint ventures, nearly all of them with customers. It beggars belief that anyone can object to this now in 2009 – on the basis of some principle entirely new to this industry – after nearly 50 years experience both here and internationally which has shown definitively that companies can have close and productive relationships with customers and at the same time maintain commercial independence.

Moreover, for both Rio Tinto and BHPB, this solid rump of experience now includes Chinese SOEs – to the enormous benefit of both companies, the future of the Pilbara and for Australia as a whole.

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Finally, we are receiving right now palpable benefits from our deep alignment with customers, especially in China. You’d normally expect in a downturn that preference would go to the local producer – they’d get the first cut at volume, even if they are not necessarily as efficient. But as I said before – this is not our experience – we are seeing displacement of Chinese production to the benefit of the seaborne producers exactly when we need it.

There are lessons for Australia here from the micro-economic world. Australia has the same choices: to encourage recognition, responsiveness and alignment with its customers. Australia’s relationship with its customers has underpinned its economy for many years, and giving customers a reason to develop resources elsewhere in the world would spell disaster in the current circumstances. We need their demand and we need their investment.

Customers can go elsewhere – as we have seen it in the past. Australia, and we the producers, recovered that mistake, although not before Brazil was established as our competitor. This is a time to recognize that trade and investment go together in resources and to position ourselves accordingly.