

Rio Tinto 2014 Full Year Results Q&A transcript

12 February 2015

SAM WALSH (Chief Executive):

Now if we could move to questions, and if I could get you to provide your name and organisation, I'll take three in the room and then I'll take three from the phone, and I'll just sit down so that I am not standing over you. And tradition has it that Rob Clifford is first so, thank God, you have come through Rob.

QUESTION:

Thanks Sam. I've got the blue tie as well. Just a question on the mechanics of the buy-back, can you talk about – and this is the 'on-market' buy-back – the timeframe that you're planning to do it, who is managing it, what are the price limits, is it going to be done weekly, what are the mechanics around that?

And just secondly on the buy-back, when the Board sits down in a year's time how do they think about the ongoing nature of the buy-back in terms of sizing it and matching that with capex requirements? How can you be confident about it being ongoing in nature in terms of the additional returns?

SAM WALSH:

Okay, let me answer the second part and, Chris, if you can help me in a moment with the first part.

In relation to the process that the Board goes through in relation to assessing shareholder returns and analysing the progress of the business, both current and forward, let me assure you it is a very robust process and it's something that the Board is very interested in but also takes it very seriously with input from a range of areas.

We've had the tradition in recent years of reviewing that around this time each year and that's really what is going to continue. But importantly what we are providing at this early point in the year is a strong balance sheet with a debt/equity ratio of 21 per cent which depending on how the business flows through this year will give the Board serious options to consider this time next year.

But we are very early in the year, it is a volatile market. Chris and I believe we have taken leading action in terms of our cost reduction activity, refocusing our capital and really putting the business on alert that, yes, the year is going to be pretty tough for the industry but we are entering the year in a very, very strong position, a very strong balance sheet with real momentum.

I have talked before about this, there is a pendulum and it's moving, it's underway, and the organisation is very focused on delivering the improvement that we started and it's not a one or two year journey, it is going to be over time. But it's a very strong business.

Chris, if you could help us with the mechanics of exactly how the buy-back is going to operate hour by hour?

CHRIS LYNCH (Chief Financial Officer):

Thanks Sam. First up I think the off-market buy-back in Australia is probably the first thing to talk about. It has a defined timeframe; we're announcing it and that will run the course. It will be completed within April, so the cash flow to that is US\$400 million, is the sizing of it – we reserve the right to go up and down – but the target is \$A500 million, and

roughly the ratio is basically in the ratio of DLC components of the PLC and the Limited stock.

So the first 'cab off the rank' – well, in the first half of the year the off-market buy-back in Australia will take place and we'll spend about \$600 million on the PLC buy-back during the first half. But the intent is that the \$2 billion will be spread throughout the year, and it will be done on that basis, and we have a series of different methodologies for achieving that, but it is basically 'stand in the market' in the PLC stock and the off-market in Australia.

We will probably flesh this out over the next few days as we get a bit deeper into the conversations, but the capital sum assigned to whatever the buy-back price ends up being is \$9.44 for the Australia off-market buy-back; the remainder will be what the Australian jurisdiction deems a deemed dividend, which will be fully franked, so the way the mechanism works that's what allows people to bid at a discount to the market price. So there is a discount available usually in those off-market buy-backs.

So the first 'cab off the rank' off-market in Australia and commensurate with that will be about \$600 million in the PLC stock for the first half.

SAM WALSH:

Thanks Chris. And if we could take the next question in the room, perhaps Jason, but everyone will get a chance.

QUESTION:

Maybe a simple question, Sam. You mentioned your colleagues in Minerals and how they are doing some work to sort of match capacity production with the market demand for that product. Maybe the bigger question for Rio Tinto is iron ore - you are one of the world's largest producers - to what extent do you feel a responsibility to play a role in balancing supply and demand for iron ore?

SAM WALSH:

If you look at supply and demand for iron ore it really hinges on the marginal producer and we have seen that prices have dropped substantially during 2014. If you look at 2015, we are expecting that about 100 Mt of new capacity will come on, there will be growth in demand of about 20 Mt and there is around 80 Mt of capacity that is likely to come off - if you look at their cost of production and their ability to respond, they are underwater.

Beyond that, there is about 80 Mt that we would describe as being at risk. Now these are people that are currently underwater but they have got the option of reducing costs and making the improvements to keep their business afloat. Now I know there are some people hanging on by their fingernails and some of them are burning the furniture and reducing expenditure on maintenance and sustaining capex and firing Board members and all sorts of things. You can only do that for a certain time and sooner or later you've really got to recognise the reality of life.

As we've just mentioned during the presentation, if you take the current spot exchange rate and the spot energy price into account then the Iron Ore business costs are running at around \$17 per tonne cash cost, and that's compared to the selling price today of \$62 a tonne, so there is a significant margin there for us, and you saw the volume effect as Chris went through the numbers. The impact for our business is substantial.

But, as I have said before, if you want to balance the market then you can't just take off 3 or 5 Mt and expect that suddenly the price is going to go through the roof. You have actually got to take off sizeable chunks, probably 100 Mt of capacity and guess what happens when you take 100 Mt off? Well, the price goes up and all those people that went out of the market come back into the market and, guess what, the price gets back to

where it was and, whacko, we would be down 100 Mt. That's not in the best interests of our shareholders.

So whether you like it or not there is no OPEC in iron ore, it's independent producers making their independent decisions, and the decisions we make are in the best interests of our shareholders. That's very, very important.

QUESTIONER:

Sam, sorry, can I put words in your mouth?

SAM WALSH:

I don't know; it depends what they are.

QUESTIONER:

So as the low-cost producer you don't feel any responsibility to balance supply and demand in iron ore?

SAM WALSH:

No. Look, these people when they came into the market didn't phone me up and say, 'Jump for joy, I am going to bring on some high-cost production'. So I don't feel any – any – responsibility for them. Now yes, I am sad for employees and communities and so on, but people need to realise that the mining industry is cyclical, it goes through cycles, it's supply and demand, it's seasons, it's a whole raft of things, and importantly people need to plan accordingly and that's why we focus on Tier 1 assets, that's why we focus on having the most competitive businesses in the market. That's what it's all about.

Now the good news is, yes, you go through the cycles but if you look at the long-term picture the world is going to continue to develop, urbanisation is going to continue to happen. China, a huge market, yes, we are seeing it more resembling a developed country rather than a developing country with growth slowing from 7.4 per cent last year to around 7 per cent this year but the base is much, much bigger.

And this morning we woke up to read that India has now passed China in relation to growth. And before you tell me, Sam, there is a bit of services and tertiary industry in that growth, yes, there is, but we are also seeing the fundamentals increase for steel production and iron ore as urbanisation, industrialisation, consumerisation takes hold in India.

Beyond that there is Asia, Middle East, Africa, South America, as the world continues to develop. So the long-term fundamentals for our business, whatever the commodity is, is very, very sound but it is a cyclical industry. How do you cope with that? You make sure you're Tier 1 and that's why I made the comments that in these times Rio Tinto thrives because of our low-cost position.

We had a question just in front of you, Jason.

QUESTION:

Two brief ones, the first is on copper. You talked a lot about creating options for the Board but the options in copper seem to be quite long-dated or progressing very slowly. Is there anything you can do to push that business a bit harder or make it look differently because 2015 is clearly going to be quite a tough year, to say the least?

And then secondly, on steel consumption in China, Rio Tinto has always been very resilient or confident - some would say stubborn - in its views that a billion tonnes of steel is going to be consumed in China. What gives you that continued resilience despite last year being quite a tough year for steel consumption?

SAM WALSH:

In relation to copper, of course we have our existing operations: we have Kennecott Utah Copper; we have the OT open-cut operation, which some people forget is operating and operating well; we have our tonnes at Escondida and the availability of tonnes out of Grasberg depending on their production; and we have got the OT underground project; La Granja and Resolution are all in the hopper.

OT underground: we have put our best and final offer to the Government of Mongolia in November and they are currently considering that. There have been some positive moves in relation to a number of shareholder issues, there has been resolution of some operating constraints, for example in relation to water availability for the project, and also the provision of third-party power for the project. So there is progress and we are patient, it is long-term project, we need to get it right, we are not about to rush this and jeopardise the long-term future of the project.

Resolution, the land swap, which went through the US Congress just before Christmas, that was a significant move for that project and provides us with full optionality in relation to how we develop that project. Yes, it has got to go through a range of environmental and other governmental approvals but work on that development is continuing, as with La Granja.

In relation to the billion tonnes in China, that is still our forecast, that China will reach a billion tonnes of production by 2030. That requires 1 per cent growth per annum and we believe that is eminently possible when you look at the fact that China's current urbanisation is around 54 per cent and we expect that it will move to 70 per cent, and everything we are hearing from China indicates that urbanisation process is still underway.

Now, importantly, growth in construction is continuing in the Tier 1 cities. In the lower Tiers, yes, we have seen a surplus of real estate and a lot of people are focused on that, but the demand for high-grade iron ore continues. And not only is the issue of urbanisation/industrialisation an important issue for us but also the issue of improving pollution in China - this is smog - this is an increasing issue for the people in the major cities in China and improving the grade of iron ore is actually going to help it improve the efficiency of their anti-pollution measures.

Now do we have a question on the phone line?

QUESTION:

Hi Sam, it's a question just in regard to the working capital release. It was a great job in 2014 releasing that working capital to boost the cash flow. Can we expect a further sort of boost to cash flow from working capital release this year?

SAM WALSH:

This is a very pet project of mine. Look, I see Chris there and Chris sort of wants to get in and answer this, so over to you, Chris.

CHRIS LYNCH:

Thanks Sam. We do talk quite a bit about this internally. But if you go to the \$1.5 billion reduction, about \$400 million of that was to do with the price effect on receivables, the rest of it was all about the inventories and the overall discipline, and we've been keen to get after this sort of idle capital. Basically any dollar that we tie up in working capital unnecessarily is a dollar that we can either put to work in growth or give back to our shareholders. So that's been the focus.

It is really saying that this stuff, unless it's actively promoting a different revenue outcome, then why do we have it, why do we have working capital, why do we have idle capital, if you like, on the balance sheet? So there is liberation of \$1.5 billion. Yes, \$400 million odd was as a result of lower prices but the rest of it is all about making sure we collect receivables, making sure we have the optimum levels of inventory. That's been a lot of hard work, across the business the guys have all had a red hot crack at this.

Now we do think that there is more scope, obviously not at that sort of level, but we are actively after it again on a continuing basis. So we've not going to stop here but we do want to make sure that inventories wherever they occur are optimum. If you think about a business like ours you can think about product inventory, but equally we have got to have a good hard look at warehouse inventories as well, what's on the input side into our process is still capital tied up in that area as well.

So we have got opportunities to attack it on a variety of fronts, it's a lot of hard work to get further reductions from where we are, but we are actively after it and we have got people charged with delivering that result.

SAM WALSH:

Thanks for that, Chris. Those of you that know me well, will know that I started my career in the car industry that introduced 'just in time'. Now whilst there are differences between mining and making cars – well, I have noticed – the same sort of philosophy can be applied but it takes a different mindset, it takes breaking 140 years of that tradition, and it's a journey that we need to go through. But, as Chris said, we both been very, very pleased at the work during 2013 and 2014 with a total of \$2.1 billion being reduced out of working capital and, as Chris said, there are other opportunities.

Of course, it's outrageous and totally unbelievable when I say that if I can buy a book and Amazon can deliver the next day, why do we even need warehouses? Now I'm being a little bit cheeky there in terms of saying that because we operate in a lot of remote locations, but it is a different mindset, we are in 2015, not 1873, and you need to take advantage of that, you need to take advantage of improved communications and improved logistics. The Operation Centres actually help us in terms of being able to integrate the process of maintenance shuts and schedules and ensuring that everybody actually understands which widget, which rotatable, which spare you are going to need when.

Let's take another question from the phone line. I will just take two more from the phone, but I will be back, don't worry.

QUESTION:

Thanks very much. Look, Sam, I just wanted to ask you a question about slide 17 where you have projected capex out to 2017 and reduced, I guess, the ceiling to around \$7 billion. It looks as though that has largely come from the 'yet to approve' section and I am just wondering whether you could provide a bit more colour about why, I guess, the 'yet to approve' projects have come down?

And then, I guess, a further question on that slide, it talks about comparing projects to a buy-back and I am just wondering exactly how you do that internally? Thanks.

SAM WALSH:

Okay, I will let Chris describe how we compare projects to the alternative of buy-back.

But in relation to the capital, if you look at the reduction for 2015 we have indicated with capital that was going to be around \$8 billion we are now indicating less than \$7 billion. If you can get the full flow through, the full effect of exchange and oil prices, then that accounts for about \$450 million of the reduction.

The balance of the reduction is actually looking at timing, streamlining projects, value-engineering work which is underway with South of the Embley and the Zulti-South

and OT and other projects. So part of that exchange effect will actually flow through if exchange rates stay where they are in subsequent years.

There are a couple of factors there and of course we are always looking at improving the way that we actually develop our projects, recognising that we are seeing a whole range of input costs, labour and materials that have actually also reduced. It is one of the things that flows through from, I guess, people being more focused on capital that you actually see capital costs go down and certainly we are seeing it not only in the minerals industry but we are also seeing it in oil and gas, that the heady days of all these projects are coming to an end and it's important we actually take the benefit of that as we go forward.

Of course the other answer in relation to that is the importance of being prudent in terms of our cash management and our balance sheet as we go forward and that's something that we consider important in terms of being ahead of the game, in terms of recognising that the market fundamentals in the near term have actually changed.

Chris, would you like to comment on the comparison of projects versus buy-backs?

CHRIS LYNCH:

Yes, thanks Sam. Look, in simple terms it is really a function about what cash flow stream that you are buying, whether it's an investment in a project or a buy-back, and we will always have a view about the future cash flows, and in the case of a buy-back you look to the future cash flows of the entire company and make your judgments about that against that background.

I think one point we haven't sort of talked about in the presentation and all those sorts of things, but the efficiency of some of our processes have increased substantially, internal processes for review and the like, and we are a whole lot more onerous and rigorous about making sure the projects are ready to go when they come through for approval. There are some things that I would much rather spend three or six months longer making sure that we are as well prepared as we can be before pulling the trigger on a project rather than sort of going off early and having consequences at the later stages when spending can get out of control in that regard.

The other point too to make in regard to the reduction in some of the numbers, Sam referenced the point about the currencies, and I think the other one is the same cyclicity that driving some of price outcomes that we are seeing is also driving the capital construction cost dynamics as well, so you can get a lot more 'bang for your buck' in this sort of market than was the case back in very hot markets for those sorts of assets.

So we are saying it is not just a resources issue, it's across-the-board, and if you go to the oil and gas industry, I think you are going to see some fairly significant reductions in that area pretty quickly, and the US shale is probably the most obvious example there where the response can be a bit quicker than perhaps the routine offshore oil.

But in answer to your deliberate question about how do you measure buy-back, well, it's against the future cash flow stream that you are buying and what you pay for it, and that's your return, so that you can get a number on that. We don't publish that number but you can get a number on that quite easily.

SAM WALSH:

Thanks Chris. We will have one more question on the phone.

QUESTION:

Hi Sam and hi Chris, my question is directed at Chris and it relates to franking credits, which must be the greatest under or unvalued asset in the entire Group. Chris, could you walk me through what you thinking about franking credits and their core value, what your thoughts are on the recent precedents and developments in Australia regarding releasing the core franking credits, and how to keep that issue going forward?

CHRIS LYNCH:

Thanks Peter. Obviously franking credits are a well regarded asset in the Australian environment; they are probably not as well understood actually in the UK, so maybe just a little bit about them. Basically in the distribution of a dividend in Australia, you get a tax credit with that dividend on the basis that the company has already paid tax before it declared the dividend in earning the profit, so as long as you paid corporate tax on the way through earning that profit, when you come to distribute the dividend, the dividend itself in the hands of the shareholder can carry a tax credit with it.

Our dividends in the Limited stock are all fully franked and by fully franked it means they carry a 30 cent tax credit with them. And the off-market buy-back in Australia allows you to utilise some of those franking credits because the nature of the off-market buy-back allows – this is complicated but it's worth taking a bit of time to try and explain it – it does allow people to bid at a discount to the market price to sell into the tender and the reason they can do that is because we have an agreement with the Australian tax office about the allocation of whatever the purchase price ends up being between capital and a deemed dividend.

The capital in the case of our buy-back is estimated to be \$9.44 per share, so the remainder of the buy-back amount that's ultimately tendered will be a deemed dividend and it will carry with it a deemed franking credit. That franking credit is what allows people to bid the discounted offer into the tender.

Now what Peter is referring to is some recent activity in this area in Australia. Peter, I presume you are talking about the Tabcorp issue just recently, where I haven't seen the full details of this so it is a little bit difficult to sort of get too far away from it. But Tabcorp here in the Australian jurisdiction have done basically an accelerated renounceable entitlement offer, a form of a rights issue, and their proceeds from that will be basically, as I understand it, a special dividend with a franking credit attached to it. Again, I haven't got all the details of that and I haven't seen the tender booklet and so on, so it would be imprudent to sort of get too far into that.

In our own case, we have got to be a little bit circumspect about that sort of mechanism because we have the issue of the DLC structure which requires equal treatment of both ends of the DLC, so if we were to pay a dividend in Australia, a real dividend in Australia, we would have to have either the same dividend or some form of matching action in the PLC stock, and that's a significant difference for us with the DLC structure versus someone who is just in a Limited structure.

We will get a chance to talk more about that offline, Peter, but I think that's the short answer. So in terms of what are we doing with the franking credit balance, we do have a significant franking credit balance, clearly the dividend in the Limited stock will be fully franked and the off-market buy-back will be another utilisation of some franking credits that will go to benefit the price we ultimately pay to buy back the stock.

SAM WALSH:

Thanks Chris. Thanks Peter. Let's come back into the room, in the centre there.

QUESTION:

Thanks Sam. I just want to talk a little bit about Aluminium; you are actually earning more EBITDA and net earnings from Aluminium than you are from Copper. The Aluminium Group has never been worth more to you now as a group since you bought it. How sustainable do you see the earnings within that Aluminium portfolio are and what do you think the dynamics are of expanding your bauxite and alumina exports into China? And, at the same time, China was recently exporting a significant amount of aluminium products to the rest of the world, does that have the potential to harm the earnings of the smelter portfolio?

SAM WALSH:

Thanks for the question. I mentioned during the presentation that we have seen significant improvement in the Aluminium business and I guess everybody is now seeing it. In 2012 we made \$50 million in net earnings in Aluminium, in 2013 \$550 million, and this year \$1.25 billion, so a very significant journey, and Jacynthe, followed on by Alf, have taken \$800 million of cost out of the business. We have taken 700,000 tonnes of metal out of our production; we have shut/curtailed/sold businesses; we have renegotiated our contracts, a whole raft of activities.

If you look at the metal business, when Kitimat comes onstream – the Kitimat modernisation, expansion, whatever you want to call it – around 80 per cent of our businesses will be in the first quartile. That's a very strong position for us in metal.

In relation to alumina, alumina continues to be a tough business and clearly there is a lot of work underway at Queensland Alumina, at Yarwun, in terms of improving our cost base there. And we have indicated by separating our bauxite and alumina earnings for the first time this year that the alumina business lost \$200 million last year. So a lot of focus, a big spotlight, and we are working to improve that business. We did take action last year to curtail the Gove refinery and action like that is actually improving the bottom line of the alumina business.

In relation to bauxite, bauxite continues to be a very prospective business for us with the increase of export capacity from Gove, from around 6 Mt to around 8 Mt of export. With its infrastructure that means we are having to ramp that up during this year with new conveyors and handling systems.

The South of Embley project, we have approved the study funding recently for the full feasibility study and we are expecting that the full project will come into the Investment Committee and the Board later this year. There is some preliminary expenditure that we are looking at to ensure that we will hold the timing at 2018 for that project. And there is further work underway, small bikkies, in Guinea at the CBG project looking to have a small expansion there to match port capacity.

So in terms of sustaining the business there is a lot of work underway in bauxite and primary metal to continue to improve that business and to continue the journey. In alumina it's special effort to get that business back to positive earnings.

In relation to the trade-off, do you supply bauxite or do you hold back and hope that will mean China and elsewhere will reduce their exports, well, our view of that is one way or another the bauxite will be supplied and we are in the ideal position with proximity to China, out of Weipa, to actually supply that material to them - if we don't, it will come from somewhere else.

South of the Embley is actually one of the most attractive projects that we have got. So it is something that is of particular interest to us, it is something that we will continue to progress and by having 80 per cent of our aluminium metal business in the first cost quartile that keeps us in a very strong position going forward irregardless of what may happen in China.

Let me just close this item off by saying you have also got to look at the long-term prognosis for aluminium in China, that currently they are using a lot of stranded power and what better than, whacko, build an aluminium smelter and that will provide jobs and provide other business opportunities.

But as China moves to a more consumption-led economy, and during the past year it moved from 34 per cent consumption to 48 per cent consumption, which means households are buying refrigerators and washing machines and air-conditioners and every electrical gadget known to man, they are going to need that power and there will suddenly be a huge draw on that power as the middle-class in China increases and having bought the fridge they want to be actually able to turn it on.

So there is a shift there, and for those who say, 'Sam, you are dreaming', just have a look at what happened in Japan. Japan prior to the 1970s had an aluminium smelting industry and exactly the same thing I am talking about happened there; today there is not an aluminium smelter in Japan. Over time the same thing will actually happen there (in

China), so there will be a transition and that will limit their ability to supply domestic requirements of aluminium, so they put it actually into the refrigerators and washing machines and everything else.

Okay, another question in the room. We have one just here, and everybody will get a chance.

QUESTION:

Two quick questions coming back to the themes on the financials, with capex you mentioned that you have got your sustaining capex down to \$2.5 billion, and that seems a pretty significant reduction from 6 months ago. I was wondering, you mentioned the \$450 million of flow through that can come from FX and other things, but I was wondering if you can give us some colour around how you have managed to reduce that so sustainably?

And then on the working cap, obviously at Half Year and at the Investor Day you talked a bit about looking at working cap reduction, more long-term with respect to Japanese auto industry 'just in time', and obviously that's a multi-year process and not a monthly process. With respect to that, did I get it right that you said you freed up \$470 million of capital from Diamonds alone and does that imply that you are going to be making, that there are also significant gains to be made in other divisions, or it is just there was more opportunity to free up capital in Diamonds & Minerals?

SAM WALSH:

Chris, can you help me with these?

CHRIS LYNCH:

First, Tim, regarding the sustaining capital, we have talked consistently there is a currency effect, there is a value for money effect, currently being able to bid far more aggressively and more competitively so we have that aspect.

At the start of any year if you went into any one of the businesses they have a long laundry list of projects that they would have some inkling or some intention to do either this year or on their work agenda for some sort of time period that would be relevant to that scale of business. Probably at the end of any year about 50 per cent of that has been done and the other 50 per cent has been displaced by other things that became maybe either near term, more pressing, or that emerged as a better thing to do than what was originally in that sort of mindset, if you like.

So where we are now is to say, yes, we have had questions - can you manage this as tightly as you can? - and we have had the response and the like. We have also had improvements in productivity, so some of the sustaining capital will go into things like fleet and that type of heavy mobile equipment, and for that again we are getting better life, we are getting better time between refurbishment, or meantime to failure is getting longer and the like. There is a raft of things where improvements are going on to help you with the thing, so currency, more 'bang for the buck', and better practice means less demand on the sustaining capital.

With regard to working capital, the cash release from Diamonds & Minerals - so that's not just Diamonds, it is Diamonds & Minerals business - it has been significant but they did have quite high inventories relative to the scale of their business, we have been actively working to reduce that, Alan and his team have been on that for sometime now, and for that sort of activity the opportunity varies across the patch.

But we still got, for instance in iron ore, product up at the mine end of the infrastructure chain which has been bulked out, that once we have got capacity to be able to move that down the infrastructure chain and get it available to a port, then that can be further reduced by way of example.

If you go into the smelting businesses, there is probably less opportunity in there, in the aluminium smelters side of the house.

We have been able to achieve a fairly significant reduction in Mongolia, by way of example. Earlier on there were some concerns on difficulties about actually permitting to ship the production. We have been able to reduce that, get that inventory down a totally normal level now, so if you look at the data for Mongolia we actually shipped slightly more than we mined during the course of the year and that's the result of moving down that inventory.

So there are opportunities across the patch, and I mentioned earlier and Sam probably mentioned earlier, about the whole area of warehouse inventories and the like. We are not going to get a D10 delivered by Amazon the next day, but we can improve the outcomes of our warehousing in terms of what do we actually need, if we were smarter with the way that we ran them what would we actually need for the various systems that we have around the patch? So there is a lot of opportunity, hard work, a lot of focused work, and that's really where we are going to be going after it.

SAM WALSH:

Thanks Chris. One more question in the room – perhaps in the middle.

QUESTION:

Just kind of following up on three questions earlier in the day, in terms of the sustainability of the buy-back if you kind of look at spot commodity prices and given your working capital guidance, your capex guidance, saying no significant M&A, do you think it is highly likely that the Board will be in a position to announce at least a \$2 billion buy-back in 2016 this time next year? We are not going to hold you to it but it would be interesting to see what your senses are, at spot commodity prices.

SAM WALSH:

I won't be here; I'll be fired.

QUESTIONER:

And then, secondly, on the capex side, every two months you have reduced by \$1 billion, i.e., from the sounds of it this is a deflationary kind of currency move, is it right to assume that your long-term volume growth target is still around 5 per cent or is that starting to come down or at a risk of coming down?

And then, finally, just on iron ore and supply discipline, obviously you are adding 50 Mt of the 100 Mt so you're kind of the biggest contributor this year, but I think the more interesting side is IOC because at current prices I suspect it is not generating a huge amount of cash flow. Are you prepared to take action there if it moves into a cash flow negative situation? Thank you.

SAM WALSH:

Okay, thanks for those. In relation to shareholder returns, I mean I jokingly comment about that, but it really is a Board decision and the Board represents you, the shareholders, and the Board will want to look at that this time next year to really assess where we are. There are a lot of moving parts.

Now the world is far more volatile today than I suspect it has ever been, not just in relation to commodities but in relation to world politics, in relation to a whole range of things that sort of impact in one way or another on our business and quite sensibly the Board will want to look at that after we have finished 2015 and determine the returns.

Having said all that, we are absolutely committed to the progressive dividend; beyond that, it will depend on the economics, it will depend on the business, but let me assure, Chris and I and all 62,000 of us are very focused on continuing to improve the business,

continuing to provide the options for the Board that will allow them to consider what they do in relation to returns.

I think in relation to growth our intention is that our growth would be continuing at the indication we gave of 5 per cent copper-equivalent growth. Clearly again, moving parts in relation to what does happen with exchange rates and energy prices and, as Chris mentioned, what happens with capital equipment and so on, but we are very focused on getting the balance right between shareholder return, future growth of the business, future value to shareholders, and our feeling is that 5 per cent is getting it about right. Certainly when we raised it in November/December with shareholders the shareholders accepted that that's pretty reasonable, that's pretty fair, that ensures you've got ongoing growth.

The last question – my pen ran out of ink – so ...

QUESTIONER:

IOC.

SAM WALSH:

Oh IOC – oh, now I know why it ran out of ink. Look, we are very pragmatic about ensuring that our businesses are actually cash positive. It is a hypothetical question but clearly it's something that the business is aware of, the business is taking aggressive action to improve its cost base in terms of a whole raft of activities: getting the manning right, getting the shift patterns right, getting the balance right between internal work versus contractor work and so on. Kelly Sanders is running that business. Kelly has actually moved out of the IOC Head Office in Montreal, he has moved into Labrador City so he can be very focused with his team there on-the-ground, and that's obviously for a reason.

I think with the reductions that I guess the iron ore business in Canada has seen in relation to Wabush, in relation to Bloom Lake, Millennium, you name it, we are seeing a community there, we are seeing suppliers, we are seeing a workforce that is actually far more attuned to the realities of life. Having said all that, IOC produces a premium product, it produces a premium concentrate and a premium lump and attains a significant value in use for that, so it's not just a cost equation, it is also a value equation in terms of what they are actually receiving for their sales.

Perhaps with that, I've changed my pen, and we move to the phones for another three questions.

QUESTION:

Good morning guys. Look, a quick one on the balance sheet probably for Chris, we are all really surprised by the debt, and that's really quite positive getting that down to around \$12 billion, which is probably \$4 billion or \$5 billion below where consensus had it pegged. What also surprised me was that there was a really big drop in the Property, Plant and Equipment from half year to the full year, it was down by about \$5 billion over that period and a lot of that was in Iron Ore. I think there was about \$3.7 billion drop in the operating assets over that period of time. Now I know currency has fallen, I worked it out to be about a billion dollars differential, so I just wondering if you can talk me through why it is a big drop in the 6 months in the PP&E and in particular in Iron Ore which is obviously a growing business?

SAM WALSH:

Chris, we have lost your voice. Oh, there we go.

CHRIS LYNCH:

The key thing in this sort of market is the issue of balance sheet strength and I do want to make the point about in this market so fundamentally benefiting from a strong balance sheet. And in Sam's earlier references to potential future buy-backs and the like, the strong balance sheet is essential in order to be able to be in a position to do that and we do have balance sheet capacity there.

In relation to your specific question on Iron Ore PP&E, we will get back to you on that directly, but the key thing from our point of view here now is to make sure we maintain this strong balance sheet and that's why the buy-back has been sized the way it has. But a strong balance sheet in volatile markets is absolutely essential for robustness against whatever that volatility throws and it also gives you the capacity for returns by a balance sheet capacity and it also gives you the readiness to be able to respond to whatever opportunities present.

SAM WALSH:

Okay, thanks Chris, and we will get back on the PP&E question. Another question from the phone?

QUESTION:

Good morning Chris and good morning Sam, two questions on the Aluminium Division considering it delivered the largest beating of the consensus forecast. Firstly on costs, the original target you provided - I think it was back in 2013 - was \$1.1 billion in total cost reductions, so you have achieved \$800 million thus far, and I wanted to know does the \$1.1 billion target still stand or can you go beyond this?

Also considering the PacAl assets performed pretty strongly, have you completed your portfolio simplification or rationalisation for Aluminium?

Then also on bauxite, I noticed that the spot bauxite price has increased by about 15 bucks a tonne over the last 12 months, yet it looks like your realised bauxite price was flat year on year if I look at a CIF or FOB basis, so I'm wondering when you expect higher bauxite prices to start flowing through? Thanks.

SAM WALSH:

In relation to the cost target, yes, Aluminium still has their target to further reduce their cost and Alf and the team are very, very focused on that.

In relation to PacAl, look we have seen a significant improvement in that business with some very impressive cash generation from the business.

In relation to any of our businesses, we are open to anybody if they want to make a stunning offer that values the business more than we do; beyond that I am not going to comment on what we may do and what-have-you, but I have got to say, in this market divestments are pretty challenging.

We have got a strong balance sheet. I wasn't brave enough to say that we have probably got the strongest balance sheet of anybody in the industry, but we are certainly amongst the strongest, and that puts us in a unique position but it also signifies that, hey, others are treading water.

In relation to bauxite prices, we do have some legacy contracts; we also have some internal transfers, but Chris beyond that I can't think of why that increase in bauxite prices may not be flowing through. Do you have any feel?

CHRIS LYNCH:

We have the Gove effect. We are now selling more direct bauxite rather than processing it through Gove over the last year and a half or whatever, and I guess not all bauxite is fungible. Depending on the characteristics, it depends on what the audience is for that particular bauxite, is it high or low temperature and so on, so there are some idiosyncrasies about bauxite.

It is one of the reasons why we will continue to treat – we will give you the data about bauxite and alumina separately, which we have done now and hopefully that will be appreciated for more transparency on that data – but from a business and accounting point of view we will continue to see that as one what we call ‘cash-generating unit’ on the basis that we still have a relatively balance system in the aggregate and not all bauxites can go to all refineries; a refinery has got to be set up to receive a particular type of bauxite, if you like.

So we have got to be a little bit careful about translating across a headline number to every particular tonne, they are not all the same and they will attract different prices depending on how big the audience is for that particular type of bauxite.

SAM WALSH:

Yes, thanks Chris. Let’s come back into the room and do we have another question?

QUESTION:

A couple of quick ones. You made a pretty unequivocal statement about M&A, I just wondered though if you could talk about what you are seeing in terms of value in potential opportunities? Is value becoming more attractive given some of the share price moves etc and the pressure on people’s balance sheets? And the extension I guess is, is it still right to be quite so unequivocal about that M&A point given the strength of your balance sheet relative to the rest of the industry?

And then if I could ask a second quick one, iron ore lump premium has clearly been a big benefit for you guys in insulating against some of the downside in the benchmark price. Could you maybe talk about what you are seeing in terms of customer behaviour etc? There was I think an expectation that we would see that lump premium come off a bit by now, it doesn’t seem to have happened so far, are you expecting that to remain at current levels through the course of 2015?

SAM WALSH:

Okay. In relation to M&A, yes, I was very strident in my comments here that we are not looking at any major M&A. There are a raft of things that, I don’t know, are on the market but there are a lot of the stressed assets, and guess they are distressed for a reason, they are high-cost, they are the sorts of businesses that we are talking about earlier when we talked about people needing to take the business off the market because it’s underwater, losing money.

If you look at the true opportunities for M&A, and never say never, these are few and far between if you are really focusing on Tier 1 low-cost opportunities. And unfortunately if one of those came on to the market, and who knows when, they will be contested so despite the fact that we have got a very strong balance sheet it doesn’t automatically flow that we are going to rush out and do it.

There have also been a lot of journalists and what-have-you who have said you should rush out and buy Freeport or Anglo or whatever, and that’s just not on our radar; it absolutely is not.

In relation to our iron ore prices, you are actually seeing a couple of effects there, you are seeing the effect of the balance of our sales portfolio between quarterly lagged and monthly lagged and spot, plus, as you quite rightly say, the lump premium. We have seen a stronger premium than we thought, which comes back to my comments earlier

about the Chinese mills trying to improve environmental performance, and they are coming under significant pressure to do that. But look it's a very volatile world out there and I leave the market to determine where the price is going to be going forward.

Do we have another question?

QUESTION:

Just two quick questions. Going back to your gearing ratios, obviously you've put out the 20-30 per cent target and then obviously Chris has said we want to be at the bottom end of that target. I guess what you are saying to the market is effectively that range is actually much narrower, between 20-22 per cent and not 20-30 per cent, because of all the uncertainty and everything that you give.

So I guess the question is, what will make you gear up effectively? What you are saying obviously today is you don't want to gear up to do a buy-back, but would you gear up to maintain your progressive dividend and sustaining capex or are you saying, well you think things are going to get worst so therefore you want that headroom in your balance sheet to basically draw down if market conditions get worse, because it gets worse if the cyclical mining companies obviously gear up at the bottom of the cycle, not gear up at the top of the cycle which you have been renown to?

And then, second, a really quick question, obviously with your capex guidance I know you have historically given out your FX guidance around that but that would help in modelling in terms of that \$7 billion, what you are assuming for the CAD and obviously A\$? Thanks.

SAM WALSH:

Look, I will let John and his team come back to you on the FX.

In relation to the gearing ratio, look it is what we said it is, that we are shooting for a ratio of 20-30 per cent and we indicated back in November that we would prefer to be in this market at this point in time at low 20s rather than high 20s. It does give us the optionality that you describe, it puts us in an incredibly strong position but noone should underestimate the volatility of the market right now, and I don't think anybody would have predicted the drops that we saw between November and February in terms of a range of commodity prices.

We would like to see a bit of stability there, we would like to see that things have stabilised out before we change our position in that gearing ratio. Having said all that, quite frankly we are in an incredibly strong position and that's a huge competitive advantage for us to do whatever we want to do in terms of returns or investments or M&A or whatever, but right now a very prudent position to be is exactly where we are.

I think with that, if I could wind up and if I could just thank you all for being here, thank you all of you on the line, and Chris thanks for staying late in Melbourne, I really appreciate that.

We said we would materially increase our shareholder returns; we have done exactly that. We said we would reduce our costs, we would improve our business and we would position ourselves in a challenging market; and that's exactly what we have done. We said we would strengthen our balance sheet; well, we have. And the good news is it's a journey, we have not arrived at a destination, it's part of a journey and we will continue to improve the business, we will continue to provide the options for our Board to increase our shareholder returns.

So thanks once again for being here, I appreciate your interest and your support. Thank you.

(End of Q&A session)