Rio Tinto 2014 Half Year Results
North American Conference Call Q&As

7th August 2014

SAM WALSH (Chief executive):

Thank you for your attention. I will now pass back to the operator who will explain the system so that you can ask questions.

OPERATOR:

Thank you. If you would like to ask a question at this time please press the star or asterisk key followed by the digit 1 on your telephone. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. Again, please press star 1 to ask a question. We will now pause for just a moment to allow everyone to signal.

I would remind you, to ask a question please press star 1 on your telephone keypad.

SAM WALSH:

Well, it sound like we don't have a question at this time but let me perhaps feed you back some of the items that were of particular interest this morning with the London and Australian based investors.

Firstly, they are interested in getting an understanding of the cost reductions and where we stand. Certainly if you look at the $3.2 billion the major contributors have actually been the Aluminium business, the Energy business and Copper business which with each of those roughly achieving around $800 million each; Iron Ore at about $600 million; Diamonds & Minerals have experienced lower volume and obviously achieved lower cost reductions.

Whilst the cost reduction has been very, very pleasing, in announcing a new target it is important I mention that that target has come bottom up from the organisation. I was very loathed to have a new top down target – it could run the risk of cutting into the muscle or cutting into the bone of the organisation – so it was important for sustainability to ensure we don't drop any balls, that the cost reduction actually came from the business, and that's what we've developed.

But as you read through the material you will note that it is getting harder and that shouldn't be any surprise at all. We're expecting that through the second half of this year we will achieve $250 million of cost reductions, through 2015 we'll achieve $750 million of reductions. If you look particularly at this year there are a couple of areas that will actually offset the cost reductions, one of them is a smelter maintenance outtage at Kennecott Utah Copper.

So we have taken all of that into account in terms of developing the new set of numbers. It will be a challenge but I have got the organisation right behind me in terms of providing the focus, discipline and accountability to deliver that.

If I think more about sort of topics that have focus, look, certainly there was a lot of commentary about, well, what does materially increased shareholder returns mean? We didn't give any figures and that's a decision for the Board, but we have indicated to investors that this is a decision we will make in February not only in terms of quantum but also in terms of the exact distribution, the way of achieving that.

You know as an organisation we are committed to the progressive dividend and we have seen dividends increase this year by 15 per cent, last year by 15 per cent and the year before that by 34 per cent, so we do have a track year of delivering increases. This time the Board has indicated that it will be a material increase, so clearly it's focusing us on something that is substantial.

The other point that I'd make is that, apart from the progressive dividend, there are other avenues for returns like special dividends or buy-backs or whatever, and I know that different shareholders have got different views on this and people have been very vocal in describing their preference. But it is a decision that the Board will make, looking firstly at economic circumstances, obviously depending on the full year results and depending what happens with commodity prices, exchange rate, energy costs and so on.

But also, the actual means of distribution is a Board decision and that is something that they will be considering at the time and determining what is the best way to return this cash.

But perhaps if we could have another go and see if we have got any questions now?

OPERATOR:

A final reminder to ask a question, please press star 1 on your telephone keypad.

Our first question today comes from Nathan Littlewood of Credit Suisse.

NATHAN LITTLEWOOD (Credit Suisse):

Hi Sam, and congratulations on the result. I was just wondering if you might be able to give us a little bit of colour on some of the recent management changes at Iron Ore Company of Canada? I noted there has been, I guess, a few years of fairly disappointing ramp-up and commissioning of the expansion there. I am not sure whether the two are related but I would be keen to get your thoughts?

SAM WALSH:

The most important change is that Kelly Sanders has taken over. I think many of you will remember Kelly from his time at Kennecott Utah Copper. Since that time Kelly has been working on our heavy mobile equipment tender where we are about to announce the results really of the first stage of that.

Zoe Yujnovich has been at IOC for quite some time and Zoe was offered a number of positions elsewhere in the business but she's decided that she would like to go out on her own. As you know, we regularly change people three, four, five years in their role and Zoe had reached that point.

Now of course what happens when you make a change like that, a new broom comes in, there's a new focus, a new sense of urgency, a new sense of what the opportunities are with a fresh set of eyes, and that's exactly what I'm expecting with Kelly. He is experienced, he does understand the fundamentals of the business and processing plants and I am working on the basis that Kelly will make a real difference on-the-ground there.

IOC has completed their expansion projects, CEPs 1 and 2, the concentrator expansion projects, 1 and 2, and that is now up and operating with the new conveyor delivering ore from the mining pits, so it's a good platform for Kelly to come in and to make that difference.

NATHAN LITTLEWOOD:

Okay, great. Thanks very much.

SAM WALSH:

Thanks. Do we have another question?

OPERATOR:

Yes, our next question comes from Morissa Hernades of Neuberger.

MARISA HERNANDEZ (Neuberger Berman):

Good morning, Sam, and thank you for taking my question, and congratulations on the excellent achievements. We are very happy to see Rio having a much better balance sheet and earnings approach by your commitment on enhanced shareholder returns.

I have two questions, if I may. Number one, one the Oyu Tolgoi mine in Mongolia, is there any growth capex you've marked for the underground development of OT in your capex guidance for 2014 and 2015 and, if not, how would that change over time?

SAM WALSH:

Okay, let me answer that question first. Yes, the OT underground expenditure is in our capital forecasts. You would have picked up that we have reduced our capital guidance for 2014 by $2 million. We had previously announced around $11 billion, we are now providing guidance of around $9 billion, and I think that reflecting a whole raft of things, obviously tighter capital control, some improvements in terms of project delivery, and the Iron Ore business has returned $600 million of capital.

Certainly the OT project is a small part of that, with the approval of the project finance now expected later this year, but it's also comprehended as we go forward into 2015 and onward for capital where we have provided guidance of around $8 billion going forward. It's something we are working through with the Government of Mongolia, the capital is in the projection, is in our plan.

Importantly, the project must be financed through project finance. This was an issue that we've made clear to everybody, including the Turquoise Hill shareholders, that every shareholder has got to take the responsibility for funding their part of it, albeit it will be through project.

MARISA HERNANDEZ:

So when that happens that would be an addition to net debt in your balance sheet, Sam? You consolidate that, right?

SAM WALSH:

Yes, we do consolidate it. And yes, that will be comprehended in our balance sheet.

MORISSA HERNADES:

Understood. Okay. And if I may ask you a second question, obviously you are making huge progress in guiding cash generation from cost and capital controls, which are the viables that you can control. We very much appreciate your comments regarding shareholder returns. Now what type of adverse price environment do you think could impede further returns to shareholders next year? How do we think about how value can be for that not being able to happen?

SAM WALSH:

Clearly the biggest driver of our cash generation is the Iron Ore business and we are seeing iron ore prices stabilise at around $95 a tonne. If you look at the forward curves for iron ore the prices are holding at around that level through 2017. The price will obviously be what the price will be, but I think it is important to look below the spot price to really see what is the flexibility below that, and by that I am referring to the juniors and the lower quality ore.

Firstly the spot price is the landed price so, for example, if you want to look at Australian supplies you have got to take off $8 for freight. Then you had the juniors with 56 per cent iron content, 58 per cent iron content, offering between $15-20 of discount in order to move their material.

Why have they had to do that? Well, primarily because the Chinese mills are being forced to improve their environmental performance in order to reduce the amount of smog that the Chinese are seeing in 17 of their major cities and the best way for the mills to do that is to actually go upmarket in relation to the quality of the product, so that they produced less slag and obviously use less energy and more environmentally efficient.

The juniors, in order to even persuade the mills to take some of their ore, have had to discount very, very steeply. So you are seeing their prices some $23-30 or $28 below that current spot price of around $95. That’s starting to severely impact a number of juniors. We have seen 85 million tonnes of capacity already come off around the world year to date; we are expecting through 2014 that 125 million tonnes will come off.

The current price levels have had quite an impact and in a way I think the forward curve is picking up the fact that when you look at the impact on the juniors below the spot price it actually almost puts a floor, if you like, on iron ore prices. I mean prices will be what they will be, but personally I’m not expecting any major dislocation to the iron ore prices.

Now clearly when we are looking at our projection for cash flow we look at our price assumptions. When the Board looks at the actual dividend decision they will look at the performance for the full year, they will look at the calendar year results and our expectation going forward in 2015 for our cash flow. The Board has taken all that into account and the Board has endorsed the comment that we will materially increase our returns to shareholders, so I think we are on pretty stable ground.

MARISA HERNANDEZ:

Wonderful. Thank you very much.

OPERATOR:

Our last question today comes Eliot Glazer of W M Smith & Company.

ELIOT GLAZER (W M Smith & Company):

Thank you so much, Sam, for giving us that colour on the situation in iron ore amongst the juniors and how much it is coming off-line. Could you extend that please and shed some light on how the competition is conducted between the three majors: Rio Tinto, BHP and Vale? Does China accept everything all three have to offer? Is there some kind of allocation? How is that business conducted please?

SAM WALSH:

Look, it's a free market. It really is the dynamics of supply and demand that is taken into account. The three majors are providing grades that are attractive to the steel mills and as such it really is the situation of free supply.

Now of course there are impacts of price that need to be taken into account, and I mentioned the freight from Australia to China of 8 bucks. Well, currently the equivalent price from Brazil, for example, is between $18 and $19 so obviously there is a price trade-off that the mills need to take into account.

Some of the Brazilian ore is higher grade product so there is a value-in-use factor that they take into account, but it certainly doesn't offset all of that $10 to $11 freight disadvantage that Brazil has purely and simply because of the distance.

Now the other thing that the mills will do is to enter into long-term contracts. They will be priced by a market price mechanism but the mills will enter into whatever, five or 10 year contract, whatever they deem appropriate for supplies. So that will actually determine how much of a particular supplier's ore is taken up. The price mechanism – it varies quite a bit – is always, as I've mentioned, based on market prices but some of it is based on spot, i.e., what's the price today or what's the price when the ore lands in China?

Some of it is the average of the price over the current month, so it tries to move some of the daily variations out of the question by averaging over a month. Some are based on a three months period, a quarter, and this can either be three months in arrears or it can be current three months. So there is a range of factors there and quite plainly the mills shape their portfolio so that it fits their particular needs.

For example, where you have got a situation where a steel mill is supplying for example the car industry on the basis of quarterly pricing, well, they will go to quarterly iron ore pricing; where they are supplying steel into the stock market they'll want to base it on the stock price. But it's different horses for different courses depending on what actually suits them.

Does that sort of answer your question?

ELIOT GLAZER:

That's an excellent answer and I am very grateful.

SAM WALSH:

All right. Good. Thank you. Do we have another question?

OPERATOR:

We might just have one more question. It comes from Davina Prognocova of Voyeur {?}.

DEBBIE BOBOVNIKOVA (Voya Investment Management):

Hi and good afternoon, Sam. Actually I have a couple of questions. First on the cost reduction programme, so there is a billion dollars still left by end of next year. Can you help us understand how you think of it breaking down between your main segments?

And then the second question is on your capex, so you've said $8 billion for next year and probably thereafter. Can you help us understand how much of that is your sustaining capital and how much of that are projects that are already approved, i.e., what is the room to play around with in terms of either things that are not yet approved or projects like Oyu Tolgoi underground – I guess they are not officially approved – so maybe that's it, maybe just in terms of understanding what is the potential for that capex number to actually come down unless you approve further projects?

SAM WALSH:

Okay. Dealing with the cost reduction firstly, as I've mentioned we have indicated we are expecting $250 million through the rest of this year and then $750 million in 2015. As you would expect, the cost reduction is really in line with the cost base of the businesses.

Now Energy and Aluminium have still got a way to go on their original targets so, for example, the Energy group had a target of roughly a billion, they are hitting it at around $800 million and so they have got a couple of hundred million to go. Aluminium had a target of $900 million, they are at $800 million and they have got a $100 million to go.

But the rest, as I say, will be evenly spread across the businesses according to their size. We've not actually gone through the numbers today. Clearly it will be a range of factors: productivity improvements, overheads improvement, purchase costs improvement, really the whole gambit in terms of how that cost improvement will actually be generated.

The capital for 2015 and beyond - we are sitting with sustaining capex at around $3.5 billion a year. I suspect there is room to fine tune that number but that's really the basis of how we've arrived at those numbers, so clearly we have got $4.5 billion beyond that in terms of straight development capital.

There is a range of projects over the near term for us to complete. Certainly the Pilbara 360, that is contained in the immediate part of our capex forecast. Kitimat also is a project that we need to complete, and OT underground that you mentioned, OT Stage 2, is a project that we are very hopeful we will commit to this year but of course it will depend on the negotiations with the Mongolian Government, and obviously project finance is going to be a very important part of that.

Beyond that, there is a range of projects across the Product Groups and obviously there will be different timeframes. But one that I have mentioned today is the Aluminium division's bauxite project in far north Queensland, the South of Embley project, which is a very attractive project and the team right now are looking to determine how we could accelerate that project by 12 months, i.e. shorten the construction process.

We have in South Africa, at Richards Bay Minerals, the Zulti South project, the titanium dioxide project. In the far north of Canada, we have the A21 diamond project, which is again highly prospective.

In the coal business in Australia, we have the Mountain Pleasant project which despite the fact that coal prices are currently under pressure, is very low strip ratio, low operating cost, which makes it quite an attractive project.

Of course in Copper, beyond OT underground, we have La Granja in Peru and we have Resolution in the USA and there is clearly a range of other projects in Iron Ore. Once 360 is completed there are clearly options there to creep that volume further, and there is the Simandou project in Guinea. So there is a range of attractive projects in the portfolio to provide the growth but recognising we believe that $8 billion is sufficient to delivery the necessary growth.

Meanwhile, as I have said, we are committed to materially increasing our shareholder returns, and I think for those of you who have done your modelling and had your analytic team look at these numbers, it does provide us with the opportunity to materially increase our returns.

DEBBIE BOBOVNIKOVA:

Thanks Sam. So what will 2015 and 2016 look like in terms of capex if there are no further new projects sanctioned by the Board?

SAM WALSH:

Capex will be $8 billion in 2015 and we have given guidance today that in the near term our capital will continue at around $8 billion a year.

DEBBIE BOBOVNIKOVA:

Okay. So you have a high confidence that all the projects will be sanctioned to fill that $8 billion?

SAM WALSH:

Yes. I mean I've mentioned a range of projects and some of these projects are well developed, some are not, but some are well developed so I think we have got a pretty good view of what the pipeline consists of.

DEBBIE BOBOVNIKOVA:

Right. Thank you.

SAM WALSH:

Thank you.

OPERATOR:

As there are no further questions at this time, I would like to hand the call back to Mr. Walsh for any additional or closing remarks.

SAM WALSH:

Thank you all for coming on the line. I appreciate it. It has been a good day for Rio Tinto; it's good news. For me it is rather odd because the first half was completed in June 30. In a way it's like having a grand final and immediately after that grand final well you are focusing on the next, and that's very much where I fit and clearly we are well into the next quarter and focusing on what we need to continue to do to deliver value.

Importantly we do have these solid foundations, as I have mentioned, that will result in materially increased cash returns to shareholders. It is stronger words than we've used before and it's important that shareholders realise this is a company that is very, very focused on shareholder returns. We believe we have got the fundamentals tracking well, we have over-delivered on our cost reduction and set new targets, we are now at the mid-teen levels for debt that we were targeting so we are well positioned in relation to that.

We have given guidance on our capital that gives you assurance the growth is there but also that it allows the returns to shareholders. Look, I think the business is well positioned, today's results are good, we remain a very focused organisation, focused on delivering value, focused on delivering our capital projects and importantly focused on shareholder returns.

So thank you very much for coming on the call today. I really appreciate your time and your support. Thank you.

OPERATOR:

That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

(End of Conference Call)