

Rio Tinto 2014 Interim Results Q&A transcript

7 August 2014

SAM WALSH (Chief Executive):

It's now time to take your questions. The approach that I would like to take for questions – I have already got a few hands up I see – is we have take three questions from the room here and then we'll move to the operator for the phone line; then we'll repeat and return back to the room. If you could perhaps share with us your name and organisation. Rob Clifford, you are normally first, so I can't breach protocol here.

ROB CLIFFORD (Deutsche Bank):

Thanks Sam. It's Rob Clifford at Deutsche Bank. Look, I am going to ask the obvious question. The materially increased shareholder returns, how do you think about the best way of giving those back to shareholders to enhance value?

And secondly, how do you think about sizing that? I'm not after a number obviously but the thoughts – what is excess? What is surplus to needs? Is it about a balance sheet ratio? Is it about cash generation post-base dividends or post-growth? If you can talk about your thoughts on that, that would be great?

SAM WALSH:

We are getting a little bit ahead of ourselves, but I mean this will be a decision made by the Board and clearly the Board will review options for delivery via dividends, special dividends, buy-backs. That is the approach that I would expect they would consider and clearly the Board will take into account, i.e., where we sit at the end of this year, but let me assure you that all of our modelling and forecasting is pretty robust. But of course they will take into account forecasts for exchange rates and commodity prices and energy prices and so on and obviously that will determine the quantum.

Chris, I don't know if you wanted to add anything perhaps to that?

CHRIS LYNCH (Chief Financial Officer):

Sam, I think that's covered it pretty well. I know there is a desire to clarify it and the like, but what we have said consistently is what we are actually doing. We have said we'd focus on reducing net debt; we have done it - \$6 billion down on where we were last year. That will give us a lot of capacity to enhance returns to shareholders.

But, Rob, on your question, I think the key issue was around how you need to think about the progressive dividend and how we size that, then there would be surplus capacity beyond that, about what form that takes, and that's still the decision for the Board to make over coming months. But all will be revealed in February, I guess, is the simple way of putting it.

SAM WALSH:

Thanks Chris. It is a good story. The Board was very particular about the wording, about materially increased shareholder returns, so this is not Sam sort of just heading off into the blue yonder, this has the support of the Board.

Perhaps, Jason, here in the second row?

JASON FAIRCLOUGH (Bank of America Merrill Lynch):

It's Jason Fairclough of Bank of America Merrill Lynch. Just maybe a little bit of colour on some of the changes to capex for this year because that certainly got people's attention. I am just wondering could you talk a bit about the extent to which the \$2 billion reduction is a permanent reduction or just a deferment, a deferral of the capex?

And I guess more generally then if we look at Pilbara 360(Mt/a capacity) and how low the capital intensity is, if we look further down the road are we setting ourselves up for a big catch-up capex bill later on because you are just working these existing assets so hard?

SAM WALSH:

Thanks for that. As you'd expect, there are a range of factors that impact on this. Importantly today we have reduced our guidance for capital for 2014. We had indicated that our capital would be around \$11 billion, we are now advising it will be around \$9 billion. For 2015, we've provided guidance that it will be around \$8 billion, that guidance holds, and we provided new guidance that beyond that in the near term we expect that capital will run at around \$8 billion.

This has actually come through our working through our next five year plan in terms of bottom up from the organisation as to what they see in terms of timing, in terms of quantum, in terms of projects, what we'll need to physically continue the growth but also with a watchful eye in terms of the shareholder returns.

In terms of this year, one significant item we have got is that I have mentioned that Iron Ore are going well with their projects and continue to come in ahead of schedule and under budget, but they've handed \$600 million back so there is a large item there. Certainly there is an amount associated with OT underground and getting that project up and operating. There is also been an amount associated with tightening our sustaining capital.

But I think the biggest impact is, and this is not about Sam and Chris, it is about 66,000 people in the organisation operating as owners and spending the cash as if it's their own. We have refocused the organisation. But that's a very powerful thing to do with an organisation and that's the biggest impact.

Now I have talked about a long-tail before in our capital. Yes, you can look at the big projects; you have also got to look at all the small projects. I am not allowed to talk about the credit card analogy any more, but it is like a credit card and there are a lot of small items that add up at the end of the month or end of the year.

We have another question here.

JASON FAIRCLOUGH:

The long-term question?

SAM WALSH:

Pardon?

JASON FAIRCLOUGH:

The long-term regarding roll-up in terms of capex.

SAM WALSH:

Well, our guidance is \$8 billion in the near term following on from 2015. I don't believe we'll see a big spike beyond that period. Look, it will be what it will be in terms of where the opportunities are and what we can take advantage. But critically it's an organisation that used to operate at \$4 billion of capital, up until I don't know, about seven years ago. But we're now focusing that on \$8 billion - \$8 billion will deliver very solid growth for the

organisation. So we are not looking, we are definitely not looking, at going back to the heady days of \$17.6 billion, that's just not on the radar screen.

Perhaps one more question in the room, in the third row there. You'll all get your chance to have your questions, so don't feel left out.

MYLES ALLSOP (UBS):

It's Myles Allsop from UBS. Just a quick question on M&A. If we go back 18 months you were very clear, I think you said three times that M&A is not on the agenda for Rio Tinto, it's about getting the basics right. Where do we stand now that you have been delivering on the cost-cutting and obviously taken capex down? And just with that, you said \$8 billion would deliver solid growth – are we talking 5 per cent sort of volume growth medium term after this period of 8 per cent? What do you mean by solid growth? So two questions possibly.

SAM WALSH:

Yes, M&A is not on the agenda. We have no plans for any major M&A work and that's been part of our focus in terms of stabilising the business, not doing anything smart or what-have-you, getting back to the fundamentals, getting back to the basics, getting the organisation back focusing on the critical things for the business. And look, it's working.

In relation to growth, we are projecting 8 per cent growth through 2015. We have not given guidance of the exact number beyond that, but obviously we are looking to sustain a solid growth portfolio going forward.

Perhaps if I could move to the phones now and we could have three calls from the phone lines?

OPERATOR:

We will take a question from Adrian Wood of Macquarie. Please go ahead.

ADRIAN WOOD (Macquarie Securities Group):

Yes, hi Sam. Just two questions from me, first of all, just on OT. I just wondered first of all how confident you are that we may see resolution there in the next seven weeks before the deadline for the current financing agreement expires in September?

And if we look at the current operational results, and looking at EBITDA as a proxy for cash flow relative to the capex, it doesn't look like it's generating free cash flow yet. Notwithstanding the recent sale of South Gobi by TRQ, if those financing agreements are not met would you be willing to prop up TRQ again in the way that you did last year with the equity raising?

And then the second question just on the Pilbara expansion, you mentioned you are due to be making the investment decision on Silvergrass in the third quarter. I just wondered what the latest thoughts are and how that fits in with the lower capex guidance that you have given us for this year? Should we assume therefore that that's not going ahead or not going ahead in the near term?

SAM WALSH:

It sounds like half-a-dozen questions, but I'll have a go with a little bit of help from Chris in relation to EBITDA and cash generation at OT.

CHRIS LYNCH:

Sam, just so you know, I can't hear any of the questions.

SAM WALSH:

In relation to our ongoing discussions with the Government of Mongolia, look, we are hopeful that this can be resolved. The Government wants the project to proceed, Turquoise Hill shareholders and we want the project to go ahead, and that's certainly what we are very focused on.

Having said all that, this is all about value; it is how we are running the business. This is a long-term project, it will run for 50-plus years, it's important to get it right. It's important not to put lead in our saddle going forward, particularly in light of the fact that it took three years to negotiate the investment agreement which comprehended stage 2, the underground mine, so we are not reinventing things from the start here.

In relation to timing of this, look, it will be what it will be. We do have an extension in project finance through to September 30. Importantly I am not about to destroy value because of a deadline. Having said that, I am hopeful that we can reach agreement. The project finance is fundamental to the project.

This project is owned by the Turquoise Hill shareholders - and the Government of Mongolia - of which Rio Tinto is a part. This is not 100 per cent owned and it is not a project we should be funding 100 per cent from Rio Tinto, so critically we are seeking project finance for this to go ahead and we have been very, very clear about that at least for the last year-and-a-half.

Chris, perhaps if you could comment on the EBITDA and cash out of OT?

CHRIS LYNCH:

Sam, I couldn't hear any of the question from the feed, so if you could flesh it out a bit more. But I guess the key thing I would say about OT at this stage is it is absolutely ramping up, there's nothing more than that at this point, and the key issue is really around the product now is starting to flow.

We are now selling more than we are producing in any given month in terms of running down the inventory that had built up in the early stages of the production, so I think you have just to be a little bit more patient with regard to the data that flows out of OT to see how it shapes up once it's up and fully running on a normal flow of product from mine to customer.

SAM WALSH:

In relation to the question about Silvergrass in the Pilbara, Iron Ore are putting forward their plans in relation to the mine capacity associated with the move to 360. You would have picked up that a large majority of that has actually been through squeezing harder existing mines and that work is proceeding quite well. In relation to Silvergrass specifically, I'm not exactly sure of what the timing would be for that project but it will be there to meet the ramp-up.

Another question from the phone?

OPERATOR:

Our next question comes from Clarke Wilkins of Citi.

CLARKE WILKINS (Citi):

Hi Sam, just an idea – can you hear me? I'm getting feedback.

SAM WALSH:

There is a little bit of static, but let's keep going.

CLARKE WILKINS:

I guess it's okay. It is a question just on the Kitimat side in terms of the capex there, \$4.8 billion, the modernisation, and maybe the increase of \$1.5 billion is probably a bit more than expected. Is that the cost of building our new smelters now in the Western World or what went wrong with that project considering the figures, an increase in the budget, that would usually improve and sort of double what it was when it was originally proposed back in 2008?

And a second question just on the operating cost side, when you look back - and you have already exceeded the year-end - where have you done better than expected in terms of pulling the cost out or getting the improvements in terms to bottom line?

SAM WALSH:

Okay. Thanks very much, Clarke, for that. In relation to Kitimat, there have been a number of factors at work there. The most important factor has been labour and escalations in labour costs in British Columbia associated with LNG, but also the productivity that we were actually achieving there and significant turnover of staff which meant that we were continually in a mode of training and inductions and bringing new people on.

In relation to the project, we have now struck the new budget, the \$4.8 billion that you mentioned. We are targeting June 2015 for start-up of the project. We have already announced that we've changed out and restructured the way that we are running our projects and David Joyce who headed the Iron Ore projects is now in charge of all projects within Rio Tinto, the over-arching responsibility for projects, and he is morphing the systems and structures and the way that we run projects across the entire Group. Obviously Kitimat was his number one focus as he assumed responsibility for that.

We have significantly strengthened the management onsite and Alf Barrios who is now running the Aluminium group is responsible for the handover from construction to operations and he is actively involved ensuring that there will be a smooth handover of the 256 systems associated with the smelter as they'll ramp-up progressively through to June next year.

So I think there has been a lot of good action after a disappointing overrun, but importantly we have taken the steps to get the project back on track and for us to deliver that project in June next year. Importantly once that project is up and operating its operating cost is in the first decile, so that project is going to be a very attractive project going forward.

In relation to your question about the operating cost reductions, it's been across-the-board in relation to the organisation, thousands of projects, real momentum gathered. I mentioned during my comments about the \$800 million that Aluminium had reduced out of their costs, but we also saw significant reductions both in the Energy group and the Copper group of around the same dimensions and it has been across-the-board.

It has been in terms of productivity, of efficiency, of overheads, purchase costs, I mean no part of our costs have remained untouched, and for those that are sceptical about Head Offices, well, the number of people in our Head Office has halved - we have gone from 600 people to 300 people as we have gone through that process. So we are a very focused organisation. I mentioned the words lean and mean, it's a good way to describe the way that we are focusing on costs and ensuring that we are improving efficiency.

Also Iron Ore has achieved \$600 million of savings. Diamonds & Minerals have been hit by a soft market and they have been hit by volumes which have reduced the impact that has flowed through to the bottom line, however, once volumes pick up we will see a significant increase there.

Having mentioned all that and having focused you on the \$3.2 billion, we have not mentioned today that for our exploration and evaluation costs we were targeting \$750 million there. Well, we are sitting there at \$1.2 billion below our previous run-rate in 2012. So, if you like, that's the 'icing on the cake' in terms of this cost reduction story.

Chris, I don't know if you wanted to add anything more to that?

CHRIS LYNCH:

No, I think that's very comprehensive, Sam.

SAM WALSH:

Thanks Chris.

Do we have one more question on the line? Then we will move back into the room.

OPERATOR:

We'll take a question from Lyndon Fagan of JP Morgan.

LYNDON FAGAN (JPMorgan):

Thank you. A couple of questions, the first one is on the South of Embley project; it gets a bit more airtime in this presentation. I'm just wondering, given that all the approvals are done, what in fact is actually holding that project back from going ahead?

The second question is just on Grasberg. Can you perhaps clarify whether you have got to contribute to the cost of building a smelter there? Thanks.

SAM WALSH:

First in relation to the South of Embley, the Investment Committee has approved the study funds for that project, to accelerate that project by 12 months, and Chris and I are expecting the project will come into the committee by the end of this year. But it is a very attractive project. Taking the opportunity of expediting the project is worth just spending a little bit more time to work out exactly how we do it and how that would impact on costs.

In relation to Grasberg, the settlement that Freeport announced about Grasberg has been done by them. We've indicated for some time that we're not going to be a party to a smelter project at Grasberg. I visited the project a couple of months ago and I have got to say they are doing some very, very good work in terms of the underground development and it's a very impressive operation. They don't take too many visitors for some reason but it is something that is well worth looking at. They are doing some good work there.

Do we have another question in the room? Well, we have got hands everywhere. Why don't I take a question over here? I don't want this side to feel that they are being left out.

JAMES GURRY (Credit Suisse):

Thanks Sam. It's James Gurry here from Credit Suisse. Just a quick one on the peer group, it seems they're emphasising a lot on divestments and things like that, and you guys looked at it a lot last year and executed also in the first half of this year. Is there any potential for divestments or even joint venture projects in the next 6-12 months?

SAM WALSH:

Look, we have focused on divestments and I forget the total figure that we've divested – I want to say \$20 billion – but anyway it's a very large number over the last five years. Sorry?

MARK SHANNON (Head of Investor Relations):

\$17 billion.

SAM WALSH:

\$17 billion. I was close. So we have been very, very active in that area. You'll know that Pac AI and Diamonds were on the market. We took them off the market mid last year because quite simply we weren't going to generate the returns you would expect that we would expect for those projects, and we are very focused on continuing to improve those businesses.

This year we completed the Clermont sale and the \$1.015 billion has flowed through into our Accounts. I mentioned in February that we had a range of housekeeping to do and you've seen most of that flow through, so at this point in time we don't have any significant divestments on the table. However, having said that, and I continue to reiterate, if there is somebody out there who values some project more than we do then they should contact us because it is about value. But as we sit here today there is, as I say, nothing that's immediately on the radar screen there.

Can we have another question, perhaps right at the back so that we can cover those, that group too?

LUC PEZ (Exane - BNP Paribas):

Hi Sam, it's Luc Pez from Exane -BNP Paribas. A quick question on the Mozambique sales in relation to what you described earlier. I was a bit surprised to see you selling that for \$50 million, so if you could emphasise on the reason behind this and why you decided not to retain that option? Thank you.

SAM WALSH:

Yes, a good question and you would have seen us substantially write-down that project in January 2013. Look, it was not a good project and I am not going to walk away from that. We had a further write-down of the project in February, which in fact wrote the project down to \$71 million. At that point in time clearly that was our best view of the project value and behind the scenes we went out in the market to see what we could physically do in terms of divesting of that project.

ICVL and a range of others approached us and, quite frankly, ICVL was the best proposal that we received. The view of Chris and I, and the Board, was that really we needed to close that chapter. We need to close that port; we need to move forward. It has been for us a very, very disappointing, very difficult project for us to manage and we believed that the best option for the company was to actually move on and focus on those parts of the business where we will add value.

The truth is I believe that project, given our new focus on returns from projects, that project would have found it very, very difficult to get the capital it would have needed to take it forward. So we have drawn a line in the sand – we are moving on.

Another question perhaps, wherever it is, in the third back row?

DOMINIC O'KANE (JPMorgan):

Hi, it's Dominic O'Kane from JPMorgan. I just want to dig into the details on the billion dollar cost saving for next year that is targeted. So you talk about \$250 million incremental cash cost savings coming in the second half of this year. Could you maybe just give a bit of granularity on where the step-change comes in 2015 and specifically which divisions you are targeting for those incremental savings? And is that billion dollar number a conservative estimate?

SAM WALSH:

I mentioned back in February that Chris and I were not interested in setting a top-down target for cost reduction going forward. We need to make sure that the savings are sustainable, we need to make sure that the savings are not going to cut into the muscle, or even the worst cut into the bone. So we took it back to the organisation and, as we are in a process of developing our next five year plan, the organisation has come back with their expectations in relation to savings both for the second half of this year and for 2015.

We have in the press release today indicated that we expect the savings will slow in the second half of this year, if you like, the low-hanging fruit has been picked and we are now into the more difficult projects, however, we are expecting that savings in the second half will be around \$250 million this year with \$750 million in the full year next year.

So the run-rate has dropped, however, a billion dollars is still a lot of money and it indicates a sort of momentum that the organisation has got in terms of cost reduction. There are still thousands of projects that people are working through. We are an organisation who is very focused on continuous improvement and looking at ways that will improve and generally the savings will be across the Product Groups.

Chris, I don't know whether you have got any more colour that you could provide on that?

CHRIS LYNCH:

Sam, I think perhaps two points. One is that your comment about the low-hanging fruit is absolutely right. I think in addition to that we have got some known events in the second half of this year. An example of that is the Kennecott smelter outage coming up, so we know that it is going to be that much harder there.

This is not a conservative number, it is a number that obviously we hope we can get it and hopefully we can beat it, but it is going to take a lot of work and the good thing about it is that the guys have got a path for a large part of it. There is still some of it that's got to be delivered in the subsequent year, but it will take a lot of work.

But momentum is a very powerful force but it is starting to slow a little bit, we have got to re-energise it and that's the reason for the reduction in the second half. There are some specific headwinds there that we have got to take into account.

SAM WALSH:

Thanks Chris.

Another question in the room perhaps right at the front? I will get to you all. There is no need to ring us up.

MENNO SANDERSE (Morgan Stanley):

It's Menno Sanderse at Morgan Stanley. One general and two more financial questions. First on the general one, you clearly did a great job but you also dealt with a few boo-boos or hand grenades like Kitimat and Riversdale, which cost a lot of money and undid a lot of good work. Have you cleaned your cupboards? One.

And two, three quite sensitive situations: Grasberg and the renegotiations there; Simandou and not least Oyu Tolgoi. How can you give Shareholders somewhat more assurance that you are not going to have the same multi-billion boo-boos around those situations?

And the two smaller financial ones, is first in working capital we saw a big outflow on creditors. Chris, is it just a timing issue and can we expect it to reverse in the second half? There was one other financial which I've forgot.

SAM WALSH:

In relation to carrying values, clearly as part of the process coming up to the half year accounts the Audit Committee looks at carrying value, looks at trigger events and so on, to determine exactly what we should take into account in relation to our first half accounts. Look, I agree with you that both Kitimat and Riversdale not a good story. They're issues that Chris and I have inherited and we have tried to work through and mitigate and resolve those issues as quickly as we could.

But as to Grasberg, Simandou and OT, well, we have not spent any time talking about Simandou. Look, we do have the Investment Framework now in place. It has been ratified by the National Assembly, its first democratically-elected National Assembly in Guinea's history, and it has gone through the Supreme Court Review and has been promulgated by the Prime Minister. So that delivers a sound framework in relation to how that project might proceed and clearly there we are targeting December 2018 for that project to be in ramp-up.

Now you are sort of asking me to comment on hypothetical, sort of unforeseen, things. It is our belief those projects are tracking suitably, however, we have indicated in relation to OT that if there were a 12 months deferment of that project then we would be faced with an impairment. But let me assure you we are focused very much on ensuring that we do bring that project on as early as we can. As I say, everyone wants the project to proceed; it is just a fight over how you share the pie.

In relation to working capital, Chris, did you hear the question?

CHRIS LYNCH:

Yes. The short answer is "yes". We do think we can rein that in during the second half. It's an area that we probably had a slightly unofficial reduction in at the end of last year. We are doing a lot of work now to negotiate to extend those payment terms on the way out and we are making sure we are collecting on the way in, we are also reducing inventories, so I think we have got a good line of sight actually.

We have had a team working on this and working on it from the basis of what's the optimal working capital rather than sort of targeting a 5 per cent/10 per cent reduction. It is really about, what do we actually need in the business? And in several cases we've opened up quite a different potential based on the fact that we don't actually need all the inventory we have, we could run with leaner inventories. So I think we can rein it in, in the second half, and anticipating that we will.

MENNO SANDERSE:

Let me ask the other financial question, number two, which was around the tax rate. The tax rate looked very good in the first half of the year. Is your guidance still 30-35 per cent or 30-34 per cent for the full year and what's happening to MRRT with these lower iron ore prices?

SAM WALSH:

Chris, could you take that?

CHRIS LYNCH:

Yes, it will be 30-33 per cent. It's in that range but I think more the 30 end of that range. And the main issue is the rate, well, probably the single largest individual item would be the different impact that MRRT had last year versus this. But I think that 30-33 is a good range and we'll give you more flavour on that as the year progresses, but that's a good working assumption for now. I think 30 per cent and 30-33 per cent.

SAM WALSH:

Okay, let's move back to the phone lines and pick up a question from there?

OPERATOR:

We have a question from Glyn Lawcock of UBS. Please go ahead.

GLYN LAWCOCK (UBS):

Hi Sam, two questions. Firstly, just a little bit more detail on the costs. So Aluminium \$800 million, Energy almost \$800 million, they are good numbers but a year ago you said you would get over a billion out of Energy, close to \$900 million in Aluminium by the end of 2014. Have you stretched yourself a little too far and can you actually get the numbers because the energy market, obviously coal and uranium prices look tough and unlikely to probably lend you any support? I am just wondering whether you can still get those costs out in those two divisions?

And the second question, just a little bit more on this capital management, I know it's a Board decision, but I was wondering if you and Chris and the team have done any work and how you might be able to unlock the franking credits that are sitting there and building up on your balance sheet? Obviously the spread has come in too, so an off-market makes sense but then liquidity and other issues in Australia maybe prohibit that, so have you done any work and any thoughts that you might be able to share with us? Thanks.

SAM WALSH:

I will let Chris comment on franking credits in a moment, but you are spot on in relation to the cost reduction targets. Energy group were targeting a billion, they are still targeting a billion, and Aluminium were targeting \$900 million. What you have actually seen is that we have had improvements elsewhere that have enabled us to achieve the £3.2 billion.

Those Product Groups are still focusing on achieving their original targets; it will form part of the savings that we are expecting in the second half of this year. So there's still a very active focus on improving the costs and I am very pleased with Alf Barrios coming on into Aluminium, that he's picked up the baton, and he's running very hard in terms of opportunities to further streamline and improve that business.

Perhaps, Chris, if you could comment on the second question?

CHRIS LYNCH:

Thanks Glyn. Yes, we are looking at franking credits as part of this whole capital allocation conversation. As you are well aware I think, the mismatch between the amount of tax paid in Australia therefore franking credits generated versus the shareholding by the Limited stock versus PLC, makes it difficult to do it all via a traditional dividend payment, fully franked dividend. And just to stress again, obviously the dividend for Limited holders or Australian resident Limited holders is fully franked, so that's just to double emphasise that point.

But we are looking at it. We are looking for ways to see whether there is a way that we can liberate them, to get them to be more value in the hands of our shareholders, but it's not easy. And I guess we have had probably every bank on the planet sort of come and talk to us about it, but rarely do the proposals that sort of come up have appeal that would be fair and equitable to shareholders, and that's really the challenge in this.

But, as you rightly point out, the discount between the two stocks or the difference between the two stocks is narrowing. Off-market buy-backs is obviously a proven mechanism for utilising franking credits, but it's one of a mix of things we'll be looking at over the next several months as we come into that conversation with the Board.

SAM WALSH:

Okay, another question on the phone?

OPERATOR:

Our next question comes from Paul McTaggart of Credit Suisse. Please go ahead.

PAUL McTAGGART (Credit Suisse):

Hi gentlemen. I just want to follow up on some of the China comments around steel demand because you painted a reasonably robust picture. In just the data that I've seen here to date it says that steel production is up something like 3 per cent but exports are up 40 per cent and underlying domestic consumption is more or less flat, so I just wanted to get a sense of what you were seeing that was making you more positive, particularly going to the back end of the year?

SAM WALSH:

We are seeing an easing of credit in the first half of this year. We saw quite a bit of tightening. We are seeing in the provinces and nationally focus on infrastructure, particularly rail and social housing. As you mentioned, exports are up.

I guess most importantly if you look at our product offering, Pilbara Blend is the largest traded iron ore product in seaborne trade and it provides the foundation for steel mill burdens, plus various burdens. So it puts us in a privileged position, that they bill us and then they put salt-and-pepper from others on top of that. That is a unique privileged position.

The second privileged position really relates to the quality of the product and with increased focus on pollution. When we talk about the environment we are generally focused on climate change or greenhouse; when the Chinese mention it they are focusing on smog, they are focusing on actual pollution. At the China Open Forum that I attended earlier this year a small group of CEOs met with the Premier of China and he indicated that it's probably the biggest problem they have and the most difficult to solve but they are committed to solving it.

This has actually meant that there has been a shift in relation to the product that the steel mills are using as they are focusing on improving their environmental performance and a shift to higher quality ore which has reflected in terms of obviously the attractiveness of our product but also the significant discounts, the 15-20 per cent discount that the low-grade junior suppliers have had to offer to make their product even attractive to the mills.

So there is a range of factors there in terms of how we see it. We are seeing steel prices improve a bit, we are seeing steel stocks reduce, we are also seeing port stocks of iron ore reduce and we have seen some 85 million tonnes of China domestic product come off the market. We are expecting that will be around 125 million tonnes through this year. So there is a change in the dynamics, there is a restructuring underway there.

Do we have another question on the phone?

OPERATOR:

We will take a question from Heath Jensen of Citi. Please go ahead.

HEATH JENSEN (Citi):

Good morning Sam. Just a related question in terms of iron ore ramp-ups. You are still giving a range of potential ramp-ups in the order of 20-30 million tonnes a year over the next couple of years and I think you said at the Full Year Results that was really subject to market conditions, so I am interested in terms of how you are thinking about that now?

As you've said, you have knocked out potentially 125 million tonnes of domestic production and the price has come down. Do you think that's sort of at the point where you'd go for the slow ramp-up or sort of how are you thinking about that and managing that going forward in that ramp-up given where the prices are currently sitting? Will you be willing to take production out of the market?

SAM WALSH:

Look, it will be what it will be but we are seeing right now that prices have really stabilised around the sort of 95-100 level and if you look at the forward curve it confirms that's where the market is expecting prices to be through 2017.

In relation to our expansions, we are the lowest cost producer. We are producing at a cash cost of \$20 a tonne with prices around \$95 a tonne, so very, very attractive margins and a very attractive place for us to be. We are seeing 125 or expecting 125 million tonnes of capacity to come off in China and elsewhere and we are seeing a number of the juniors around the world starting to get the wobbles.

We are in a very good place in relation to this and now is not a time for the best iron ore producer in the world to take a step back. Now is the time for others to really feel the consequences of the price against their operating costs and for them to make decisions.

Perhaps if we can come back into the room and we have a question right over here. I will come to you in a second – you're next.

RICHARD NORTHRIDGE (Och Ziff):

Hi thanks. Richard Northridge at Och Ziff. In returning to the sustaining capex question and just eyeballing the chart, 2012 sustaining capex looked about \$7 billion and clearly your asset base has changed since then, so has your perception of your asset base changed so much that you now view sustaining capex at the \$3.5 billion versus the \$7 billion from 2012? Thanks.

SAM WALSH:

Look, perhaps that's a question I can pass to Chris? Certainly there have been some changes to our portfolio in relation to divestments and that needs to be considered when you look at sustaining capex. But, Chris, do you want to comment on that?

CHRIS LYNCH:

Thanks Sam. I think probably two things. One is around that number, would definitely have included Pilbara sustaining mines back at that time. I don't have the specific data in front of me at the minute, but that would be one issue. To address that point, given the expansion programme that is underway in the Pilbara, the concept of Pilbara sustaining is a lower number today.

Look, I think we have applied the same rigor and discipline to sustaining capital as we have to other forms of growth and I think part of that is showing up in some of these numbers. I think the climate for the cost of capital construction and capital sort of works has also moved on a cyclical basis in our favour in some ways, so I think what we have got now is a fairly robust view about what's actually necessary to sustain these operations and I think you are seeing that coming through now. But we are confident about our capex numbers. We are confident about the fact that they can be sustained going forward.

SAM WALSH:

Thanks Chris.

A question in the middle here?

TIM HUFF (RBC):

It's Tim Huff from RBC. I have two questions, the first on Aluminium. Six months ago when I asked you your thoughts on 'ally' going forward you said it's a difficult one, there's no easy solution. Now with the division at least on a half year basis rivalling Copper in EBITDA cost savings and capex looking lower, I was just wondering if you could maybe talk us through maybe what's changed in your view? It doesn't seem like your view on the sector has changed but maybe your view on what those assets can generate and in the medium term where they sit within Rio?

The second question is a follow-on from Menno's on working cap. Chris, just from your comments it sounds like you are targeting lower than historic working cap measures for the second half of the year. Is it fair to say that you've a fairly high conviction at this point in time that you can already deliver the same sort of first half to second half working cap swing that you guys have seen in recent years? Thank you.

SAM WALSH:

Okay. I'll certainly answer the first part about Aluminium. I think the key to the question is where we are positioned in relation to EBITDA margin versus our competitors and, as I mentioned in my comments, we are substantially better than our Western World competitors in terms of EBITDA margin and that gives us a fairly unique position.

Is Aluminium where I would like it to be or where Alf would like it to be? The answer is "no". We have still got a journey ahead of us and I have mentioned the cost reduction. There is a need for us to further streamline the operations as we go forward, but we are making the tough decisions, we are refocusing the business and I would remind you that – correct me Mark if I am wrong - 80 per cent of our metal is produced using highly competitive hydro-power, so not only is the power source low-cost, it is also "green", in inverted commas. So it is a good place for us to be.

Alumina continues to be tough and we are continuing to focus on improving our costs in the alumina side of the business, which right now, and we are not alone, is probably the toughest part of the business.

Bauxite: with bauxite selling in the spot market for around 60 bucks a tonne and with five billion tonnes of bauxite sitting in our portfolio, it's a good place for us to be. And I have already hinted about the South of Embley – or hinted as strongly as I can – about the South of Embley project.

It is a business that continues to undergo significant change. We are hopeful that the early signs of improvement in pricing in the market, as a result of a lot of action by us and others, we are hoping that will continue to flow through. My feeling is that in the medium term we have seen a lot of capacity come on in the west of China, and that power is going to be needed to power the burgeoning middle-class as they become very focused on consumer goods, fridges, air-conditioners, TVs and what-have-you. They'll all need to be powered.

And I have said before if you want to look at an example of that, well, look at Japan. Japan used to have a very vibrant aluminium smelting industry; today there is none, it's all gone. And I suspect we will see a similar, perhaps not exact, but a similar shift in China as this currently trapped power is either opened up through transmission lines and increasing the grid or direct use of that power in those communities to drive their consumer goods.

Chris, perhaps if I could move back to you on the working capital? It seems it's quite a theme today. I am sure our organisation will be delighted to hear this because this is one of Sam's catch cries and if it's not a conversation that includes working capital then something is going wrong. So thank you for raising it again.

CHRIS LYNCH:

Tim, I think you rightly point out we are targeting some fairly strong improvements in this over the second half of the year, that I am confident that we can achieve and I think it's something that we should be doing. We have done a lot of the pre-work in the last 6-12 months and it's been targeting about what these ideal levels should be.

I think we have got two bodies of work going and underway. One is around, what's the ideal level of inventory we need to sustain our various operations? And you'll see some of the things like Oyu Tolgoi now starting to ship in excess of what they are producing in the open-cut. We have got some of the iron ore that's been held up at the mine site that we can now have a better opportunity to get it down the infrastructure chain to the port, so there are opportunities like that.

There is also opportunity to negotiate different outcomes with regards to the payable side of the house. So that's really the things we work toward, getting that total number down. But thinking about it more, about what the ideal levels are rather than some sort of target and 5 or 10 per cent reduction is far more meaningful but it's a bit slower but more sustainable. So that's our ambition and we are confident we can achieve it.

SAM WALSH:

Okay, perhaps we have got time for one more question in the room. (A pause) Well, it looks like we've handled them all. So thank you very much.

I am very pleased that we've been able to share this story with you today. It is a great story. I am seriously pleased at the progress we have made to date. The job isn't finished, which means that there is opportunity still there within the business. We are back on track, we have laid solid foundations to deliver greater value for shareholders, and that was the underlying theme of my comments when I took over in January and at the February results last year.

The theme continues and I am delighted that the Board has picked up the theme. We are confident we will continue to generate strong and sustainable cash flows over the coming years. And have another look at that third paragraph of the release, it will allow us to materially increase cash returns to shareholders – very different wording from Rio Tinto, but we mean it.

So there's a cuppa outside. Please feel free to join us and have a chat to any of our team here. Most importantly thank you for being here, I do appreciate your time. Thank you.

(End of Q&A Session)