

Rio Tinto 2017 Half Year Results

Q&A transcript

2 August 2017

J-S JACQUES (Chief Executive):

On this note, I will open the Q&A session. I will take a couple of questions from the room and then we will take to the people on the Call.

QUESTION:

It's clearly been an outstanding first half. If I look at slide 11, the 'bridge' is very helpful. If I combine volume, inflation and energy on the one hand and I combine the cost savings on the other hand you basically stand still as a company, and that's clearly not a bad outcome given where we are in the cycle.

Is that going to be the Rio Tinto, or the industry, we need to look at for the next 3,4 or 5 years until more projects come to fruition or can you actually do more than that?

J-S JACQUES:

Well, that's a very good question. As I said, I think we will do more. The productivity, the mine to market productivity, will give us some benefits. It will take some time to ramp up, but where we are today is, those plans are fully embedded at the site of the productivity table and people are working on the fundamentals.

But let's be absolutely clear, and you saw it because you have done your homework already, you saw there is some cost inflation coming back, and I think a good example is aluminium where you see caustic soda costs picking up, and you see it in the margins.

But, as you said, all in all our commitment to shareholders is to deliver superior cash returns, and I think \$3 billion of cash returns, 75 per cent of the earnings, is a good illustration of what we are meaning there.

QUESTION:

Just one question, perhaps an obvious one, just on the dividend and the balance sheet policy. You are clearly paying above the 40-60 per cent range, you could be very close to a net cash position by the end of this year, so what sort of room is there for the policy to evolve from here and do you think at some stage there is the possibility that we could see a progressive being reintroduced as part of the overall dividend policy?

J-S JACQUES:

You go first Chris and I'll think about this one. I will do the second part, no doubt about it.

CHRIS LYNCH:

No is the answer to the second part.

What you are seeing in these results is the benefit of the variable policy. In low performance periods it obviously protects the balance sheet and in high performance periods it gives the shareholders a chance to participate more fully in the upside, and it allows for a balance of capital allocations between growth and returns.

If you read the policy wording closely, you can see there is scope for extras in any given period depending on the Board's view of the performance of the business, the cash generated in the business, the outlook for the future, the state of the balance sheet, so there is scope for further returns.

The \$3 billion it's really the key number, the dividend is 50 per cent of underlying earnings, adding \$1 billion to the buy-back makes it \$1.5 billion for this year and, you're right, 75 per cent of the year to date earnings is a great outcome but there's capacity for that with this policy, but no return to a progressive policy.

This dividend actually, this interim, is higher than any interim previously paid. The previous record for an interim was \$1.08.

J-S JACQUES:

So let me make clear, if we had a progressive policy today, the cash return will be lower, by definition. So the policy is working as designed, which is at the top of the cycle we will have more cash and we will return it to shareholders, which is I think the best thing we can do.

QUESTION:

One of the questions we keep on getting asked, which you will be asked a lot on the road shows, is what are you going to do with the \$2.5 billion of cash you'll receive in sort of a month's time or so. Could you give some sense? Obviously you haven't got the cash in the bank yet so we are not seeing it in today's results.

J-S JACQUES:

That's very correct. The priority is to get the cash on the balance sheet. We are pretty confident about it but, you know, until it is there.

It is a very good question. We are very clear, when we have got the cash on our balance sheet we will process it through the usual capital allocation framework. We will have a conversation with the Board, and the parameters are very clear we did reconfirm our capital guidance for this year and the coming years, shareholders should expect good returns, but we will not declare anything until we have got the cash on the balance sheet and we go through the process.

QUESTION:

Will you consider out-of-cycle returns, so once the cash arrives in September could you then at the next Board Meeting decide to sort of step up the buy-back at that point or will you stick with the usual interims and final?

J-S JACQUES:

The only thing I can say is clearly we will have a chat with the Board when we have got the cash on the balance sheet, but I can't give you an indication about the timetable on this one. But I can tell you for a fact that by February, when we have the Board Meeting to review the Final Results, we will have an answer to your question.

I am going to go to the people on the Call and then I will come back to the room.

QUESTION:

A couple of questions from me.

The first one is just on aluminium costs, particularly for the primary metals segment. I notice they've gone up about 10 cents a pound to around 74 cents half-on-half. I'm just wondering if you could talk a bit more about that and whether that's the new base going forward or whether there are some one-offs there?

And then the next question is just on the lithium project. Could you talk a bit more about what the scope is, what the likely capex is? Is there anything more you can shed some light on that, given you've put an announcement out but there really wasn't a whole lot in there? Thanks.

J-S JACQUES:

Okay, I will do the lithium. We made the announcement that we signed a MOU with the Government of Serbia, 10 days' ago now. The assessment is underway. There are a couple of parts which are pretty obvious: one is a marketing study about lithium, about the attractiveness of the lithium industry, clearly on the back of electrical vehicles, batteries and so on and so forth; the second part is really, could we have a world-class asset in Jadar in Serbia?

The work is underway, we still have a couple of years to go, but we made the announcement because you know it's important that we bring our partners with us on this project and we had reached an important milestone with the Government of Serbia, and it was important to recognise this point.

But the only thing I can say today is the work is underway, no decision has been made yet and we will inform the market as and when we are ready. That's where we are.

Do you want to pick up the aluminium piece and the increasing costs, Chris?

CHRIS LYNCH:

On that, Jadar, we are at order of magnitude, it is really where we are at, so it is very, very early in the process.

On the aluminium costs, the input costs into aluminium this half versus the same half last year are about \$320 million higher, so that's a significant headwind and it's all market-related. But it goes to caustic soda, the coke and pitch inputs into the smelting system and also the energy costs, particularly in the Australian smelters. So basically caustic soda is about \$150 million, coke and pitch about \$115 million and the energy is the bulk of the remainder.

It actually accentuates the point about the power of those Quebec smelters and the hydro-power where we are in the first cost decile and that difference; we also get a bit of benefit for the green aspect of aluminium in Quebec with the hydro as well.

J-S JACQUES:

So we haven't seen too much cost inflation coming back into our cost structure today, with one exception which is in aluminium and that's what we have covered.

If we could go back to another question from the Conference Call and then I will come back to the room.

QUESTION:

Just two questions.

With respect to the Coal & Allied sale, I wonder if you could give us an insight in terms of whether there's any tax payable on that sale and what is the actual book value so one can ascertain the impact on the earnings?

And then secondly, in terms of the share buy-backs, I do recall you saying it's going to be all PLC. What would need to happen for you to do buy-backs on the ASX? Thank you.

J-S JACQUES:

I will take the second one and you take the first one, Chris.

All PLC – for one reason, is we buy the cheapest stock of the two and we look very carefully at the premium, the delta or spread, between Limited and PLC, and today it is cheaper to buy the PLC stock, and that's one aspect.

The other aspect is on the \$1 billion, on a pro-rata basis, if we were to do an off-market in Australia it would be so small that it would not work from that perspective. So today, \$1 billion of additional buy-back in the next 6 months makes more sense to do it in the UK of the PLC.

Take the other one then, Chris.

CHRIS LYNCH:

With regard to the Coal & Allied proceeds, we do have carry forward losses in the Australian jurisdiction so anticipate very, very low, if any – it may well be zero tax payable on that. It will be a pretty clean transaction; we will utilise pre-existing tax losses, capital losses.

J-S JACQUES:

Okay, thank you. We will go back to the room.

QUESTION:

I think you have been quoted today in the press talking about how not all of your assets are world-class and one of your 'Ps' here is a world-class portfolio. Without sort of asking you to single out the 'naughty children', could just remind us which ones you really think are world-class?

J-S JACQUES:

Let me give you an example of what a world-class asset could look like, and I hope you will agree with me:

Pilbara, I think that is a world-class asset.

Amrun, bauxite, Queensland, that would be another one; Oyu Tolgoi, copper, Mongolia, that would be another one. The aluminium smelters in Canada, are not in the first quartile of the cost curve but the first decile of the cost curve, are world-class. I think I've given you already a pretty good sense of which assets we regard as world-class.

I am not going to tell you which ones are for sale and which are not for sale, you know that, but a couple of points. We are not going to do a fire sale, okay. We've sold \$8

billion of assets in the last four years, and with good valuations, even if you extract Northparkes or even Coal & Allied, we did extract more than full value for those assets.

For sure, I want to clean up the portfolio as quickly as I can, but at the same time there will not be a fire sale. So that's where we are. When we make progress –we will disclose it to the market.

So the direction of travel is very clear, we want to build over time a portfolio of world-class assets by exiting some of our non-core assets, and at the same building new world-class assets. I think the three projects we are progressing today, Oyu Tolgoi Mongolia, Amrun, and Silvergrass that we open in a few weeks now, are good examples of what we want to do in that respect. But thanks for asking the question.

QUESTION:

Maybe one for Chris again about the form of shareholder returns. You are going to step up the buy-backs it seems in the second half of the year, spending four times what you spent so far. Implicitly, you are taking a bet on the share price and the share price is probably a little bit higher because of commodity prices.

So how has this progressed in terms of your thinking, in terms of potentially paying some special dividends in the future, and in that way you are not really taking such a bet on commodity prices and particularly the share price level at the time?

CHRIS LYNCH:

It's always an interesting debate; if you have three people in a room you probably have got four opinions about buy-backs generally. But in terms of a special dividend, that is one of the arrows in the quiver, it's an option open to the Board should they decide to go that path, so it's not something we'd exclude consideration of at all.

So I think the key really is that we still believe we're buying a value if you think about it that way. The return of cash to shareholders is really the key and it's an extra \$1 billion this announcement, so there \$1.2 billion to go within this year. Special dividends are an option.

J-S JACQUES:

Thank you. Are there any questions from the Conference Call, if we could go back to the Conference Call, and then we will come back to the room?

QUESTION:

The first question, Chris, is on capex.

I'm just looking at your 2017 capex guidance. It appears pretty conservative considering you only spent \$1.5 billion in the half, and I know the sustaining capex will roughly double in the second half based on your advised guidance of \$2 billion to \$2.5 billion, and there is normal timing variances and seasonality in Mongolia and Weipa etc.

But I'm struggling to see how you actually spend \$3.5 billion of cash capex in second half. And also considering you have come under guidance, capex guidance, for the past three years so obviously you are performing well, I wonder if you can add some 'colour' on just how you will spend \$5 billion in 2017?

And the second question is on the Pilbara, and it's probably for you J-S. I am sure you will agree that the June half performance in the Pilbara wasn't one of your better halves and part of that was due to the rail maintenance programme. So can you just provide some more information on that programme and what has actually gone wrong there?

Secondly, I know your strategy is to maximise margin, but can you provide some guidance as to where you think you can take a Pilbara unit cost over the medium term?
Thanks.

CHRIS LYNCH:

I think the capex year to date spend is relatively low versus the full year target, so I think the skew for variance from where we are is probably at or below the \$5 billion - I don't think there is much chance of it going beyond the \$5 billion - so I think the risk really is to an under-spend rather than a sort of over-spend, but it's not clear enough to give you different guidance than the \$5 billion.

And part of that could slide into 2018, so I wouldn't get too excited about exactly where it will be. It will be at or around \$5 billion; I don't think there is much chance that it can over \$5 billion.

J-S JACQUES:

But I think just to build on this point before I pick up the second question, and you know better than anybody else that the weather was pretty bad this year, and in Queensland where we are building Amrun, during the wet seasons you can't do anything at all. That's pretty simple, the mud is pretty significant.

I was there a couple of weeks ago with Chris and now you can see clearly, physically, a pick-up in terms of activity. So I am very confident that the ramp up of activities in Amrun will translate into additional capex in the second half.

The second element, as an example, it's clearly Oyu Tolgoi, is still ramping up and therefore current commitment will translate into cash expenditure, and so on and so forth.

We won't get to the \$5 billion maybe but I think there will be a clear step up of capex between H1 and H2.

Moving on to the question on the Pilbara, it is absolutely clear, we are totally transparent, on the fact that there were operational issues in the first half in the Pilbara. A big chunk of this was weather-related and you will see it with some of our peers as well. But we took the decision to accelerate the upgrade programme on the railway in order to make sure that we can enable further productivity improvements in the coming years. So the results are what they are in the first half.

Now what the team is doing is really focusing on the second half. What we did a few weeks' ago is really to revise the guidance. Initially the guidance was between 330 and 340 Mt for a full year, and what we said is we will reach the bottom of the guidance, and I think it was important to inform the market. Now the work is underway to deliver the plan in the second half and that's where are.

In terms of cost, that's an interesting point here because costs are absolutely essential, and but my view is that margins are much, much more important.

In the context of iron ore, when you look at the spread, the delta, the discount, between high-grade and low-grade iron ore if today you don't deliver the right grade to your customers you may be under pressure from the margins at some point. At the end of the day what matters is the margins, which translate into cash.

I had the opportunity to meet with, for example, Chairman Xiao, who is the Chairman of SASAC, who controls all the non-financial SOEs, three times in the last 12 months. I have got no doubt in my mind that the Government of China is serious about restructuring the steel industry, but restructuring the industry doesn't mean a drop in output.

They are taking out the old polluting capacity and they are concentrating on the newest, and for them to be able to produce the same output, and you have seen from the stats the output that the steel is producing has been very, very strong in China. They need to have better raw materials, starting with iron ore.

We see this, this whole question about margin, about grade, as a fundamental shift. It is still early days, I accept that, but we could have a structural shift in the demand from China and that creates some opportunities for us.

So you're right, I will not drop the ball in relation to costs but a priority for us is to optimise the revenue of every tonne we sell from the Pilbara and therefore our primary driver is about adding margin per tonne.

I go back to the room.

QUESTION:

Two questions.

Firstly, a quick one on Simandou, back in October I think you talked about trying to get or hoping to get a finalised deal done within 6 months. We're obviously a bit beyond that. Could you talk through what the stumbling blocks are there and what the updated timeline is?

And then secondly, return on capital employed has obviously been something that you guys have focused on a lot over the past year or so, improving that base. When we hear the numbers, it doesn't look like Rio has been improving its return on capital really significantly any faster than the peer group. So where do you feel Rio is, ahead of the peers in terms of the focus around return on capital - obviously everybody is trying very hard to improve that - what are the competitive advantages that you have?

J-S JACQUES:

I will pick up on Simandou and you pick up the ROCE, Chris.

With Simandou, discussions are still underway. It's a complex set of negotiations because you have three parties, but good progress is being made and we will inform the market when the deal is signed. That's where we are on Simandou. But, you know, everybody is committed to making it happen, two governments, one company, takes some time. It's not easy-peasy, as they say. We will inform the market, but at the moment we are still there.

CHRIS LYNCH:

Well, it's an interesting conversation because we have got the recency of all the Pilbara spend and all that type of thing, as you rightly point out, absolutely everybody if they are not - well, they are - are trying to do exactly the same thing.

It's not something you are going to change overnight other than via volatility and price, which isn't really the measure you are after.

But if you just think about some of the issues that we have got now. We have got over 40 trucks parked up in the Pilbara, they are heavy-haul trucks that were seen as requirements, but no longer required based on other improvements.

You have got Silvergrass now coming through, which is going to be conveyor rather than trucks and so it takes the cost down, but there is a capex involvement in there. We'll probably spend more on retro-fitting some of the trucks to Autohaul® or new Autohaul® trucks, notwithstanding we have got trucks parked up, so there are a few of those sort of complexities.

But we will get further down the path on that as we get further into the productivity programme. We are talking about the capital markets day in November/December, so we will go a bit broader on that in that timeframe.

J-S JACQUES:

With the productivity programme, we are clear that we need to improve our OCE, there is no doubt about it, and productivity is a key part to most of it. If you think about it in simple terms, okay we have got a base of \$50 billion and an initial \$5 billion gives you a sense of the direction of travel, but it is hard work. It is not easy in that sense but, as I said earlier, the plans are there, lots of activities on the ground, and we could talk about fixed plant utilisation, and we just gave you an example about the trucks.

I have got no doubt that it's a huge driver of profitability going forward, but it's a multi-tier product and there is no silver bullet – if there was one we would have found it but there is none – so it's about hard work, it's about consistency of practices across the Group.

We have got 800 trucks across the Group and we don't run them the same way. People could say, why is it the case? Well, it is what it is, but I see it as an opportunity and we are really having a more standardised and more consistent approach in the Pilbara, we have got 400 trucks in the Pilbara, but 40 are parked today, that's one aspect, the second wave will be more about automation.

Currently out of the 400 trucks in the Pilbara we have got 76 which are autonomous, over time we will bring the number higher. We do expect that to be very phased in the future because what is important is to lock in each time we make an improvement; we lock in and then move to the next one. It is slow but it is about sustained results.

An initial \$1.5 billion of free cash run-rate by 2021 is a big step up from where we are today. But everybody is doing the same. I believe we are slightly ahead of the curve in terms of automation. The trucks, we have got the largest autonomous fleet today; in terms of drill rigs we only one who have drill rigs fully automated that can do real-time sampling and so on and so forth, and we are progressing on the autonomous train as well, so we are ahead of the curve. But we are not becoming complacent, we just keep pushing, it will take some time but the prize is very clear.

We will take a question from Conference Call.

QUESTION:

A couple of questions on the 'unloved children', so to speak.

The Australian aluminium assets, we are seeing a lot of pressure on electricity prices here in Australia and I understand you have long-term contracts in power supply but we have already seen curtailment of some capacity. Have you looked at the sort of longer

term implications of that and re-testing the carrying value of those assets or is that something that could be done at the Full Year Results?

Also just in regards to Iron and Titanium business, I think you are restarting one of the furnaces at QIT, given that there's a lot of latent capacity available of those assets, what's the strategy behind restarting up furnaces, is it product-driven or is it an indication that there is a further improvement in demand seen on the horizon?

J-S JACQUES:

I'll pick up the energy one. I'm on public record as saying there is a serious situation in relation to energy in Australia. It is not only about Rio Tinto, it is across the patch. What we want as a company is a source which is affordable and reliable power in Australia. Today, that is not the case, and it is not because of a lack of capacity, it about the regulatory framework and how it is working at a State level.

The only thing I can say is please fix the problem because otherwise when I look at the plans either at the State level or at the Federal level in Australia where people want to develop more manufacturing activities, if the industry can't have access to reliable and affordable source of power that will not work. The model is broken today, everybody is in agreement with that, and it has to be fixed.

Three weeks' ago I was with the PM and we made the point again and again, and we will continue to fight for this because we want Australia to be competitive in that space, they need to fix the problem, and the Government needs to step in on this one.

CHRIS LYNCH:

The other part of that first one was around the carrying values, and I think the key there is that in order to address the carrying value you need a trigger or a catalyst and we haven't seen a catalyst that would challenge the valuation of those assets. So that's fine.

Could you repeat the second part of the question?

QUESTION:

It was just in regards to the QIT assets, in terms of I think you are now operating 8 of the 9 furnaces, but with the utilisation they have a capacity of something like 2 Mt. across those assets but producing 1.2 to 1.3 Mt this year, and it doesn't seem quite a cost-effective strategy to restart a furnace, so is there a product strategy behind that or is it an indication of a potential improvement in demand?

J-S JACQUES:

I will pick up this one if that's okay, Chris.

On TIO2, yes, there is plenty of spare capacity and remember what I said about value of the volume. We took the decision to restart the furnace not only because of product but because the conditions of the market were slightly better and we believe it was the right time in order to maximise cash flow to restart the furnace.

But each decision is taken very, very carefully and we believe it is the right decision. So we are not going to flood the market, that is not what we are doing at all, but we came to a point where an incremental volume was the right thing to do.

I go back to the room and there is one question at the back.

QUESTION:

J-S, you talked to the media about an aspiration to see Rio trading on a premium to peers. The first question would be, what is your preferred measure of that? And the second would be, over what timeframe do you think you can achieve that and what levers do you think will be most rewarded by the market in achieving that?

J-S JACQUES:

Thank you very much for the question.

Yes, the aspiration is absolutely clear; I am not going to walk away from what I said in the press. If you think before 2003 during the Two Bobs regime we were trading, if you look at the EBITDA multiples premium against our peers, and at some stage we were 20-25 per cent premium.

I am sure John Smelt would say you have to look at a series of multiples - you can't only look at one - but the aspiration is very clear, we want to be the premium company in the mining business, no doubt about it.

The way to get there, and I think today is a very good example of how to get there, if we deliver in a consistent way superior cash returns like we did today with \$3 billion, I fully believe that this combined with the recognition from the market that we have a superior, more resilient business on the back of a portfolio of world-class assets, superior performance and the strength of our balance sheet, I believe that over time we will attract this premium, and we are going to work very hard to get there.

The timetable, as always I want everything for yesterday, but on this one I think we are going to have to be patient because until we build the track record of delivery then we are not going to attract a premium. So it is not going to be weeks, it is not going to be months, it going to be years but the ambition and the direction of travel is very, very clear.

Okay, I am trying to give a question to everybody here.

QUESTION:

Just two questions.

You are obviously generating a lot of cash and returning quite a bit of that to shareholders. M&A though still doesn't really feature as a priority in terms of your capital allocation framework, but as you look to kind of reposition the portfolio you are more in divestment mode, but would you consider recycling that cash into an acquisition? Has your thinking around that changed at all?

And then just a second question around Grasberg in Indonesia. You made a comment in the past that you would consider selling that option, what's your latest thinking on that?

J-S JACQUES:

As always, the answer will not change from what I said in the past, so I am not going to disappoint you on this one.

On M&A, we have a watching brief on M&A but we will pursue M&A only if it will create value for shareholders.

If I look at some of the recent transactions, and remember we are pretty well placed because we sold \$8 billion of assets in the last four years, today when we look at different options I couldn't see a way forward to create value for shareholders because the valuations were fantastic for the sellers; I'm not quite sure for the buyers. So we will keep a watching brief, no doubt about it, but we are not going to rush on M&A for the sake of it.

Which brings us back to the value over volume; we will not pursue growth for the sake of it. Now if there is something, the right value because of the synergies, for sure we will look at it, no doubt about it, and the fact that we have a strong balance sheet gives us the opportunity to do so, but we are not in a rush.

The second questions on Grasberg, Grasberg is an option for us. There is no doubt that Grasberg is a world-class resource when you look at the copper and gold content – no doubt about it – but there is a fundamental difference between a world-class resource and a world-class business for Rio Tinto.

Depending on the conditions that the Government would impose in the context of the Contract of Work renegotiation then Rio Tinto will take a decision: are we in or out? But it will be on the back of what is going to be the outcome of the current negotiations between Freeport and the Government of Indonesia as we speak, so no change from that perspective.

QUESTION:

Now that the balance sheet restorations are pretty much complete and you've achieved that largely through value over volume and still having a bigger growth profile, I guess my question would be just around the confidence you have of the Chinese economy, especially some of those structural changes you alluded to earlier.

Can I ask, do you think the industry as a whole is spending enough on growth capex at the moment and then is your thinking changing around that at all for Rio Tinto?

Secondly, I will just ask on the Pilbara, in terms of those early stage, it looks like potentially structural changes in the Chinese economy and that's already showed with the low levels of the high grade inventories in China, do you have any way of increasing your higher value product coming out of the Pilbara at this point in terms of sort of more short to medium term projects?

J-S JACQUES:

There are lots of questions here. I can't make any comment about my peers and what they want to do for this reason, it is a Rio Tinto results presentation today. So, are we comfortable with the growth that we have in the portfolio and the capex of \$5 billion to \$5.5 billion? The answer is yes, absolutely yes.

Because, as I have said in the past, if you want to pursue lots of projects at the same time but you don't have your A-Team working on each of those projects that's not going to work. So I would rather pursue fewer projects and deliver them very, very well than pursuing many of those and delivering them in a very average way.

That's what it is, it is better to be focused and deliver them well, on time and on budget, than pursuing lots of things and having massive issues down the track.

What are our peers doing? You should ask the question to our peers. I can't say anything else. So that's what I think.

A similar aspect when we talk about growth, when we talk about growth we talk about growth of free cash flow and it links back to the question about productivity. \$5 billion of free cash flow in the next five years is the best return, the best investment, we can do. So for us growth is about the productivity on one side and the additional volume growth coming from world-class assets.

The second part of your question was about the Chinese industry and I will make two comments, if I may, one is about steel and the other one is about aluminium. I will start with aluminium.

Once again, I believe they will restructure the aluminium business over time, in the medium and long-term, and you can see already signs that today if you have your permits to build new pot lines then you can be potentially in trouble and even if you build the pot lines today and you have your permits you can be in trouble as well.

So medium to long-term, I can see them putting more and more restriction about the pace of growth in relation to aluminium smelters, and I hope I am wrong, I really hope I am wrong, however where we are very cautious is when people say that in winter they will switch on and switch off pot lines. Coming from the aluminium industry, I have got my doubts because when you switch on, switch off you destroy your pot lines it is as simple as that. As I said, I hope I am wrong.

So in the short-term I am very cautious. I know the market is saying something else, which is great because we enjoy those higher prices for aluminium.

Medium and long-term, no doubt about it, that they will do what they said they will do. In this context having an aluminium smelter in Canada, hydro based, where they are not in the first quartile of the cost curve but are in the first decile of the cost curve is a fantastic advantage, so we have no issue on this one in the medium and long-term.

On the steel industry, they are restructuring. They are restructuring, as we speak, no doubt about it. The demand for high-grade ore is significant, and interestingly enough you know when we've had lots of volatility in relation to iron ore prices this year, even when the iron ore prices dropped in a significant way, the premium, the spread, the discount product, between high-grade and low-grade didn't change and that gives me more and more confidence that it's a structural change. It's still early days, but the direction of travel is moving in what I believe is a very good direction of travel for us.

Then the last question, about can we change our grade?

We are going to have at the end of August 16 mines in the Pilbara with the opening of Silvergrass. I can't change the mine plan like that. I wish I could, but no, it's a complicated process, we have blending activities etc, so over time we can shift the mix but in the short-term I cannot switch on, switch off. That's not realistic.

Okay, two questions from the Conference Call.

QUESTION:

J-S, when Chris was out here 6 months' ago for the last Results, he said he wanted to pay down debt by another couple of billion; you've done that. He also said he didn't see the need to become net cash. I am just wondering if that's still your thoughts and, if so, could we see returns approximate 100 per cent of free cash flow?

And then the second question is just on Oyu Tolgoi. You have done a lot of travel; I wondered if you have been there lately? There have been a few political changes and I guess some commentary from the new political personnel that is a little bit worrying, and I just wondering if you have got any comments please?

J-S JACQUES:

I think the answer to your first question is no change. Do you agree, Chris?

CHRIS LYNCH:

Yes.

J-S JACQUES:

Okay, that's the answer for your first question, no change. We want to have a robust balance sheet, but having a zero net debt is not what is on the agenda. Now you can't rule out anything at all in the sense of if the outcome was to change in a dramatic way then we would revisit the situation on a regular basis, and that's the only thing I can say.

Our capital allocation framework is very clear, we gave you a clear guidance; we did reconfirm the guidance in relation to capex for the next three years. The strength of the balance sheet is what it is and we are very clear, and I think today is a good example of it, \$3 billion of cash return for our shareholder, 75 per cent of the earnings. We are doing what we said we are doing and you know we will continue to do so. That the only answer I can say.

If I move to the second point of your question about the Presidential Election in Mongolia, we have been in Mongolia for 10 years. Mongolia is Mongolia in a sense, it is a challenging place, but we are working very closely with the Government. Oyu Tolgoi is progressing well. Oyu Tolgoi will have a very significant impact on the economy of Mongolia for the next 50-100 years.

The recent statement by both the Government and the Cabinet and the President is to attract further FDI, so today we are comfortable where we are in relation to Mongolia.

If I can take another question from the Conference Call and then I will come back to the room after.

QUESTION:

I have just one question, getting back to our favourite subject of iron ore. If you gave yourself a scorecard I guess in iron ore out of 10 where would you say you would be, versus your potential, at the moment? And then I guess the follow-on from that is, where would you be once AutoHaul is the finished in 2018, just to go over the importance of that programme, when you complete it? Thanks.

J-S JACQUES:

Thanks for that. Where is the KPI you are looking at on the 1-10 score? I think you have a detailed question here. Is it a general statement or is it very specific?

QUESTION:

I guess I'm looking at the overall margin, thinking about where the margin is, where costs are, where volume is, and where you think your ideal place is and how critical is Autohaul® for that, because I guess we have been hearing about margin improvement and portfolio, shrink to greatness and margin, and I guess this is the critical part of your margin and I think about the business.

J-S JACQUES:

Yes, okay, I got the picture. I am a tough headmaster according to the team, so I've got to try to be fair on this one. I would say 7 out of 10. I am sure there are lots of people in Perth who are very upset with me as we speak. But I still believe there is lots of room for improvement across the Pilbara and I think the productivity roadmap, a combination of consistency of practices, plus automation and big data, I can see lots of upside.

So I think 7 out of 10 is a good mark. I hope in five years down the road we will be closer to 9 out of 10 and, you know, to be honest if we can get beyond 10 I would be even more happy.

Autohaul® is progressing well. We gave you the metrics. A complicated project but we've achieved massive improvement in the last 12 months. It's one of those projects which you need to do in a very phased and structured way and we are getting there.

CHRIS LYNCH:

The bottleneck is currently the rail and that leads to a lot of inefficiency in terms of how the mine and port can operate etc. The ideal place for the bottleneck is the port, you want to have rail capacity available, so part of the challenge is really getting the Autohaul® and getting the rail to its most efficient such that we can shift the bottleneck from the rail to the port. At that point you have got a whole lot more operating flexibility.

J-S JACQUES:

The picture we have of the strategy is to have a funnel where, as we said, the bottleneck is the port, which is not the case today.

If I go back to the room for a couple of questions before we wrap up.

QUESTION:

Just a couple of questions.

First of all, on iron ore market in the context of your earlier remarks and your recollections from China. The iron ore stockpiles are growing which means technically that the market remains in oversupply. An optimistic view, and some people support it, is that we shouldn't be too worried about it because as the stockpiles are growing the quality must be deteriorating in terms of grade and in terms of impurities.

Now you are supposed to know about the iron ore market more than anybody else. Do you support this view? Do you think that we shouldn't be worried about iron ore stockpiles just because the quality is changing?

J-S JACQUES:

I will answer in two parts on this one.

One is that two-thirds of the stockpiles are currently low-grade iron ore. That is correct, and it's not moving and you see the price volatility at the same time. I think I have answered to a large extent in a previous questions, and is to say I know it is early days – I know it is early days – but I believe there is a fundamental restructuring, structural change, in the way the steel industry is operating in China and therefore I think, by having the right grade, you'll be fine.

Now at the same time I believe in the short-term volatility because somebody must be sitting on massive losses here - I don't know if it's a paper loss or what – but that at some stage this volume will be cleared. So if you step back and you say there are four key drivers in the price formation of the iron ore. One is the underlying Chinese economy, and secondly it's additional supply in Brazil or in Australia, which is well documented, so it's well priced in the market place.

The restructuring of the steel industry, my sense is it is moving in the right direction. The key source of the uncertainty is really about two things. The volume of domestic production in China – remember a few years' ago they produced around 400 Mt, it dropped to 235 Mt last year, and we believe they are back to 275 Mt and, when, somebody is going to say, 'enough is enough, I have been sitting on a loss, and I am going to clear the debt on the stockpile'.

One way to look at it from our perspective is we believe the fundamentals are good but there is volatility. Now what can I do from a very practical starting point at Rio Tinto? It is to make sure I have got the right cost structure, I have got the right grade, I have got the right relationship with the customers, and that's what we are doing.

QUESTION:

My second question is your transaction deal with Shaw Gold. When should we expect any news about progress on this diamond project?

J-S JACQUES:

With exploration we are always buying in, buying out all the time properties, we are swapping properties. It's part of our business model.

We are very comfortable with the capital guidance of \$5 billion to \$5.5 billion. I don't think this one is going to change the guidance whatsoever.

Maybe one last question here on this side.

QUESTION:

This is just an observation, but if you look at your three growth projects, the high value projects, you are spending about \$7.7 billion over five years. You could almost return that this year in shareholder returns, you have already spend \$3 billion in the first half, so do you feel that this is a reasonable balance? It seems weighted more towards shareholders to me. And do you have a number of your engineers bringing a pipeline of projects to you but saying, 'we need money for this, we want this to be within this pipeline', so that you start to spread it out in the years going ahead?

J-S JACQUES:

I can answer the question very easy; there are lots of people with lots of ideas, that's for sure.

The question is, and I think we touched on it earlier today, from my perspective it's all about delivery. It's better to pursue a few projects and deliver them very, very well than trying to do lots of things and having a big issue with them. That's a fundamental principle here.

So do we have a pipeline of projects beyond Silvergrass, Amrun and Oyu Tolgoi? The answer is yes. We talked about Jadar. We could have talked about Resolution, beyond Amrun we have got Amrun versions 2.0, 3.0, 4.0 – we have got multiple optionality in relation to bauxite, we could grow the iron ore as well, we have got multiple optionality.

Remember the discussion we had earlier today about the funnel, you have got the port, railway capacity and the port, so we have optionality around this one but what is important is to deliver them on time and on budget and we can't pursue too many things at the same time.

Now your comments about capital allocation/shareholder returns versus growth, today we are very comfortable in the balance and I think \$3 billion is absolutely consistent with

what we said, which is to deliver a superior cash return to our shareholders, 75 per cent of the earnings. I think that is what we said we will do and we are delivering on our promises.

I see John saying I should close this meeting, so I hope you got the message - \$3 billion, 75 per cent of earnings. Thanks a lot for coming and thanks for your questions, and then I will see you pretty soon. Thank you very much.

(End of Q&A Session)