Q&A transcript

J-S JACQUES (Chief Executive):

On this note, maybe we should open the Q&A session, so why don't we start with the room and then we'll move to the conference call.

QUESTION:

Thank J-S. An excellent presentation on Aluminium and Iron Ore, so can you just give us a brief overview of the Copper division and where we are with that, and in particular the future of Kennecott perhaps, and if and when you are looking to replace volumes there given how challenging the operation is?

J-S JACQUES:

Thanks for the question. I think you will have seen your plan in relation to Copper, the same framework in terms of sharing best practices, relationship with the suppliers and so on and so forth.

Kennecott will contribute a lot; it should take a five year period. As and when we have the south wall pushback on line, exactly the same approach, you will have exactly the same.

And on Energy & Minerals there is the small nuance, which is to say we have got latent capacity in TiO_2 and subject to the market conditions we may restart this capacity. No decision has been made yet, but as we have said for everything today, subject to market conditions we may increase capacity but only if it makes sense.

QUESTIONER:

And did you say before, in the slides, that Resolution has a pre-feasibility study due, in the next three years is it?

J-S JACQUES:

Yes, that's right. So we are progressing the permitting of Resolution. We have achieved a lot. If you think about the last three years, we've had a lot of change, the permitting is underway, but we are in the US, the permitting process is extremely slow. We are just going through the process as we see it. But I have to say the co-operation with the US Forest Services, which is the co-ordinating agency in the US, is going very, very well.

QUESTION:

Just a couple of questions J-S, and then one for Chris, but just if you can talk a bit about your thoughts around the portfolio. I mean if I sit and look at what you have done, you are sort of 'shrinking to greatness' I guess, and you are going to end up as predominantly an iron ore business with a little bit of aluminium in North America and bauxite here if you exit Australian smelting.

So I just want to talk about how you are feeling about that and what are you thinking in terms of maybe adding something to the portfolio in terms of another commodity, just how you are placed?

And then just your thoughts on the industry in terms of discipline? I mean you have reiterated value over volume but, as you and I have talked about, balance sheets they are now pretty good across this industry, so do you think we should be starting to worry about the industry again?

J-S JACQUES:

I thought you had two questions?

QUESTIONER:

I have one for Chris; it is just very quick. With everything he has got ahead of him into 2018, do you think you can lower unit costs relative to 2017? Thanks.

J-S JACQUES:

Do you want to start with this one, Chris? I will pick up the other one.

CHRIS SALISBURY (chief executive, Iron Ore):

Thanks. I will deal with that one shortly. Look, we have been disciplined on improving our cost position, as you know, and that discipline will continue. We have a significant pipeline of opportunities but, yes, the cost structure is flattening but we are going to be pushing pretty hard on that and, as I've flagged, we do have some internal headwinds as well, including the increase in effective flat haul that we have to deal with as well.

As you know, we don't give detailed cost guidance but, you can trust me, there is still plenty of pressure on cost improvements but we are starting to feel some headwind.

J-S JACQUES:

Thank you, Chris. If I may add to Chris, what we are interested in is margins, especially in the context of the Iron Ore business. You have seen that. There is more and more evidence that the restructuring in China is becoming structural and therefore there is more and more evidence that the delta of the spread, the discount whatever, what you want to call it, between high-grade and low-grade is there to stay and therefore the priority for us, and this was presented today by Chris, is to say about having the right quality of product, the right customers, in order to maximise the cash flow from the assets.

So we are not saying that cost is not important, we are in the commodity business and therefore we need to remain cost competitive, but the priority today in the Pilbara is really about the margin, it is about the quality of the product and making sure we strike every dollar we can from the ore.

The second question you asked is on the industry and its discipline, and you'll know what I am going to say to you, I can only talk about Rio Tinto. We are very clear about what we want to do across the value over volume concept. We will continue to generate as much cash as we can.

We will allocate this cash with discipline and, as you know, it's a balanced allocation between the strength of the balance sheet, the long-term growth because we need to grow at some point in time in the right way and at the right pace, and the cash returns for the shareholders.

I think what we did last year and what we did this year is a very good example. You know, there are two options: you show a lot of nice slides, okay, and you say 'I'm going to create value for you shareholders', or you do it. The truth of the matter this year, we declared $8 billion of cash returns to our shareholders and we will pay out $6.3 billion [in 2017]. So you have a choice, you read those slides or you believe in the dollars.

On the first question, on the portfolio, we launched the Ventures concept under the leadership of Bold – Bold cannot be here today. We are open to entering into new commodities and new territories; that's the remit of Bold, but it can be all about the returns, all about the attractiveness, and the work is underway.

So the principle is we don't have - how can I say? – set portfolio strategy per se. What we want at the end of the day, really in whatever commodities we choose, is to have world-class assets in order to make sure that whatever market conditions we have we will generate a lot of cash, we will generate more cash than our competitors, and once again we will look at the cash with discipline, as we said earlier, with our balance sheet strength, investment for the long-term and cash return for our shareholders.

Maybe we can take a question from the conference call?

QUESTION:

Thanks very much. Look, the first question is just to get a bit more granularity around the capex guidance. Zulti South was mentioned in the text and I am just wondering when exactly that project starts, being spent on? That was the first one.

Then the second one was just on iron ore and looking at Autonomous Haulage. It still feels fairly slow in terms of the roll-out and I'm just wondering what perhaps is holding that back and when that project is likely to be completed? Thanks.

J-S JACQUES:

Thanks for the questions. Chris perhaps you can take the one on capex guidance?

CHRIS LYNCH (Chief Financial Officer):

Okay. Capex guidance $5.5 billion for next year and $6 billion for the following two, and Zulti South is currently in feasibility study level, so that anticipates sort of, that has got to come for decision, probably during the course of 2018, so we will notify once we've seen that for IC and Board processes. So guidance of $5.5 billion for 2018 and $6 billion in each of 2019 and 2020, and will be less than $4.5 billion for this year.

J-S JACQUES:

Thank you, Chris. And the other Chris, if you will.

CHRIS SALISBURY:

Thanks for the questions. We have been adding to our Autonomous Haulage fleet as we have added trucks, particularly for Silvergrass we added to that.

In terms of the retro-fit we are very clear: first of all, we want to make sure we are extracting value out of the capital we have already installed and I've talked a lot about some of the work we've done on payload and improving utilisation and so on, and we want to make sure we do extract that first.

The second point I would make is we are going to proceed in an appropriate manner. We have done the first maxi retro-fit, we wanted to make sure we understood that process, and we will move forward with a retro-fit strategy, but again being really clear, it is not just about retro-fitting to every truck we have it's actually got to be on a value basis. The fleets are at different ages, they are used in different applications, we want to make sure it is focused on value, not just about fitting new toys.

J-S JACQUES:

Thank you, Chris. Any other questions from the conference call, and then we will come back to the room?

QUESTION:

Good morning J-S, I have two questions. Firstly to slide 7, which had a really interesting figure there about the market sizes in which you operate, and it peaked my interest. Are you indicating that you want to be in large liquid markets only given that you do have some smaller businesses in mineral sands etc? Is that steering me towards a particular direction you are heading and you don't want to be in the small businesses? That's the first question.

And secondly, there was another point made in one of the presentations about turning assets on and off as per market requirements. Could you just talk to me a bit more about what steps you would take to do that and what would be the triggers to look at turning on and off?

J-S JACQUES:

No worries. Thanks for the questions. I will ask Chris to help me on this one as well. On the turn on and turn off, I think I am going to go back to what we did last year in December where we did switch off Hope Downs for two weeks because we were well ahead of the plan, and remember we are selling the Pilbara Blend to China therefore it's a combination of different outputs from different mines.

Last year we had the choice either to continue to produce and build a big working capital; we decided not to do it and to switch off the mine for two weeks. But Chris, if you can elaborate on this one and then what you are going to do this year because I understand you may do exactly the same thing this year with some of your mines?

CHRIS SALISBURY:

Thanks for the question. It is consistent with our value over volume strategy and, as J-S has pointed out, with Hope Downs last year. We are doing exactly the same again this year through working with our people. We asked people if they would like to take an extra two weeks off at Christmas and of course people have jumped at that. Really it is around making sure that we are focused on value and not produce just for the sake of producing and adding to working capital.

I think the other thing is, a small example also, about our value over volume strategy is by exercising some flexibility across our mine system. I did quote the example about bringing forward, changing the way we produce lump such that we could catch a market spike. So that sort of two examples of what we are doing in that space.

J-S JACQUES:

Thank you, Chris. On slide 7, I think it is back to an earlier question to some extent, as you know, we do not constrain ourselves in terms of commodities; we are looking at other commodities. We already operate in aluminium, in bauxite and copper, in TiO2, in borates, but we are looking at other commodities.

As I said, it is the remit of Ventures and Bold, work is underway, we are looking at opportunities and as and when it becomes reality we will inform the market. That's the only thing I can say at this point in time, but we see ourselves as a diversified mining company.

But the key element, which links back to the last slide you had on the screen, which is one of the fundamental 4 'Ps' that is underpinning our strategy is about portfolio but having world-class assets, so what we want is to be very selective in terms of which industries we are operating in but being even more selective in terms of quality of assets. So, as I said earlier today, whenever the market conditions are there we will be able to generate a lot of cash and therefore a lot of cash will be disciplined.

QUESTION:

J-S, the strategy of value over volume has been working in Iron Ore and a big part of that is product quality. I'm just interested in BHP's strategy, to let Yandi deplete, their lowest cost mine to be replaced by South Flank. If you guys run the numbers of letting Yandi, 60 Mt, deplete, replacing with Koodaideri?

The second question is actually on I guess what's embedded in your half-a-billion dollar productivity target for iron ore. You talk about the ports, a capacity of 360 Mt, and I remember – I think it was in 2014 site visit – we calculated full capacity of about 400 Mt for the car dumpers and the ports themselves. You have mine capacity of 360 Mt when you bring on Silvergrass, additional potentially of Koodaideri, what does your value over volume model tell you what you can creep per annum? That's it, and then I have a question on aluminium.

J-S JACQUES:

Okay, thank you. The first point is that this is an investor meeting of Rio Tinto and not BHP, just to make sure we are actually on this one, so you wouldn't expect us to comment about the BHP strategy. Go for it, Chris!

CHRIS SALISBURY:

Look, Yandi actually is an extremely valuable product. It is highly valued by our customers around Asia, particularly in Japan where our customers have finely tuned their sinter plants and blast furnaces to actually take the Yandi product. Not only does it optimise their steel production process but has flow-on effects to their quality. So in terms of value over volume it is actually highly valuable, the Yandi product, and we see it as an advantage that our Yandi product continues into the future.

Do you want me to talk about targets?

J-S JACQUES:

Yes, you begin.

CHRIS SALISBURY:

Sure. Absolutely we have some internal assumptions. What you can be sure of we are going to deliver the $500 million. But of course it comes down to again value over volume. We obviously had to make some assumptions about that, it will be a mix of volume and it will be a mixture of costs. But at this point we will be reporting every year; we are not going to actually declare that because it will be subject to market conditions.

J-S JACQUES:

Let's be clear, probably every year we reassess what is the right level of production in the Pilbara and at this point in time with the current market conditions, the guidance we've provided the market today is the one we are feeling comfortable with.

I don't know if we can move back to the slide of Chris where you see the alignment between the port, the mine and the railway. Today the railway is the bottleneck of the business. What we want is to increase the capacity of the railway – that is the priority number one – in order to give us the flexibility, subject to market conditions, to go up and down.

Today we are constrained and we want to remove the constraint and therefore having the ability, as I said, to go up and down depending on market conditions to extract maximum value from the Pilbara system. That's one point.

The second point is, and we said last time around, for us when we talk about the optimisation of the Pilbara in terms of value over volume it's about the free cash flow.

We know very well and we discussed it earlier today on the back of a question, it is all about having the right product, the right grade, making sure that we understand the impact we have in terms of prices that we have on the market place and therefore the impact as well on the life of mine and having to bring more capex faster and so on and so forth, that you optimise the free cash flow of the system.

That's what we have been doing last year, that's what we are doing this year, that's what we are going to be doing next year.

And let's have your second question on aluminium?

QUESTIONER:

Yes, just quickly, it's a question for Alf on the potential brownfield expansion at Alma and AP60. It wasn't long ago that you guys were saying 'no more investment in aluminium' and now all of a sudden we have gone from 'continue to ready these projects', this is very new, so I am just curious about the size of the potential expansion of both these smelters, what study phase we are in and what the timing looks like? Thanks.

MR. ALF BARRIOS (chief executive, Aluminium):

The first thing is we are at a very early stage. What we are talking at the moment is with the changes we are seeing in China on the supply side, we are now forecasting a market that will be more balanced in the medium and long-term. In the short-term we still see the capacity that has been curtailed - these are the illegal capacity or the capacity curtailed for environmental reasons - that will be restarted in the medium and long-term. So this is capacity which was built in the last five years.

So from that perspective what we are starting now to do is look at the potential of these projects, but clearly we are not at a price for aluminium which would incentivise these projects at this moment in time. When we talk about the price we can only talk about price above $2,500 per tonne to really incentivise supply outside China.

However, I think it is more important also to point out that it is not only about LME price, it is also about having access to stranded supply of electricity and those are not easily available, and that's where we really see our position in Canada as being very privileged. We have in Canada a business which is a first decile but, more importantly, it's hydro-powered smelting capacity which is sustainable over time.

So those projects are just projects that I mention as some of the projects we have started to look at. In terms of Alma, we are talking potentially early stages but another 250,000 tonnes per year; when you talk about AP60 you might be talking about another 400,000 tonnes per year. But again, as I said, we are still in very, very early stages of those projects.

They have been studied in the past so they are proper brownfield projects that have been discussed, but really now it's a matter of starting the work and understanding how do we get ready and move from option rich to option ready due to our privileged position in Canada to really capture that growth with obviously a focus on value over volume, as I said.

J-S JACQUES:

Thank you, Alf. I think what is very important and what we are trying to do, and it's true for aluminium and it's true across all the portfolio of commodities, is to redevelop the portfolio of growth options. I think aluminium is a good example of it, in the sense of we know that something is happening in China and we are pretty bullish, as Alf said, about both the demand and the supply side on aluminium.

But we are not quite sure how it is going to work in China in terms of aluminium versus bauxite. Now the beauty of Rio today is we have growth options both on the aluminium, on the smelter side, which will be very attractive because as we said earlier today our aluminium smelters in Canada are not in the first quartile of the cost curve, they are in the first decile of the cost curve.

So we'll have, and we already have, everything has been studied already, optionality around the smelter side and we have optionality around bauxite. As we said last year, we have [Amrun] 2.0/3.0, as much as you want, and therefore depending on how the market evolves either we go right or we go left. But the important thing from our perspective is really to have this portfolio of growth options and be able to execute as required with the market, and that's where we are today.

Maybe one last question in the room and then we go back to the conference call.

QUESTION:

Following on from your answer to an earlier question in part, did I get to understand in terms of value over volume that post the expansion of 360 Mt or 380 Mt or whatever, that you will actually think about where the market is first rather than the old Rio mantle of course of maximising volumes to maintain costs at the lowest level? That's the first question.

A second question, if I may, will be simply given your comments on a structural change in the Chinese steel mills and the productivity requirements - record or near record Atlantic Basin pellet premiums we are currently seeing – are you rethinking your position on IOC?

J-S JACQUES:

Okay. I think on the first question the value over volume on price today, we are not waiting for 360 Mt or 345 Mt or 375 Mt or 380 Mt, it doesn't matter; today we apply the value over volume. As I mentioned earlier today, we shut down a mine for two weeks last year, so we are not driven by market share or we are not driven by volume per se.

As far as I'm concerned, and I'm sure the same for Chris, is the value over volume was applied last year, it applies this year and will apply in the coming year. So that's where we are. I don't know if you want to add anything on this one, Chris?

CHRIS SALISBURY:

I think we have spelled it out before, but our value over volume strategy is a combination of all the factors including the market factor you talk about. What are the products that are required in the market? - to come back to an earlier question about the Yandi product - it is highly valued by our customers but we also think about what's the impact of any incremental tonnes on the market itself, our operating costs, and obviously the capital also to feed the system at whatever tonnes we can operate, and value is the outcome of that decision.

J-S JACQUES:

Do you want to pick up the question on China as well?

CHRIS SALISBURY:

Yes. Look, absolutely we are seeing a very keen focus on high quality products by steel mills in China as a result of the restructuring, both from the point of view of larger mills looking for higher productivity to maximise their margins, and of course the overlay then of the environmental restrictions. We are placing all of our product; our Pilbara Blend product is in high demand despite the restrictions going on and we see that continuing. That's a structural change.

J-S JACQUES:

So maybe to build on this point, there is no doubt in our minds – I have been to China, what five or six times this year, and in all the discussions I had the opportunity to meet with the Chairman of SASAC three or four times this year. He is the guy who controls 50 trillions of RMB of the Chinese economy, and he is the guy who is driving the restructuring in China.

There is no doubt, and now we have got the evidence, that they are restructuring part of their steel industry – that is the reality today – but, as we said before, taking capacity out doesn't mean that they will reduce the output and we saw it very clearly this year, in fact, they have increased the output.

As Chris said, in order to extract more pig iron first and then steel on the back of your blast furnace, BF [Blast Furnace], and BOF [Basic Oxygen Furnace] route or EAF [Electric Arc Furnace] you need better input cost, and that's what we have experienced this year so the demand for high quality ore has increased.

The other interesting piece, and we saw it through customer visits, is in the BF and BOF route you can flex your scrap ratio between 5 per cent and 25 per cent; 25 per cent is the top end, like the Japanese steel makers are running their steel mills, and you can see what we have experienced in the last few months is the Chinese steel makers are pushing harder and harder on their scrap ratio as well.

So even if they have reduced some capacity on the heavy end [high polluting] side it doesn't mean they are reducing output. But it is clear to us it creates a massive opportunity that we are fully leveraging today, is that by providing high quality iron ore we have got a great opportunity.

It leads back to a question we discussed earlier today about the spread, the discounts, the premium, that you are currently experiencing between high grade and low grade. Today there is more and more evidence that this premium or discount spread, whatever you want to call it, is here to stay in the long-term.

If we can take a question from the conference call?

QUESTION:

I've two questions on aluminium. But first, Chris, I'm not trying to put you into the thick of things here, but just going back to the meeting we had with you on the 9th August, post the Half Year Results, at a little meeting we had with the Sell Side, Chris when I asked you about aluminium at the time you said, and I quote, 'there was no rush in aluminium'. In terms of your expansion in bauxite you were happy'. In fact, in terms of the Chinese curtailment you said 'it was too early yet'.

So given you've probably had maybe four board meetings since then, what was the 'light bulb moment' and when did it occur in the last four months as to change that backdrop? I agree with your thesis and I like where you are going but I'm wondering what that moment was?

And secondly, PacAl, where does it fit, how does it fit, how do I think of that within the portfolio now?

CHRIS LYNCH:

In the first instance what we are talking about in aluminium and in bauxite as being option ready, we've already been option rich and we are option ready. So with regard to 'too early to tell' was really around the conversation about the curtailments that were foreshadowed in China.

They take two forms. One is curtailment of stuff that was built illegally or without the due process - this stuff was built faster than we could get a permit in the western world – but anyway it was built without any permitting in China. There is approaching 4 Mt of annual capacity being curtailed on that basis; I think it will slide to 3.6 Mt.

And then in regards to the winter curtailments, they have been in operation now for three weeks so it is not a lot of time to make an assessment as yet as to what form they are actually going to take, how effective they are going to be, and how permanent they are or are not. Nothing has really changed in that outlook. I think we have got to be patient and sort of see how that plays out.

With regard to PacAl, I think the position on PacAl is that we have got four very good smelters there. They are currently sourcing energy from external supply and for long as that's the case then they are always going to be a challenge in that regard. If you contrast that with the Canadian smelters, the first decile cost structure with hydro-power, has the benefits of being 'green and clean' and the like and the RenewAl concept that Alf has talked about today.

So I think with PacAl nothing has really changed in the status on PacAl. We are happy to hold and run and get good value from them; equally, if there was a buyer ready to pay a price that we thought was a good value equation we would be more than happy to sell them, so that's where we are with PacAl.

J-S JACQUES:

Thank you, Chris. If we go back to the room.

QUESTION:

If I could pose a question for Alf. In the aluminium industry this year one of the interesting things is the lag in the bauxite price where we have seen aluminium prices going up, we have seen a spike come through in alumina pricing, we have seen bauxite really lagging behind. Could you talk a little bit about why you think that's happening and also does it start to change all your thoughts around where the value in the chain is captured and does that change where you think you might head over time?

J-S JACQUES:

Go for it, Alf.

ALF BARRIOS

It doesn't change our position at all. I think what we are seeing is each market being driven by the fundamentals and the current moment in the market, and what we have [also] seen on the bauxite market is price increasing in the last few months pushed by the curtailments that's been happening in China.

So we have being seeing prices for bauxite increasing with that lag, as you mentioned before, but are now responding to the increases that we been seeing in alumina and aluminium. In fact, we have now this year been selling inland into China to capture that additional margin resulting from that increase in prices that we are seeing.

J-S JACQUES:

Thank you, Alf. Maybe we have got time for one last question.

QUESTION:

Probably a question for Chris S in terms of iron ore. The comment around Yandi being highly valued by the market and your customers, what is the potential though that we do see discounts increase at Yandi in terms of how those discounts are set? Is there a risk we go into next year given the discounts of those lower grade products in the market, is there a risk they will get push back from customers to increase the discounts?

Also just in regards to the cost pressures in WA and iron ore, those haul distances, the cyclical maintenance costs, is that just a one year thing in 2018 or does that carry over to 2019? And likewise, I think the comments in the past are that the strip ratios are pretty flat, but again does that just flow into 2019 or do those cost pressures start to reverse or do they remain into 2019?

CHRIS SALISBURY:

Okay, just on Yandi, Yandi does suffer a discount from the 62 per cent for iron content but it then receives a premium back in terms of low alumina and other ingredients, so that hasn't changed. But essentially we are seeing that the Yandi product is still highly desired by those customers who configure their steel making process to suit. So what we want to do is make sure that we place our highly valued Yandi products in their hands and they are willing to pay a premium for that. So that's where we are with Yandi.

Of course, it always comes back to a value over volume equation but right now we are very satisfied, in fact, the feedback from our customers is they want to get their hands on Yandi product. It's not something that's being threatened by what we are seeing in terms of the other low-grade products; it's not really in that category. That's the first one.

The second on cost pressures, yes, strip ratio is flat over the period and, as I spoke about, in terms of the effective flat haul, that is a change that we are going to see for a few years. As we extend the mining areas away from processing facilities, that haul distance is increasing and that will be a feature until we bring on new mines, for instance like Koodaideri and so on, that will reset that.

Just on some of the other cyclic pressures, of course we've expanded, almost doubled the business, in the last ten years and bought a whole lot of new fleet. Much of that now has to go through some cyclic maintenance change, so that's a little bit more I guess episodic, if you like, and we do have a bit of a hump over the next couple of years and then it flattens again as the equipment reaches it second and third generation lives.

J-S JACQUES:

Thank you, Chris. I am going to wrap up the session. First of all, I would like to say thank you for joining us in Sydney today.

There are three points I would like to leave with you:

The first point, there is no change in the value over volume strategy. It's working, $8 billion of cash returns [announced] this year.

The second point is, we believe the industry fundamentals are pretty sound, are pretty good, and we are very well positioned to benefit from them on the back of the quality of the assets, the quality of the relationships with our customers, and last but not least, on the back of the quality of our products.

The third point I would like to leave with you is our $5 billion target post tax in relation to mine-to-market productivity is an important component for us to continue delivering superior cash returns. We will deliver it, $5 billion of cumulative free cash flow post tax, 3 [percentage] points of Return on Capital Employed and it more or less equals to $10 billion in terms of NPV, depending on which metrics you want to use.

So that's it for today. I think the story is pretty straightforward. We have delivered on our promises starting with the $8 billion of cash returns [announced] this year, we will continue to deliver on our promises, and on this note we'll see you in February. Thanks a lot.

(End of Q&A Session)