Rio Tinto 2019 Half Year Results
Q&A transcript

1 August 2019

J-S JACQUES (Chief Executive):

At this point, why don't we open the Q&A?

QUESTION:

I just wondered if you could elaborate a bit more on OT and in particular if you had the benefit of hindsight what technical work could you have undertaken ahead of time that would have identified the issues that you are now dealing with and the learnings for that, when we don't think about something like Resolution and potentially other block caves?

Then carrying on from that, I am also thinking about the impairment that you have made on the asset; you're using an 8.3 per cent cost of capital. Given the discussions that have been going on in Mongolia with the government, how should one think about that? I suppose what I am thinking about is, if that's 8.3 per cent what's the discount rate for the Pilbara?

Then finally, TRQ have already stated that they are going to run out of cash by the end of 2020, so clearly some kind of re-capitalisation needs to take place there and, again, how are you thinking about that re-capitalisation and your participation in OT and the stake you have got now? Thanks very much.

J-S JACQUES:

Thank you. I will deal with the last one; it is an easy one. The funding of Turquoise Hill is a question for the board of Turquoise Hill, so let them do the work and as a shareholder of Turquoise Hill we will discuss this with them when the time is right. So I think this one is an easy one to deal with.

I will let Jakob to deal with the discount rate and the impairment.

But I think the first one is very important, what is the level of drilling we have done and we could have done? You'll want a technical answer I know and I am going to ask Steve, who is here, to tell us what drilling has been done.

Don't try to make it too complicated, Steve, and if we can go back to the slide as well, the slide where you had the footprints, explain the level of drilling we have done from the surface, then what we could see and what we couldn't see and then the drilling that we are doing now would be very helpful.

STEPHEN McINTOSH:

In terms of defining the resource at OT that drilling was done from the surface, a lot of drill holes, 2 to 2½ kilometres deep and vertical to sub-vertical drilling. So obviously what we do there is get a very good definition of the ore body, so resource grade. But what happens is that in essence disproportionately this will identify more of the horizontal structures because you are drilling vertically down through them.

It wasn't until we got underground that we really could start to see the vertical structures in more detail, we can see some of them but not in detail. As soon as we got underground, as soon as we had access to Shaft 1 we started drilling out horizontal holes. They are really the key ones in terms of understanding the infrastructure that you need to put in ahead of you.

That drilling was done from the south to the north and it wasn't therefore until we are able to drift up, develop up to the side of Panel 0, and start drilling across that we actually see the more north-south running fault systems.

So in essence you have to be underground, you have to get off to the side of the orebody and you have to be able to drilling across pretty much at right-angles to be able to illuminate all of the structures in 3D.

It was at that point that what we could see the faults on that south west corner of Panel 0. That's where we are planning, as J-S said, to build critical infrastructure, things we call mid-access drives ore handling systems, ore passes.

Obviously in those pieces of more broken ground we either need to work out where to move them to or how to protect them as we move forward, and that's the basis for the mine design underway.

J-S JACQUES:

I think the important point is that this is typical for a block cave; there is nothing new there. As we've said in the past, it's not until you get into the orebody where you can refine your design in that sense. So that's what we are going through and at this point in time we are looking at multiple options.

So some of the questions, as I mentioned, are where are we going to put mid-access drive for the ore handling? You can shift it. Do you need to have a mid-access drive and so on?

There are lots of questions and we are looking at multiple options and we believe we will land on something early next year and then we need to give time to the team to go through all the mechanics of doing the costs in order to get the definitive estimate.

There was only so much drilling we could do from the surface and we are doing the last batch of drilling as we speak, and still drilling as we are having this conversation, and we are refining the model to make sure we really understand the stability. Remember the model we have is a 1 metre by 1 metre block in order to make sure we understand.

What is important there, and I thought Steve was going to say it, is that it's a 4D model. Time is of the essence here. So not only have you got the 3 dimensions but the model is run forward so as and when we run the cave then we can see how the stress is going to move into the system so it's a 4D model.

As you can imagine, you've got millions of cells and people have to run those models in order to see what is the situation on Day 1, one month, one year, ten years and so on. So it's complicated, it's block cave; we just have to go through the process.

Is there any concern about the orebody per se in terms of copper content and gold content? The answer is "no", from what we can see today, but what we need to get right, and as I said the top priority number one on this one, is to make sure we have something which is stable and sustainable.

We are going through this process, multiple options being looked at, we should have an answer early next year and then the team will do the costing and we will come back to the market with a definitive estimate. But what we are going through is no different from – I mean you know that as much as I do – some of the other block caves globally.

So that's where we are, but I thought it was important to bring Steve today just to give you a better sense of what we could have seen and your question is absolutely 'bang on the money', is what could we have seen from the surface and there was so much we could do and so on.

On the discount rate, an easy one for you, Jakob.

JAKOB STAUSHOLM:

We had a project update on 16th July, we also wrote that was kind of a trigger for our full impairment assessment, and what you do there is that you have to kind of separate out. We have a very systematic approach to discount rate because actually all project specific risks you build in with contingencies in your projections.

We gave some updates on ranges of options to costing and schedule and we have basically weighted a number of multiple development options together. Then all the cash flow is being discounted and you quoted a number.

The first thing, just so that people don't misunderstand that, is that number is in real terms so you have to add inflation to it, that's important, so it is of course a higher number. Actually you can read it in the accounts because we have a smaller impairment in ISAL as well.

Our WACC is to the tune of 6.9 per cent. When it comes to gold business we have a lower WACC and therefore the weighted WACC would be for 6.3 per cent and we add a 2 per cent country risk on it. We have carefully reviewed that, looked at a number of external measures for that, and I think it is an entirely appropriate risking in, so that's how we have done it and that is consistent with how we are doing impairment testing in any assets across the world.

J-S JACQUES:

While we are on this one, I am going to ask Arnaud who is in charge of Copper and charge of Oyu Tolgoi. He has been involved now for a few years and dealing with the government.

Arnaud, do you want give us an update on the discussion with the government and how you see the sovereign risk from that perspective? Because we have been in this project a long time and discussion with the government has been a feature from Day 1 and will be a feature for a long time. Arnaud, do you want to give us an update on this one?

ARNAUD SOIRAT:

It's good to be in London actually for a change. We are in ongoing discussions with the government, as you know, but we agreed a year-and-a-half ago on working together on four critical opportunities that are addressing the needs of the government and look at how together we can work together within our existing agreements to create more value for all shareholders in Mongolia.

The first working group is dedicated to Power. As you know, last year we made an announcement where we agreed with the government the framework, the legal framework, to be able to build a power station at Tavan Tolgoi on the coal deposit. So we are working with the government to progress that project and to honour the commitments that we made in the investment agreement about sourcing 100 per cent of our power from Mongolia using coal.

The second working group is on the tax. We had a tax audit a year-and-a-half ago that found the government thinks that we should have paid more tax, so we are working with the government to resolve this issue. We are working very collaboratively with them.

The third working group is on interest rates. Within our Investment Agreement there is the provision to review the interest rate every 7 years and so we are in discussion with them on this.

The fourth working group is dedicated to increasing our support for the development of the economy, particularly the local economy.

If you look at the big picture, Oyu Tolgoi is already a major contributor to the Mongolian economy with the open cut mine.

In the future, what we are working with Steve's team to build is the underground project which is going to make Oyu Tolgoi amongst the third or fourth biggest copper mines in the world so this is going to be a huge boost of benefits to all shareholders.

We are currently with, around 17,000 employees, the biggest private employer in Mongolia – 90 per cent of our employees are from Mongolia.

We have invested around $9 billion in the country, we have paid around $2.4 billion of tax or so since the beginning of the project, so the economic benefit to Mongolia is already very tangible.

We are continuing to work with the government to look at how we can even further increase the benefits within our existing agreements.

J-S JACQUES:

Thank you, Arnaud. We will take a question from here first and then from the conference call.

QUESTION:

Two quick questions: just on the capex guidance, your 2019 capex guidance hasn't changed but you are guiding to higher sustaining capex. So could you just help us understand what the change is in terms of growth capex allocation?

And when we look at the 2020-2021 numbers, which again are unchanged, is there anything in there for the OT capex revisions, ie, should we expect when you announce at the end of next year upside risk to those 2020 numbers?

J-S JACQUES:

I will pick up this one very quickly. There is no change in the capex guidance and we have already in the past guided that over time we will increase our sustaining capex, so there is nothing new from that perspective. There is no change whatsoever.

We are coming out of a long period of high investment, as you know, and we have the 'sweet spot' where we didn't have to spend a lot of money to maintain our assets. But we said 6 months' ago or a year ago I think, we have guided this one for some time, that we would increase the sustaining capex going forward, and that we would increase as well the replacement capex particularly in Iron Ore going forward.

Because as and when you move one million tonnes per day then at some point you need to open new mines, and one example of this is the decision we made on Koodaideri and the investment of $2.6 billion.

The second part of the question on the capex on Oyu Tolgoi, there will be no increase per se because what you are going to have to do is that it will take more time to build the mine, that's why there is a link in our range between the timetable, the timing, and the capex per se. But are we going to be spending more money in the short-term, the answer is "no" for that.

QUESTION:

A second question, just understanding the capital framework, so a pro-forma net debt of $6 billion, and I think back in May you indicated that $6 billion was the level of net debt that you were comfortable with.

J-S JACQUES:

I said $5-$7 billion

QUESTION:

So as we look forward is that the type of net debt number we should be thinking about Rio is comfortable with in terms of capital headroom and implications for future shareholder returns?

JAKOB STAUSHOLM:

Look, I'm very happy and I'm going to disappoint you a little bit because we are really not setting a target for net debt. I was describing the capital framework when I last presented here in March and we are very happy with a strong balance sheet, but ideally we want to be able to act a little bit counter-cyclically and that means that net debt can go up and down.

Right now where we have very strong results we are comfortable and we are seeing very low levels of debt, but I don't think we should take that as the parameters. The key parameter is that we have a disciplined approach to capital investment, independent of the cash flow we are generating and so we are looking at providing a superior return to the shareholders.

J-S JACQUES:

There is no absolute formulaic solution to your question. I think what we will do is, to go beyond the point of Jakob, is we will look at this on a regular basis on the back of two or three items: one is how we see the outlook in terms of commodities, that's very important; what is the capital programme that we have ahead of us and therefore what is the risk profile with the level we want to have on the net debt?

But you know, if you step back, the equity story of Rio is very simple, it is about the resilience of a business case, the resilience of value proposition under any kind of market environment.

It's a combination of a few things, and I am sure you heard that four P's before, the quality of the portfolio with world-class assets like the Iron Ore which delivered 72 per cent of the EBITDA margin in the first half.

It is about the strength of the balance sheet and we fully accept that we are conservative, or that some people will accuse us of being conservative, and maybe we could return more cash to the shareholders, on the back of the strength of our balance sheet but we look at it through the cycle.

At the end of the day it's a cyclical business, it's a capital-intensive business, and therefore we believe – it's a belief, people may have other strategies to that – but there is a belief that having a strong balance sheet at the end of the day is the best insurance policy you can have. If you go back to your models in, like, 10-15 years I think the proof point is there.

Why don't we take a question from the conference call and then I will come back to the room?

QUESTION:

Thanks very much. The first question was just to try and break down some of the Iron Ore performance. I am just wondering if you could perhaps share the root cause of some of the issues. Listening to commentary, you have linked the waste-stripping to the deferrals of Silvergrass and Koodaideri and I guess I just wanted to try and understand this a bit more. Are you saying that those assets would have provided better access to higher-grade ore and therefore that got deferred and that's what causing some of the issues or I just don't quite understand how we got into this position?

Then the next question is just to share, perhaps if you could share some of your views on Chinese steel production next year? We are still annualising 9 per cent growth in China in June. I am just wondering looking into 2020, whether you expect further growth in Chinese steel production on an annual basis? Thanks.

J-S JACQUES:

Chris, do you want to have a crack at the first question?

CHRIS SALISBURY:

Just firstly I think what J-S was describing about the deferral of Koodaideri, which was a good decision, it still is a good decision, but what it meant was we do have to kind of run our existing mines, our brownfield mines, harder.

If I then dive into more specifically the issue that arose at Brockman hub. Brockman is a very large part of our system, it is about 100 Mt coming out of the Brockman hub, and more specifically if I get to the root cause of the downgrade that we made, that was associated with Brockman 4 which is 40 Mt of the 100 Mt.

Being very specific it was simply around conversion of AHS, there was a convergence of events. We had some poor fleet performance. We brought in a back-up fleet while we were converting some trucks; that back-up fleet didn't perform to expectations.

Secondly, at the time there was a lot of labour turnover, the market is tight, the labour market is tight in Western Australia, so we actually had literally some trucks standing because we didn't have the people.

None of that is acceptable and we are going to fix it, we have already started fixing it, and as J-S said we have brought in extra equipment to do it. Secondly, looking further ahead, we will continue to invest to ensure that we have got a robust and reliable system right across the Pilbara.

J-S JACQUES:

Thank you, Chris. Let's be clear, we knew that the plan was stretched. We knew that because of all the reasons mentioned by Chris that we would have to run the mines hard and if you look at the slide here it's a blend and because it brings so much value to our customers it attracts a premium. But it's complicated to get there and we were running at a very high level. Now, as we say, it is not acceptable and we are throwing the resources to deal with it.

But we had a choice and the choice we made with Chris and with Simon – that's Simon Trott who is dealing with the customers – was very simple. We made the choice to protect the quality of our blend. We made this choice. It is absolutely essential and I will link it to the next part of the question about the market demand.

We made the choice to protect the blend, not to damage, not to lessen, the quality of the product. That could have been an option. We took the decision to protect the quality of our product and to protect the relationship we have with our customers and as a result we took two major decisions, as I said: one is to reduce the production of the Pilbara Blend and the second one is to throw resources to fix the problem.

But that was a very important decision and I was with Simon in Korea at that point in time when we had this conference call with Chris and a few others. The decision was in the current environment when you look forward, when you look at the market conditions, when you look at the market demand from our customers and mainly in China in that context, the need to provide high quality product, the need to build a strong relationship with our customers, we took this fundamental decision to protect the quality of our product and therefore we did reduce the guidance.

I have got no doubt because when we took the decision I was in Korea on my way to China so I was getting the flight from Seoul to Beijing and met with CISA, the key association, the following morning; and Minmetals and a few others. I have got no doubt in my mind that was right decision. We didn't want to pass on the problem to our customers because that is not sustainable. So that's the first part of it.

Simon, do you want to talk about the China and the demand, how optimistic you are?

SIMON TROTT:

Currently we have seen really strong numbers out of China during the first quarter, in fact the first half. The meeting over the weekend highlighted that and what you have seen consistently is China taking very targeted measures to continue to support, as we expected China continues to slow, and those target measures are having an impact, so you are seeing really strong construction numbers through the first half and that's certainly underpinning steel demand.

As we go forward, we will see fluctuations in those numbers but the overall macro conditions continue to be sound and those targeted measures will continue to flow through.

J-S JACQUES:

To add to what Simon is saying, there is no doubt that the Chinese economy will continue to slow down, so 6.3% GDP growth in the first half, will continue to slow, and they are managing very smartly to be honest. I have got no doubt that they will put a stimulus packages in place. I have to say the stimulus packages they have put in place so far have been, how can I put it, heavy on steel.

Do I believe that the Chinese government will continue to implement a stimulus package going forward? The answer is "yes". There are a couple of areas which gives us some confidence about the future: one is the work they have started to do on rebuilding cities or refurbishing cities or parts of cities that were built 20 or 30 years' ago of not the right quality, and that is a great piece of news for us.

Then further investment especially in some of Tier 2 or 3 cities around building subways, trains and so on, which will give us some comfort as well. But is the economy going to continue to slow down? The answer is "yes".

Now the second point we should never, never forget. There is no doubt that the Chinese Government will continue to implement their environmental policies, taking capacity out in order to underpin their "Blue Sky" strategy. So seen from a Rio standpoint, there will be an ongoing demand for high quality iron ore going forward, hence the decision to protect the Pilbara Blend. That's how it is.

So are we having any issues at this point in time in placing our product? The answer is “no”. But we have to place the right product and are making sure we have a strong and good and sustainable relationship with our customers.

So what we are going to do in the next two weeks – flying to the US next week to do the roadshow and then after we are going back to Australia for a few days with Chris to be on-the-ground, then we are flying back to China to meet with our customers.

But for us at this point in time we have seen no material impact on trade and we have seen no material impact in relation to demand from our customers in China.

So if we move to another question from the conference call and then I will come back to the room?

QUESTION:

J-S, the first question is on the Pilbara rail maintenance, and maybe it’s a question for Chris actually, can you add some context, ie. what percentage of rail capacity is this impacting? You also mentioned this is continuing into 2020, so how should the impact shipments in 2020? That’s the first question.

The second question is on OT. I know it’s really complex in the study phase at the moment, and I am looking at 16-30 months delay on the project, and that’s a very wide range, so considering the study timeframe seems quite fixed what are the one or two main items that is driving that 14 months range? Thanks.

J-S JACQUES:

I am going to turn to Chris in one minute, but the rail maintenance is very simple, as I said in the speech it is one of the most heavily used railway systems on Planet Earth so we will have to maintain it at a high level.

We had talked about this in the past but clearly people didn’t pick it up, but there will be a series of shuts on a regular basis to maintain and strengthen the health of the asset.

So we want to flag or to re-flag the fact that we have a super-shut at the end of September for a couple of weeks and then there will be a series of super shuts next year, and then there will be a series of super shuts the year after and the year after and the year after, so we are just flagging that there will be a heavy load of maintenance, I can say forever in the Pilbara for those reasons.

Chris, do you want to say much more on that and I think we have disclosed some level of costs as well?

CHRIS SALISBURY:

Look, just be clear, this is already built into our guidance but we choose to be transparent. It is a fairly major shut, it's two weeks, it is 25 kilometres of rail. We are going to shut the whole line for three days, and actually the East Line for five and West Line for five, so it is a major piece of work.

It is already built into the guidance but because it was so significant we've decided to flag it. We will then as part of the detailed planning for 2020 continue to plan these super shuts at the appropriate time and the appropriate scope.

J-S JACQUES:

We will give you, as I mentioned, a 2020 guidance for iron ore at the end of October at the Capital Markets Day. So we will give you more granularity around this piece.

Study, Steve, one of the key elements: I thought we had the slide showing the key decision point, but go for it.

STEPHEN McINTOSH:

Basically what we have looked to do here is book-end the range of different options, get through the study phase, and to J-S's point with a view to making sure that we can both safely construct, operate and protect our investment looking out over 25-50 years ahead.

So again to this image we have here on this slide, we had some critical questions that are right ahead of us, as J-S also noted. Are we able to hold things like what we call a mid-access drive? That drive, essentially horizontal tunnel that cuts through transversally across the resource, across the mine footprint, actually is in three different levels, so in what's called the Apex, the Undercut and the Extraction Level.

We get enormous construction efficiency by having that drive in because, as you can see with those arrows, it means we can develop north-south into those headings, if they are removed we have to develop all the way from the south all the way to the top of Panel 0, so there is a schedule impact.

We are looking at everything here.

How do we keep, protect the critical infrastructure in the mine footprint through that complex 4D modelling that J-S referred to? And we will sequence our way through each of those decisions. But basically if we remove some of them and we have to then actually take the ore handling system potentially outside the footprint of Panel 0 that has a time, a schedule, impact for us.

As we do the modelling through the back end of this year, by the end of the year into Q1 next year we expect to take the final, essentially design into feasibility and then we will take that final design that we have approved into the definitive estimate process and so in the half two 2020 we will have that final definitive estimate.

J-S JACQUES:

As we say, there are multiple options, multiple scenarios, just to give you a sense.

We are looking at all options including maybe not a full mid-access drive - we could have only half of it and so on. That's the level of optimisation that we are doing, so we have thrown in the best resources we have in order to get the best solution to unlock the value of this world-class resource, but keeping in mind that the priority number one is safety. That is absolutely clear on this one.

Why don't we go back into the room?

QUESTION:

I'll try and exhaust a few more Oyu Tolgoi questions, three things.

First of all, on the impairment, back in December you had $3 billion of headroom in your Annual Report, so it looks like quite a big impairment. Have you changed the long-term pricing, the WACC obviously moved up a little bit, but why is it such a large impairment to the NPV?

Secondly, I was reading this kind of financing support agreement from the Turquoise Hill website and I was getting a bit confused because, as I read it, it looks like you have an option to basically determine whether they do an equity issue if there is a cost overrun. Can we get more clarity as to the position with Rio and Turquoise Hill in deciding how the cost overrun gets shared out?

And then the other one was around the parliamentary working group, because there is a 'lot of noise' and it looks like they are going put some proposals forward to change the Dubai (UDP) Agreement. Should we see that as just noise at this point or how worried should we be around the agreements?

J-S JACQUES:

Arnaud, do you want to pick up the last two, if you can give more details on the parliamentary working group? And then the financing arrangements I think you should cover it, Jakob

ARNAUD SOIRAT:

You would all be aware that the Parliament decided to do some audits on the benefits that OT is bringing to the country. We fully collaborated with those auditors and we provided thousands of pieces of information for months. It is quite an extensive audit. A report was published and that report has been shared with a sub-set of the parliament which is called the Economics Standing Committee.

The Economics Standing Committee has nominated some parliamentarians to review all this information and to come up with recommendation to parliament and to the government which is called the Parliament Working Group Resolutions. So that work is in progress and we'll see how things are evolving in the coming weeks.

Meantime in parallel to this, there are some typical positions that have been taken by some politicians around OT, around the agreements - you are referring to the UDP. I think it is important to understand that the UDP has been an important agreement because fundamentally it has clarified some of the previous agreements and it has enabled the project financing.

So the $4.4 billion that we borrowed from around 20 different international lenders and institutions is underpinned by all of those agreements, so the UDP is as important as the ARSHA and as important for the investment agreement. Those agreements are really critical. It is on those agreements that we have been able borrow money, it is on those agreements that we are able to continue heavily investing through TRQ in Mongolia.

So, as I said before, we are in continuous discussion with the government and working collaboratively with them to look at what we can do within our existing agreements to create more value for the shareholders.

J-S JACQUES:

Thank you, Arnaud. Jakob, if you can cover the impairment and the financing?

JAKOB STAUSHOLM:

The impairment part is very well captured by you and you have carefully read our Annual Accounts, and you are in part right. We gave an update and explained that we had some delays on particularly the main production shaft. We built that into our cash flow and we came to a result that there was headroom of $3.1 billion.

At the same time, we raised the issue that the weakened ground conditions might lead to significant re-design of the mine below the ore body, but we couldn't state anything else, that we would get on with that and therefore what we convinced ourselves, what we knew at that time, was that there should be sufficient headroom to cover for that uncertainty.

So you could say the headroom that we saw in March was between zero and $3.1 billion, we were just not able to establish that. Now with the update on 16th July, that was a trigger, we have new information and we have done the story and we have come to on a 100 per cent basis the $2.2 billion lower asset value.

J-S JACQUES:

Do you want to cover the Turquoise Hill financing?

JAKOB STAUSHOLM:

Turquoise Hill have independent governance, so it is really for them to talk about the financing. We are very happy to enter the dialogue with them and when there is news it will come out.

J-S JACQUES:

Are there any other questions from here?

QUESTION:

Just on your iron ore costs, perhaps it's too early to ask the question and maybe it comes with the Capital Markets Day, but do you expect your costs for 2020 to trend back down to the $13-$14 or is it too early to say?

J-S JACQUES:

I think it is too early to say.

I will make two comments right away, which is to say we will continue to drive the Iron Ore business on the back of the EBITDA margin and, as I mentioned in the speech, this is what we need. I will give you more details when we are in the Capital Markets Day, to make sure we have the right level of costs and sustaining capex to maintain the health and maintain the resilience of our business.

The important piece, if there is one message to take away from this one, is we drive this business on the back of EBITDA. If you drive it only on the back of costs then you may have a very, very different outcome. First half of this year, a 72 per cent EBITDA margin, so we will provide more details at the time of the Capital Markets Day and Chris will cover that.

And your second question?

QUESTION:

On Aluminium, just the operating efficiency $1-1½ billion, if we assume the costs stay as they are and they don't retreat back in the Aluminium business what does that $1-1½ billion do?

J-S JACQUES:

It's in the range.

So what we want to flag I think is the following: if we look at the costs last year, the impact on our bottom line was around $500 million of cash input, and it was not only aluminium there was TiO2 but a big chunk of it was aluminium. Do we believe that some of the costs have reverted as we are having this conversation? The answer is "yes", but not to offset totally the $500 million that we had last year. So there is an element there.

But the important piece is why we give a range, and that is that we will continue to drive our Iron Ore business on back of the EBITDA margin and it links back to value over volume. What I am not willing to do is to drive volume for the sake of it in order to have a fixed cost absorption and therefore to meet a target which is slightly artificial in that sense.

We will continue to drive the Iron Ore on the back of the EBITDA margin. If it means producing more, yes, if it creates value; if it means not producing more, so be it, and I think that is absolutely essential. So that is what we are trying to flag.

What we are trying to flag is we could be at $1.5 billion, we could be at $1 billion, there are two key elements and the main driver is Iron Ore, it is not the Aluminium costs. You can make the sensitivities but the bulk of it, of the range, is about Iron Ore volume, but the message I want to convey is we will take a decision about the Iron Ore volume on the back of the value over volume.

I think what we have decided recently is a good example of it, I want to protect the Pilbara Blend, I want to protect the premium, and that's what it is. So that's why we are just flagging it, and maybe we have done it before but maybe we didn't do it well enough. At the end of the day it is about EBITDA, it is about cash and not just hitting a target on costs.

Now am I going to continue to put Chris and the team and the other executives under pressure on the costs? Absolutely, because I don't want the business to drift along the cost curve, but the priority to run this business is on the EBITDA margin otherwise you'll have the wrong outcome.

Another question?

QUESTION:

A couple of questions, and first on Iron Ore, would you be happy to keep this year's volumes in Pilbara if you can't get to your optimum blend until Koodaideri comes in and, in that scenario, does the $1-1½ billion improvement still hold?

J-S JACQUES:

I think I just answered the question on this one. I have just answered exactly the question, which is value over volume, is we will add volume in any year at any point in time but only if it creates value and the range we are giving on the mine-to-market.

QUESTION:

So the $1-1½ billion still holds even if you don't increase any volumes from this year in iron ore until Koodaideri comes in?

J-S JACQUES:

I have just said it, and that is to say if you get the $1.5 billion on the cost barrier, if you increase the volume over and beyond where we are today, but we will take this decision only if it creates value and an EBITDA margin.

JAKOB STAUSHOLM:

Look, we are not going to guide about future volumes, that's clear, but I can help you a little bit. The updated guidance for this year actually is quite a significant step up in production in the second half compared to the first half. I think you can get half the answer there.

QUESTION:

Thank you. The second question on OT, obviously every investment competes with each other but if it makes financial sense would you be comfortable taking more attributable country risk if it comes to that point by increasing your ownership effectively?

J-S JACQUES:

Do you want to pick it up, Jakob?

JAKOB STAUSHOLM:

Yes, but I just want to understand fully what's behind your question?

QUESTION:

You are adding 300 basis points as country risk premium to your impairment calculations. If it comes to a point would you be comfortable increasing your attributable country risk by increasing all the ownership?

JAKOB STAUSHOLM:

They are two different things, but I actually said 200 basis points in real terms. Look that has nothing to do with the project; that has something to do with the country risk. On the ownership we are very comfortable with the current shareholder conversation, it is very normal in major projects are joint ventured, and you have some kind of risk sharing, and that's our position.

J-S JACQUES:

I will pick up on this one, it is very simple, I mean there is no change of policy here. If your question is about M&A, do we have a watching brief on M&A? The answer is "yes". There is no change. Are we looking at opportunities/options? Yes, but we will trigger the options only if it means creating value for our shareholders and nothing else.

Why don't we take from the conference call?

QUESTION:

Just a couple of quick ones, firstly, we have obviously done Iron Ore to death, I just want to touch on IOC a little bit. Realised pricing seems a bit soft. Can you just remind us how they sell iron ore versus spot and how we should think about that, given that it didn't seem like all the spot premium prices came through in that half?

And then just on Pacific Aluminium back here, it is back to an EBITDA loss and where you are sitting on that asset which obviously a power price pressure in Australia. Thanks.

J-S JACQUES:

Simon, do you want to pick up on IOC and then I pick up the later one?

SIMON TROTT:

There are a number of factors in the IOC pricing including, for example, the Japanese fiscal year and including some lag similar to our Iron Ore business where prices are reflecting a prior period, so that's the main two impacts you've got in the realised pricing.

J-S JACQUES:

Thank you. And then on PacAl, absolutely there is an energy cost issue in Australia, and it is a well-known one, which shouldn't be the case if you step back and think about Australia being very mineral and energy rich, then it should be one of the most competitive place to have energy. We are working very closely with Federal and the State government to find a solution to this challenge because the energy cost is massive, we are not making money in those assets.

Those conversations are taking place as we speak, we will inform the market in the appropriate manner, but we are taking it very, very seriously and there are active discussions because the current situation is not sustainable here. I know the aluminium market is not being helpful in the sense of for the first time in terms of demand the demand on aluminium is pretty weak.

Historically we have said, and it's the case, the demand for aluminium products is above GDP growth rate, however it is currently around 1.4/1.5% which is pretty low, and the reason why aluminium demand is low is because of the situation around transportation, auto-motives.

We have a situation where the demand for aluminium product is pretty low and at the same time, as I have explained, the supply side is being challenged for a series of reasons, one which didn't surprise us too much which is the pace of the restructuring of the aluminium industry in China.

But the second point is that when one of our competitors was under sanction they didn't stop producing, they did build a big inventory and as we are having this conversation they are releasing and monetising this inventory.

So we have a pricing environment which is not very favourable but at the same time we have challenges, especially in relation to the cost structure and energy and that's why we are having those conversations.

I am going to wrap up this meeting. I think we have had a pretty good conversation and we did cover a lot of ground. I am sure a few of you still have a few questions and I understand there are a few other meetings coming along so we are looking forward to it.

Now I want to step back.

We've had a very strong set of results. Look at the results, a 47 per cent EBITDA margin, 23 per cent return on capital employed, and this combined with all the hard work over the last few years a very strong balance sheet.

So, all in all, we are in a position to return $12 billion of cash to our shareholders this year.

Yes we had operational issues, we fully acknowledge it; it's mining.

Are we addressing those issues? Absolutely, and the team is working on this as we speak and we are making good progress.

Looking at the outlook, the outlook is positive.

China is slowing down and we have talked a lot about it but, as you know, we have a strong position to work from.

The strategy is working and what the shareholders should expect from us is what we have been doing for the last 3½ years, is to continue to create value, superior value, in the short, medium and long-term.

That's is all I have on my side today and, on this note, thanks for coming and I look forward to the ongoing dialogue. Thank you.

(End of Q&A Session)