

Rio Tinto 2015 Aluminium Seminar, London Q&A transcript

8 December 2015

ALF BARRIOS (Chief Executive, Aluminium):

We are now happy to take your questions.

QUESTION:

Two related questions. The first one is on keeping your competitive advantage in bauxite because one of your previous GMs at Weipa described this as 'advanced landscape gardening'. It's very abundant, it's very easy to mine, it's just wet dirt basically and there's lots of it in the tropics there. So the first question is, how you maintain your competitive advantage and not spend all this capital to feed China something for which the price will drop?

And the second one is, this is a big change in focus from Rio. Rio has previously said, 'We don't want to sell bauxite because we get tens of dollars a tonne for that and we 1,500 plus for the aluminium out of that, so we would rather get more dollars than fewer'. How has your thinking changed over the last five years since that was the answer to the question?

ALF BARRIOS:

In answer to your first question, I think, as we explained in the strategy, it is about market-paced growth, it is about growing the business together with our customers. Therefore, we are looking, as we look at pathway options to grow Cape York, to do it together with our customers and not to do it without having that clear link with our customers. And therefore they're either building new refineries, or changing their configuration to be able to effectively run our bauxite. So, our perspective there is that we will grow it as the market grows, and I think we have been very specific about that.

Regarding your second question, I wasn't around at the time, so it is difficult to comment. I can't comment on the reasons given at the time.

I think clearly, the aluminium demand is increasing and it's driving the growth in bauxite demand and we are very well positioned to supply that growth with our resources in Australia as we have talked about before. So I think from that perspective, we see ourselves really capturing an opportunity that is there in the market. An opportunity that allows us to position ourselves as the product of choice for the bauxite seaborne market.

QUESTION:

Maybe a question for you, Alf, or maybe for Gervais. Just on price discovery for bauxite, you started to talk a little bit about it there, but it almost reminds me of iron ore 10 years ago and then iron ore went through this period where pricing needed to get more sophisticated. Is that something that needs to evolve? And as a larger supplier into that market is Rio Tinto the company to drive that, the evolution of that price discovery process?

GERVAIS JACQUES (Chief Commercial Officer, Aluminium):

Well, I think what we are currently doing is we are making sure we are pricing the bauxite based on its own fundamentals. As I explained, all bauxite is not equal and we need to make sure that the customer can value the value in use because the ultimate goal is really to produce alumina with that, and we can see that in the example I gave during the presentation that for some type of bauxite, like Weipa bauxite, it takes just a little bit more than 2 tonnes; for some others it takes 3½ tonnes.

Then we need to valorise that in the pricing. This is what we are doing and now the way we are doing that is through bilateral negotiation on a quarterly basis. But things will evolve over time. You know, we started to sell bauxite 8 years ago and iron ore I think is something that maybe started 40-50 years ago, we are not on the same level of maturity.

QUESTION:

This is a question for Vivek. Two sort of long-term questions on aluminium demand and supply, one around scrap, and with the extra loading you're starting to see in cars, will that see an increased market share from scrap?

Then the second one, there has been some big numbers starting to come through on disruptive technologies in vehicles, sort of shared driverless vehicles and what that's going to do for the overall global fleet. Have you started to think about those at all in your demand assumptions? Thank you.

VIVEK TULPULE (Head of Economics and Markets):

On the scrap question, we essentially take this into account, so we have scrapping rates for vehicles in different locations – so for example for trucks it's 12 years, for cars it's 9 years – we count the amount of aluminium in each of those and the recovery rate – and then we factor that into our scrap calculations and that's what generates the scrap forecast we have there. So that broad adding up process happens.

On your second question, the scope for other materials and other forms of mode of transport to take over from conventional forms. We are starting to take some of that into account. We think it is potentially a longer term trend that needs to be addressed but probably not one that's going to be extremely disruptive in the kind of timeframes we are talking about here.

QUESTION:

The first one is on the smelters of PacAl. You have been politically correct about those in a sense that you said everybody has to generate cash and you think next year they will do so. However, is there any need for smelters outside hydro-basins and China longer term?

ALF BARRIOS:

So I am very proud of the work that the PacAl staff have done over the last few years. You will remember years ago PacAl was losing money. PacAl last year made more than \$500 million of EBITDA and in the first half made more than \$300 million of EBITDA. If we look into 2016 at current prices we actually have in place, all our PacAl smelters will be cash flow positive.

That said, I've talked before about the strategy of ensuring that our smelters are either the first quartile or have a clear path to get to the first quartile, so with that in mind we obviously will always continue to explore value-accretive options for our shareholders.

QUESTION:

And two follow ons, on scrap it's clearly going to be big. How is Rio Tinto going to participate in scrap, if at all, going forward? And secondly, we haven't talked much about the capex requirement in Aluminium on a maintenance basis. What level should we think of for the next couple of years?

ALF BARRIOS:

I'll answer the second one and handover to Gervais to talk about scrap.

Regarding sustaining capex, you saw the slide before, we are talking about \$629 million. We will stay around levels which are slightly below that but similar to that as we move through 2016. We have reduced capex significantly, sustaining capex, in the last few years. Since 2011, we have reduced it by 40 per cent, so there has already been a significant reduction and we do manage it very tightly.

GERVAIS JACQUES:

Well, the question relating to scrap, you know the key competitive advantage that we have is we are located close to the power generation, which means also that we are quite far from where the scrap really is. Then in order to make a business case to reuse scrap it makes no sense to bring scrap in at Kitimat or in the Saguenay.

But having said that, we are a provider of primary aluminium and we are teaming with our customers and most of our customers are reusing their own scrap or they can also add scrap into their process. Then that's how we are contributing to make the world a better world by providing low CO₂ aluminium and also allowing our customers to use their own scrap.

QUESTION:

It's pretty challenging in the short-term but in the longer term through your thinking in this business, and you have only just come to it in the last couple of years, do you ever envisage a time when you might expand your primary production capacity again or do you think that's a game you would rather stay out of given that you seem to be using the maximum that you can from the natural water assets that you have? You are using 100 per cent of the power. Is there any chance to increase that?

ALF BARRIOS:

There are options to increase the capacity in Quebec, I have talked about that in the past clearly we will do that if the market is right. At the moment we are not considering any expansion in the current market conditions. But clearly if the market conditions were to change, I think we are one of the best placed in the North American market to increase capacity.

QUESTION:

Two questions if I may. The first is on the off-take contracts that you mentioned, so 50 per cent of Amrun's production is contracted. Could you maybe comment on the nature of those off-take contracts, the duration, customers etc?

ALF BARRIOS:

I'm sorry, we can't, that's confidential information. That's commercial information, so we can't really talk about that.

QUESTION:

Okay. The second question is on the Group capex numbers that you put out this morning, if you could answer, but the 2016 capex guidance for the Group has reduced by a billion dollars. Could you maybe give some insight into the composition of that capex reduction?

ALF BARRIOS:

I will ask Greg to comment on that.

GREG LILLEYMAN (Group executive, Technology & Innovation):

Look, there is very little FX changes in that, a small amount but very little. Sustaining capital is a little lower than what we had originally forecast in amongst that estimate as well, and the rest of it flows through from things like you have just seen me describe on Amrun and the phasing and timing of expenditure on our other capital projects as well.

There is no deferral of major projects or deferral of expenditure, it's more efficient use of the same capital dollars that allows us to now guide to around \$5 billion rather than under \$6 billion for next year.

QUESTION:

Just a couple of questions. Could you give us some numbers now as well? If you look at spot aluminium prices, what EBITDA or what cash flow is your division going to generate? How much cash are you going to contribute to the Group's dividend in essence, assuming Kitimat is up and running, pre-Amrun, pre-capex because we have got a sense of what capex is, that would be very helpful?

Also, just on the market outlook, I don't know how long this 'it will be better tomorrow' lasts - this medium term kind of positive and near term cautious - what can we really 'hang our hat on' in terms of believing the medium term story for Aluminium? Because obviously you were bullish when you bought Alcan, when Rio bought Alcan and it hasn't played out, so maybe it's a question for Vivek who's been around a long time? Are you more confident today or what gives you more confidence?

ALF BARRIOS:

So free cash: what I can say is that we will be clearly free cash flow in 2016 and the Aluminium group will be able self-fund the Amrun project. That's as far as I can go today.

VIVEK TULPULE:

Thanks. And you're right; I have been around for a long time.

The expectation is that we will see strong demand growth for aluminium over the coming few years. It's worth keeping in mind that in China this year, demand for aluminium grew by 6 per cent and that's in what one could probably describe as a weak macro-economic environment, so I think it's reasonable to assume that the demand growth will be there and strong. So, we are looking to the supply side I suppose as the clear driver of the price outlook.

We have already seen substantial curtailments taking place. Gervais has talked about the need for curtailments to see progressive improvements in the price and we have seen those curtailments take place in the high cost smelters. I mentioned 2.5 million tonnes of Chinese curtailments since April, it's actually 3 million tonnes since the start of the year, outside China curtailments in the order half-a-million tonnes, so very substantial curtailments.

Of course, there have been expansions in capacity in the north-west of China and in particular at the start of the year when I think we saw very, very extensive expansions but when we look on-the-ground right now, when we do our bottom-up assessments and Gervais has talked about some aspects of that, we are just not seeing those expansions taking place.

So I think it is reasonable to assume a decent demand growth over the next few years, very, very tough conditions on the supply side and when you pull those numbers together it's actually quite difficult not to start to see the stock position beginning to improve.

And just remember, it has actually improved. It has come down from 16 weeks now to 13 weeks of total consumption, so that trend is something that we should expect to continue, and balancing the market will be at around 7-9 weeks, it's hard to know precisely these dynamics but in that order of magnitude, and so you see that kind of balance beginning to emerge over the next little while.

Now everything that I've said depends on the global macro economy obviously and so you'll need to make your own assessments about how the global macro economy will proceed over the next several years. I mean, our view on that is very much in line with what you'll find in consensus estimates, a little pick up in growth in OECD economies over the coming little while, China growing at around 6.5 per cent in line with their planned outcomes.

So, I think with fairly conventional GDP growth projections and a view that with these weak prices, it's very tough on the supply side, I think you can start to expect to see improvements, but they will be gradual.

QUESTION:

Just getting an idea from all of you how well you talk to each other and it follows on from Greg's question, obviously 10 million tonnes of bauxite is ~2.5 million tonnes of aluminium, so you are impacting your bauxite market at the same time you are impacting the aluminium market. I mean, are you playing some sort of game theory here in terms of what the impact of one is going to have on the other and how well you are going to come out ultimately in the end?

ALF BARRIOS:

As I mentioned before, we see a great opportunity in the bauxite market. The seaborne bauxite market is growing, not only because of the aluminium demand, but also because of the depleting stocks in China, and we see a great opportunity to capture that position that we are already playing a leading role in for Rio Tinto. That is our strategy.

That is the strategy I presented last year around this time and today we have been talking about the first project to get ourselves on that journey of continuing to grow our bauxite position and we have pathways to do that and, as I mentioned before, we'll do that at a market-paced growth.

QUESTION:

A few questions for you if I may. With regards to how you project China supply/demand balance going forward, as from Q4 2014 we saw the massive increase in semis exports, what are your views in the short-term and medium term with regards to that?

And the second question, related to it, to what extent do you fear China could change the taxes on Chinese exports of primary ingots?

ALF BARRIOS:

I will ask Gervais and Vivek to comment about it.

VIVEK TULPULE:

I think the first question was about Chinese semis exports, so I will take that one. The export of semis is very much a function of arbitrage between the Chinese market and the market outside China and so the future of that trade depends on the extent of those arbitrage possibilities and we have seen those tend to close.

So the answer to your question depends on price level relativities between China and outside China. Now outside China, we are seeing a relatively tight market as a matter of fact, the conditions in the West mean that we have got decent demand growth but at the same time not so much curtailments and not so much capacity growth.

So that means in the West, you could expect to see somewhat demand firmly continuing and so there is probably some scope for Chinese exports into that market. But ultimately the level will depend on this arbitrage and those conditions are always difficult to picture. Gervais talked about macro-economic drivers and financial forces in this as well.

ALF BARRIOS:

And could you repeat the second questions please?

QUESTION:

I was asking to what extent are you fearing that the Chinese could change the fiscality on the taxation of semis, moving it to some incentive to export primary ingots?

GERVAIS JACQUES:

You know exporting primary ingots for China, it is more or less exporting solid energy and it's all about if you are short in energy, if you need to buy your coal, because even if they have strength in coal, they are also buying coal from the outside market, does it make sense for an economy in the long-term to really export their energy based on coal? And the second question you can think of is, in terms of pollution where will be the limit? Because at some point you cannot have smelters and smelters, you are going to reach a point where it doesn't make sense any more.

QUESTION:

I agree. But if I draw the parallel with what has happened in the steel industry and how China has been exporting steel and it's not making major sense for them to export steel, which is growing pollution they consume iron ore in order to get there, so why could they not do it for aluminium primary ingots?

GERVAIS JACQUES:

Well, so far what they have done and they have been quite clear, they are really trying to optimise their value-added product and the trend that you can see is going further into this valorisation. This is where you can add more jobs, create more value-added jobs as well. What we see in terms of the Chinese really is, doing the second and the third transformation in China and then instead of exporting semi-finished product, exporting finish products and this is probably where the value sits.

ALF BARRIOS:

Thank you. I was going to take a few questions over the phone.

QUESTION:

Thanks for taking my question. I have two questions actually. First of all, regarding the commentary that all of the smelters will be free cash flow positive in 2016, just a bit of downward stress testing given the current environment, roughly how much of the 3.6 million tonnes would be free cash flow positive if say, for example, LME prices were 10 per cent lower versus spot, and separately if LME prices were 20 per cent lower versus spot, obviously assuming premiums stay the same? That's my first question.

ALF BARRIOS:

As I said before, all our smelters in 2016 will be free cash flow positive at current prices, and I am sure you can do the analysis of the sensitivities as well, but we are not in a position now to disclose any more information than that, that they are all free cash positive at current prices, and we will strive to make sure they're free cash positive under harsher conditions if need be.

QUESTION:

Okay. Just my second, I do have another question. Regarding the portfolio optimisation, given the positive longer term view that was presented earlier but you have the weak environment near term, is it reasonable to expect Rio Tinto to be done with the Aluminium-related divestments, asset sales, JVs etc for at least the next 12 months?

ALF BARRIOS:

As I said before, our drive is to get all the assets into the first quartile and they need to have a clear pathway to get there and we expect all our assets to be profitable. So in this regard if assets don't have a clear pathway we will continue or start exploring value-accretive options for our shareholders. It's the right thing to do and we will do it if need be.

ALF BARRIOS:

Can we take another question over the phone?

QUESTION:

Thank you very much for taking my questions. The first question: I just want to drill down a little bit more on the primary aluminium market and I wanted to talk a little bit about the normalised level of inventory, and I think you mentioned 7-9 weeks as kind of the new normal. I was wondering based on your internal market analysis how long do you guys think it will take to get there to that level, the so-called pinch-point level, if you will?

ALF BARRIOS:

Thank you. Vivek, do you want to take that?

VIVEK TULPULE:

Yes, 5 years. But it's precisely what I said in my presentation, we are looking to get to a balanced market, in a 5-year period. But look, there are uncertainties obviously, that depends on macro-economics as much as anything else, but our estimate, our prediction, is based on normal economic circumstances, 5 years.

QUESTION:

Okay. And the second question I have would be based on just looking at the opportunities for aluminium, the metal, in China versus copper in power generation and distribution etc, transformers. I wonder if you can talk a little bit about that, as to the work you have done and how much are you assuming from substitution gain for aluminium?

ALF BARRIOS:

We very happy to do so. Vivek, do you want to? We have done a lot of work around that area.

VIVEK TULPULE:

Yes, we have. Look, I think the substitution trends in the power sector are certainly moving in favour of aluminium, and there are two dimensions to that. The first is that there is an expected increase in the penetration of ultra high voltage power lines. The average level of aluminium in one kilometre of power line is about 1.8 tonnes; it is significantly higher for an ultra high voltage cable, so we are expecting to see a trend in favour of those cables pushing up the demand for aluminium in the power sector in China.

At the same time, as you've mentioned, there is also a likely trend, although we don't factor too much of this into our calculations, in favour of aluminium against copper in China.

There is clearly scope for aluminium to increase its penetration in power cables inside China when you compare the relative use of copper versus aluminium in China compared with other countries and recently the Government in China has started to encourage greater use of aluminium relative to copper. So we see scope for that kind of trend, but I think it is a little too early to pin a particular tonnage on that.

QUESTION:

I wonder if you could talk more broadly about the corruption situation as it relates to the power industry. How advanced do you see that right now? Is it generally beginning to clear a little bit? Are we starting to see an improvement generally in spending trends from a power sector standpoint over there?

ALF BARRIOS:

I'm sorry, that's not a question we can answer. So thank you very much.

Shall we take another one on the line please, on the phone?

QUESTION:

Just considering the alumina refineries, obviously they have not been positive EBITDA contributors for the last few years and we have got weaker prices now, just sort of the process of getting those back into profitability. What are you sort of looking at doing to help reduce costs given obviously bauxite is such a major part of the cost base?

ALF BARRIOS:

Thank you for the question. If you remember, last year when I talked about alumina I talked about a business that was not at the time making money. In the first half of this

year the alumina business was profitable and that was the result of a number of actions – I touched upon a few of them that we have taken since then.

I also mentioned a few other actions and a number of initiatives that are underway in our alumina business to continue driving costs down, to continue driving working capital down, to continue reducing sustainable capital requirements, and we are confident that we will turn these businesses around again and make these businesses profitable.

QUESTION:

Okay. Thanks.

ALF BARRIOS:

Shall we take questions from the room?

QUESTION:

I have just got one more quick one. You are very bullish on the bauxite markets and increasing your exposure to the seaborne market. Is there an opportunity potentially maybe in Brazil where you have got the joint venture with MRN? If one of the partners of that mine were looking to sell, would you at least make a bid? Probably you have got first right options, I'm guessing. But would you look to increase your ownership of that asset?

ALF BARRIOS:

We talked briefly, I think not in detail, in the presentations and on the slides about opportunities as well in the Atlantic, not only the Pacific, and as you mentioned there might be opportunities around MRN. There are opportunities to expand CBG and we will obviously look at those opportunities as the opportunities come up and compare them to the other potential row of options that we have in the portfolio to make sure we are doing the right thing for our shareholders.

QUESTION:

Look, I might have missed it but I couldn't see AP60 mentioned anywhere in the presentations or a big fan fare on technology, what does that mean? It's not delivering what you thought it would for you and how does that fit within your view on spending on technology and staying down at the bottom of the cost curve for the next, say, few years and then into the decades beyond?

ALF BARRIOS:

As you know, AP60 is the lowest cost, the most energy efficient, most environmentally friendly, smelting technology that's got through to become a pilot plant that we have in Quebec. So it is one of the technologies which has been proven and all the KPIs that were set for the technology have been demonstrated in the last year-and-a-half that we have been operating at AP60.

At the moment, clearly the market will not incentivise the construction of new smelting, we have talked about it before, and in line with that, what we have done is make sure we are

focusing our technology team on improving the performance of our current smelters, and that's where the team has been focused. We have been restructuring the team and resizing the team appropriately for that focus at this moment in time, although we obviously continue to do R&D work.

But the idea at the moment is that the focus needs to be on performance in the short-term, and that's where the focus is for the team. As I said, the technology has been proven. The technology is the best technology available on the market and it's there ready to be used in the future if we were to expand any of the smelters if the market justifies incentivising an expansion.

Do we have any more questions on the line?

QUESTION:

Thank you very much for taking the question. Just as a small follow up, if you could give a broader view on your capex in the coming years? We know where you stand on maintenance and we know your biggest projects, but if you could give us some idea of what will be the lump sum for the next couple of years?

ALF BARRIOS:

I've talked before about the sustaining capex and, as I said, it was \$629 million this year and we continue to drive that down and we are looking at ways of how to use capital more efficiently and also looking at ways of prioritising that investment accordingly. So we expect the sustaining capex to be 'south' of the number that we have for 2015.

Regarding growth capex, we showed you before the growth capex that we have for Amrun and at the moment that is the focus we have in Aluminium. It is a focus on maintaining our assets and it is a focus of growing a bauxite strategy.

QUESTION:

So is it correct to say that taking your sustaining capex and Amrun would be more or less all you are going to spend?

ALF BARRIOS:

We will continue to drive the capex down; I think I have said that clearly. The numbers you have are the numbers for this year. The numbers you have for Amrun are the numbers that were put on the slide by Greg, but we will continue to work to try and reduce our capital spend as we work through the next few years.

QUESTION:

Kind of following up from some of the earlier questions, I guess we have heard from Sam many times that if an asset is not generating cash flow you will close it and clearly you expect all the smelters to be cash flow positive at the current spot prices, but prices move quite quickly in this world and they seem to be heading more 'south' than 'north' for most commodities.

Should we kind of assume that if prices go 'south' from here and any asset does become cash flow negative you will quickly take action and close it? I mean, how should we think

about that? Is it what Sam was saying before, the way you are thinking about the Aluminium business?

ALF BARRIOS:

I think it was pretty clear that I will not tolerate any free cash flow negative assets in my portfolio and we are working hard to make sure that any assets that might be free cash flow positive at current prices addresses the issues and becomes free cash flow positive next year and I am confident that all our assets in the smelting businesses, as I said before, will be free cash positive in 2016.

It is logical that we will continue to explore alternative opportunities that are value-accretive for our shareholders as we look at our portfolio.

QUESTION:

On that last point, just because there are about, what, 4 smelters which are clearly not Tier 1 assets and you have been looking to exit for three or four years, is there just no value-accretive exit strategies or do you think the processes around those smelters are moving forward now and maybe we'll see some further divestments over the next 12 months?

ALF BARRIOS:

You are referring to the PacAl assets. As I mentioned before, the PacAl assets have done an amazing turnaround in the last few years and they are free cash positive today, they have delivered an amazing EBITDA and I am confident they will be free cash positive next year. But, as always, we will continue to explore options that are value-accretive for our shareholders.

(End of Q&A session)