

Short Run Risks and Long Run Metals Prices

Neal Brewster
Rio Tinto

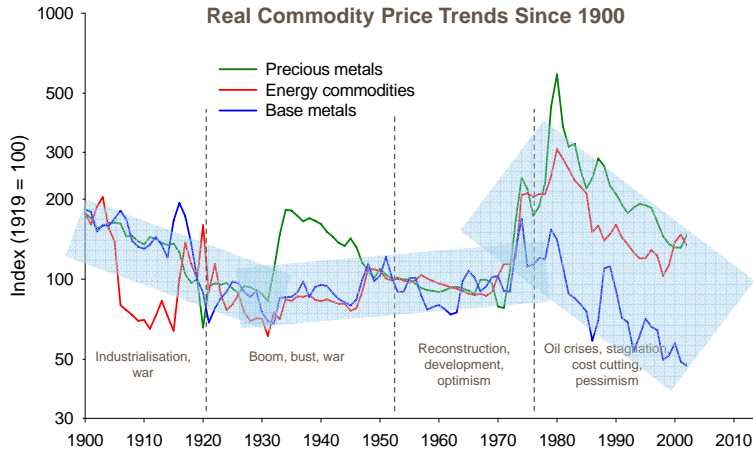


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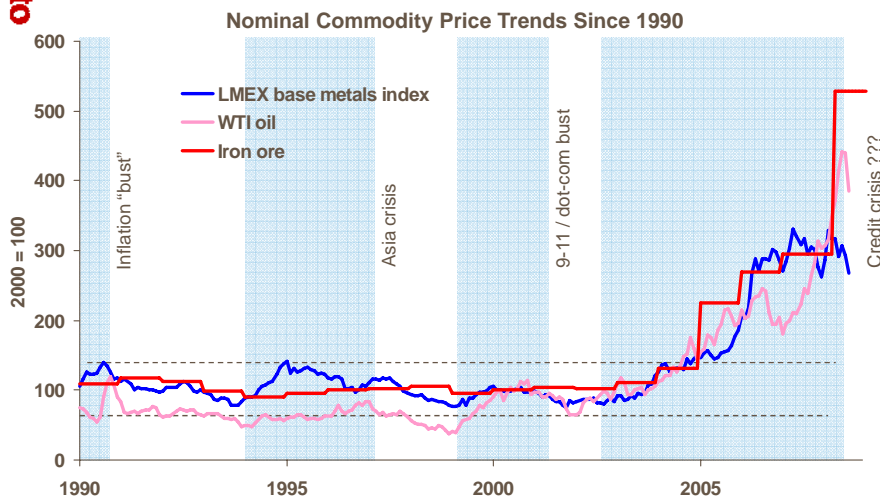
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The mining industry went through 3 decades of steeply falling prices until 2002 but before then had experienced varying trends



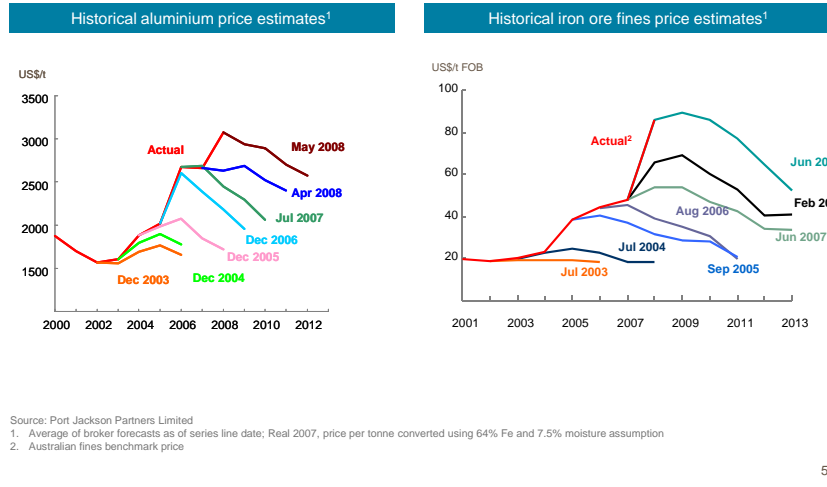
Source: LME, NYMEX, LBMA, Ecwin, Rio Tinto estimates

Rises in commodity prices since 2003 are nevertheless unprecedented

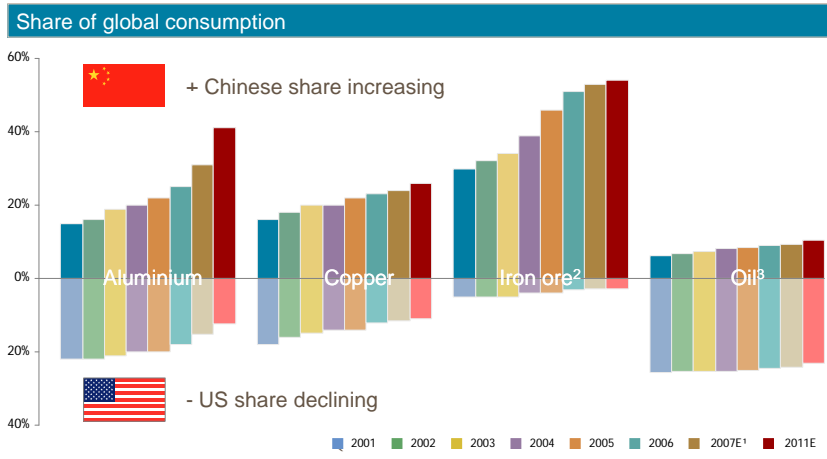


Source: LME, NYMEX, Ecwin, Rio Tinto press releases. Note: Iron ore is Australian benchmark price

Brokers have consistently under-forecast commodity prices in recent years



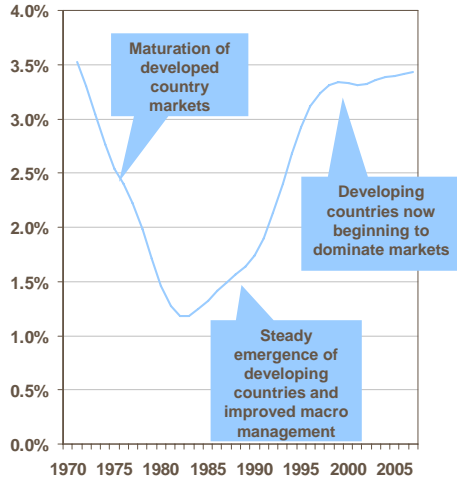
China is the new force in commodity demand that has driven this change



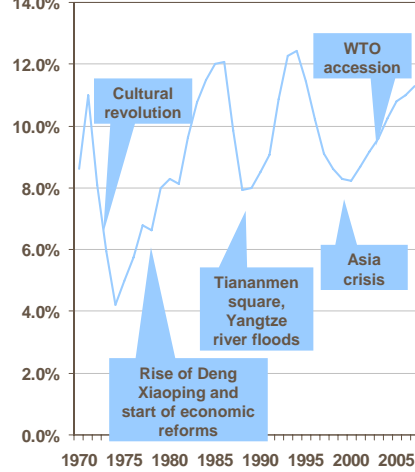
Source: AME for aluminium, copper and iron ore. 2001-2006 oil data source is BP Statistical Review of World Energy 2007
 Note: Consumption data for aluminium, copper and iron ore represents "apparent" consumption rather than actual consumption and is determined by:
 apparent consumption = domestic production + imports - exports - change in stocks (where available)
¹ Forecast available only ² Seaborn ³ Data for 2007 and 2011 is calculated by applying expected consumption growth rates from IEA (International Energy Outlook) to historical data

But the direction – if not the scale – of this change was already evident much earlier

Smoothed Percentage Annual Change in World Copper Demand

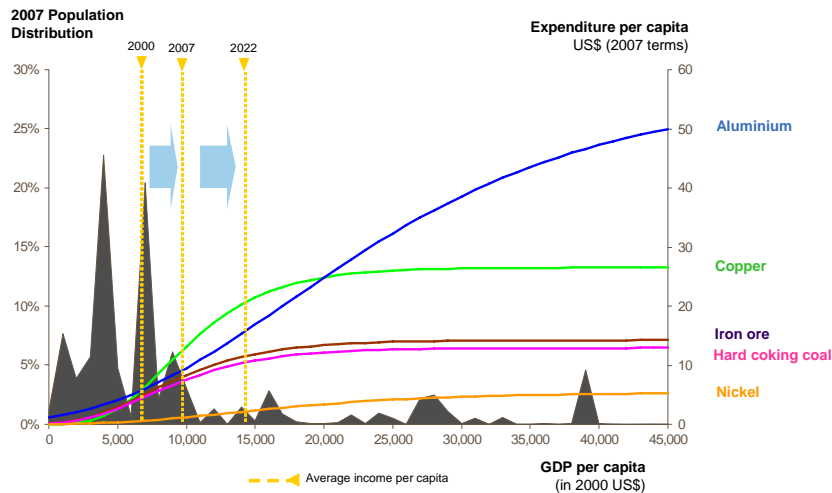


Smoothed Percentage Annual Change in Chinese GDP growth



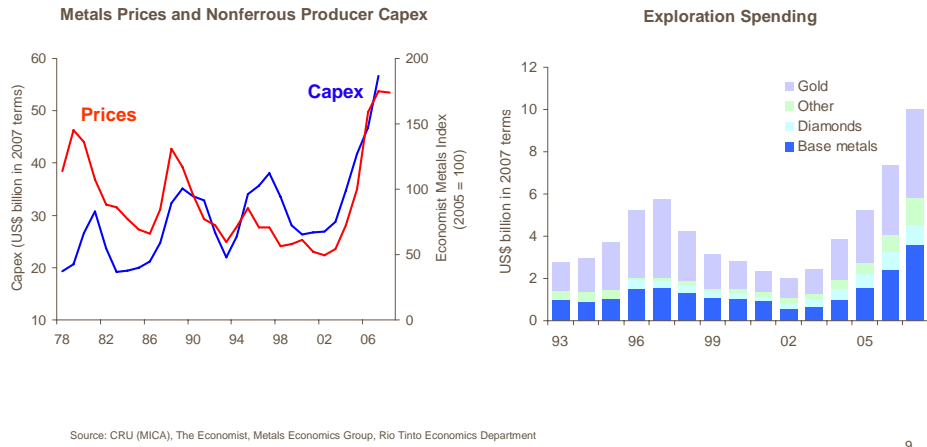
Source: CRU, Global Insight, Rio Tinto

Faster underlying metals demand growth is expected to persist and demand for many commodities may double over the next 15 years

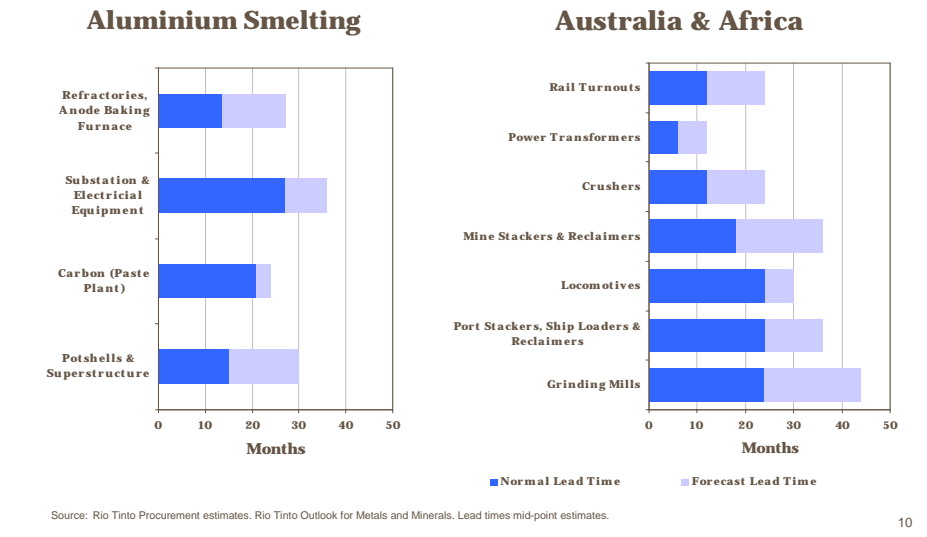


Note: Expenditure profiles are based on Rio Tinto estimates of global income and consumption relationships and average real terms prices between 1990-2006. Iron ore and hard coking coal expenditure calculated based on crude steel demand projections, assuming all met by blast furnace production at historical average export prices. Source: Global Insight for population distribution; Rio Tinto estimates for commodity expenditure profiles.

The industry has responded by raising capital and exploration spending to record levels

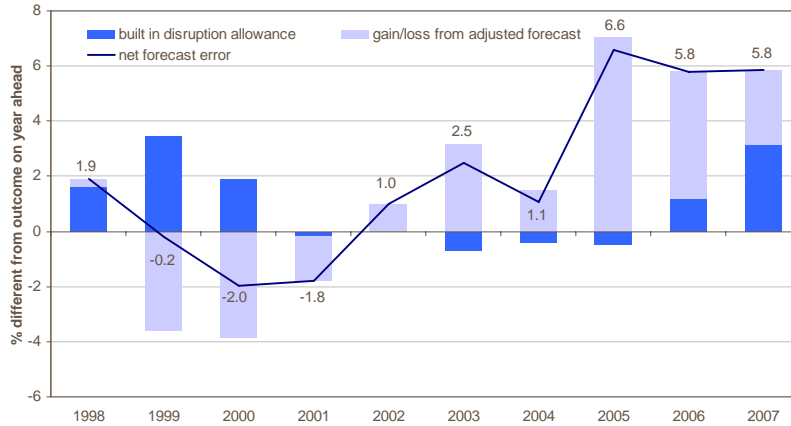


Indicative lead times for key equipment have extended



Low cost supply growth will again disappoint this year and new high cost entrants are evident in a number of markets

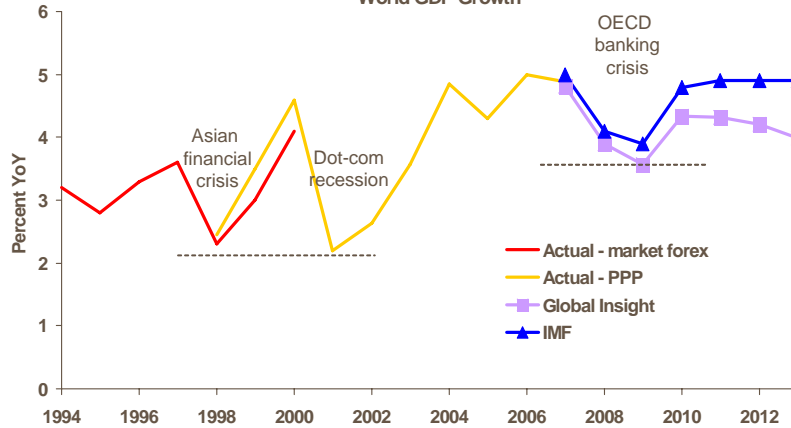
Copper Mine Output Disruptions



Source: Brook Hunt; company reports; press searches

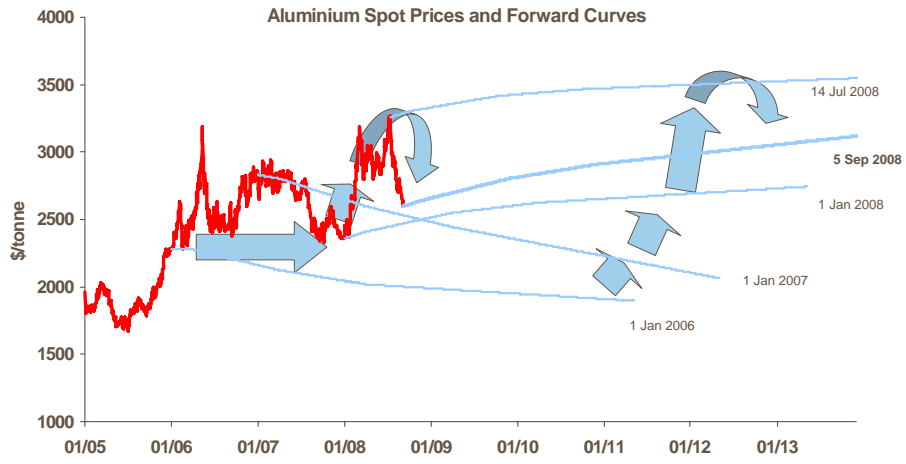
Constrained supply has recently been offset by weaker demand but the current slowdown needs to be seen in relation to previous downturns

World GDP Growth



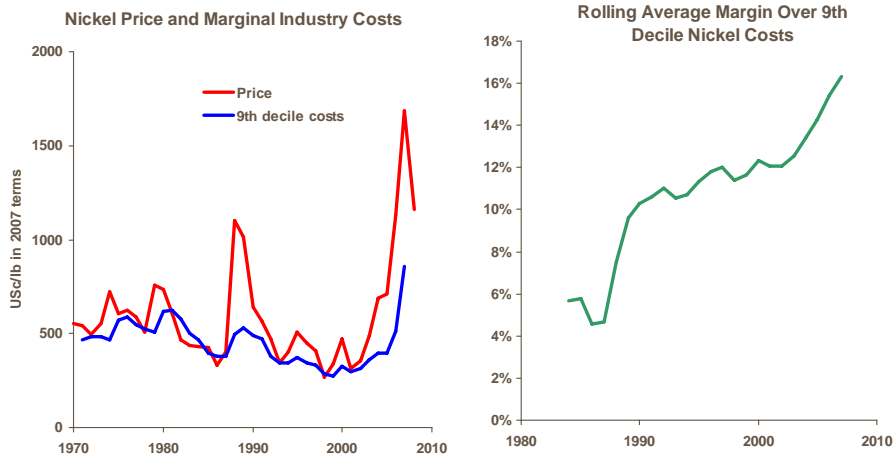
Source: IMF, Global Insight, Rio Tinto Economics Department

Forward curves remain generally positive on the long run price outlook



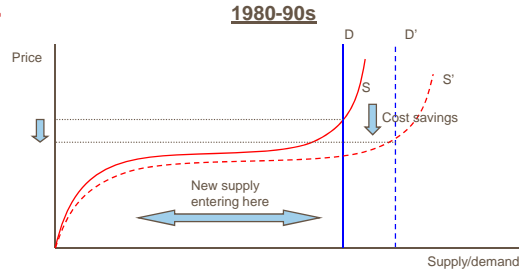
Source: LME, Ecwin, Rio Tinto

Over the long run prices have had the strongest underlying relationship to cash operating costs but causation is two-way

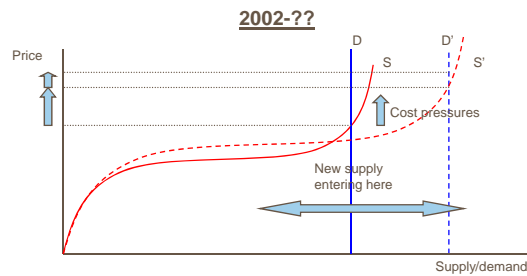


Source: Brook Hunt, Rio Tinto

Major structural shifts in demand, supply and trends will drive future prices



- Slow demand growth
- Efficiency savings at existing operations
- Gradual displacement of high cost supply by new 1st/2nd quartile operations

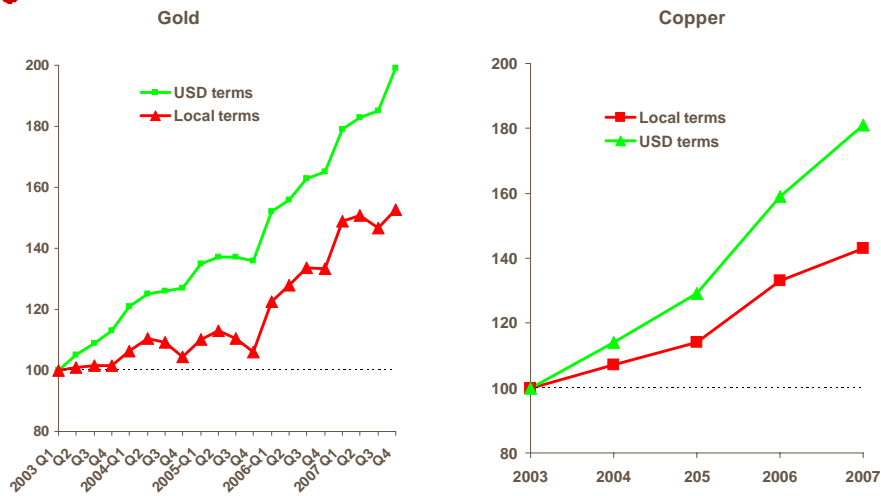


- Rapid demand growth
- Rising input prices lead to higher costs, reinforced by forex linkages
- Entry of newer higher operating cost producers pushes up marginal costs
- Rising "incentive prices" reinforces upwards shift in cost curve shift
- Periodic shortages result in further uplift to margins

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Industry is still observing real operating cost escalation

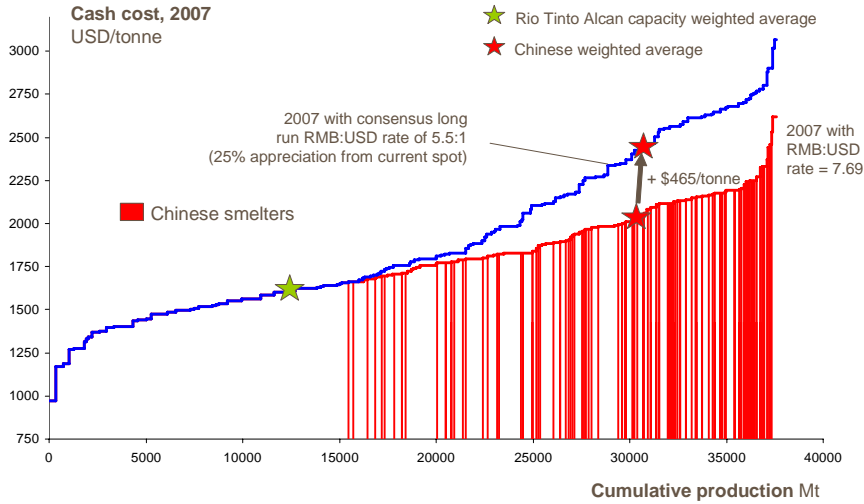
Index of Industry Operating Costs



Source: Company Reports, Rio Tinto

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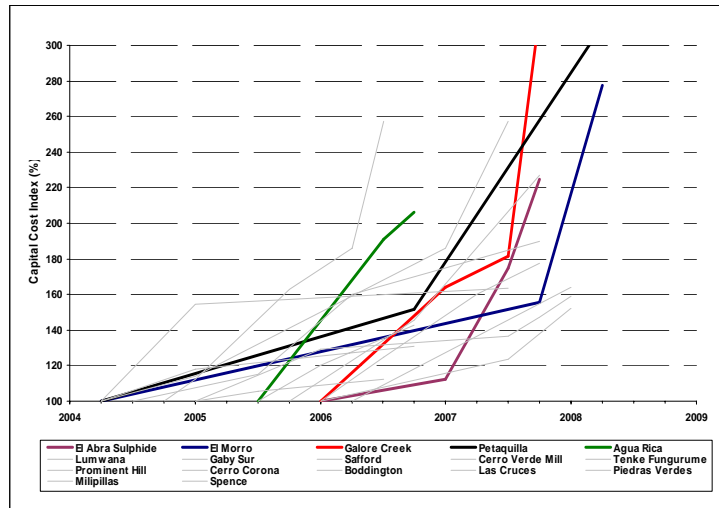
China has added substantial capacity at the high end of the global aluminium cost curve



Note: Rio Tinto Alcan share of assets only
 Source: CRU – Primary aluminium Smelting Costs 2007 Edition – Smelter Cost Profiles and the Benchmarking Model Version 2.0; Rio Tinto

Capital cost escalation has been even greater than operating cost changes

Cumulative Capital Cost Escalation at Projects Now at Bankable Feasibility Stage



Source: Brook Hunt

There are a number of major long run uncertainties facing the industry

- Underlying demand trends
- Rate of resource discovery
- Changing location of supply and access to resources, water, ...
- China “going out” and resource competition
- Investment behaviour and risk of overshoot (“memory” of high prices)
- Impact of carbon pricing
- Technological changes
- Impact of stocks, funds and investment buying on price

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Key message: Need for greater consideration of risk and uncertainty in analysing commodity markets and value

- Short run risks to both supply and demand remain significant in both directions but forward markets remain positive for most commodities
- Commodity markets experience periodic structural shifts and the industry has typically been conservative in adjusting to such shifts and the adjustment process has long lags
- The recent boom has highlighted a number of emerging issues; forecasters need to take a more proactive view of the impact of these
- These issues also have significant implications for changes in value across the industry

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