

Edition ▼

# Mongolia could be Rio's copper growth key

Jean-Sebastien Jacques has been a prolific seller of Rio Tinto's tarnished silverware. And he is not done yet, with perhaps another US\$4 billion in less than shiny assets (Pacific Aluminium and the Canadian iron ore pellets business) expected to be given the heave-ho.



## Copper > Research

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Since January last year, JS has flogged \$8.5 billion in assets, including the entire coal business. The latest deal was the widely flagged \$3.5 billion sale of Rio's post-2022 40% share of production from the Grasberg mine in Indonesia to state-owned interests.

Generally speaking the prices received in the clean-out have been above market expectations, and it has to be said that faced with the prospect of having its 40% Grasberg stake becoming 20% under Indonesia's resource nationalism agenda, taking \$3.5 billion off the table was a good outcome, particularly as the exit from the controversial project boosts Rio's environmental credentials.

As with the previous assets sales, Rio does not need the Grasberg money. Debt is where it wants it, cashflows are strong, and growth capital expenditure is back from the boom time craziness to levels that are more manageable.

So there is no surprise that every time Rio ticks off a an asset sale there is orgy of speculation about how quickly the excess capital generated can make its way back to shareholders. Fair enough too, given how they missed out during the boom.

But the much bigger question now is does Rio need to make some acquisitions to replenish the silverware cabinet.

Getting out of coal had its virtue benefits in a world that is increasingly active in combating greenhouse emissions. But the exit will leave a big hole in earnings, particularly if currently elevated coking and thermal coal prices persist.

The same goes for the Grasberg exit, post 2022 at any rate. It is the world's second biggest copper mine with credits from gold and molybdenum helping to make it one of the lowest cost. It is getting bigger and better too with its move underground.

Its departure means that a big hole is punched in Rio's copper (and gold) exposure post 2022. Given Rio's copper exposure is already underdone compared with that of BHP Billiton, plugging the post 2022 hole would seem to be a priority.

Dare it be said that without rebuilding the copper position, there is a risk to Rio being over reliant on iron ore and aluminium. After all, Rio has said repeatedly that copper will go in to supply deficit around 2020. Whichever way it is spun, that cannot be said about iron ore and aluminium.

Without the 2022 kicker that was to come from Grasberg, Rio's copper exposure is reduced to a 30% non-managed interest in Escondida (BHP 57.5%), its ageing Kennecott operation, and a long-dated option on the Resolution copper project.

Oyu Tolgoi was left out of the list there because if there is a simple fix to replace the copper lost with the Grasberg departure, then it has to be OT.

The problem with OT is that while Rio runs the show, its exposure is limited to an indirect stake of 33.6% courtesy of its 51% in the Canadian listed Turquoise Hill, the 66% partner with the Mongolian government holding the remaining 34%.

This space is not alone in suggesting that cash freed by the exit from Grasberg position might best be deployed in Rio acquiring the 49% of Turquoise Hill it does not already own for \$3.8 billion, which includes a 30% premium.

As it is, there has been some noise from some of the biggest minority shareholders in Turquoise Hill that the company is run as if it is a wholly owned subsidiary of Rio anyway. While they want greater independence from Rio, that independence can be bought for a 30% premium, which probably has more to do with their agitation than any real governance concerns.

Think of it as an around-about way of inviting Rio to bid.

Rio has been running OT since 2010 and was instrumental in securing the agreements with the Mongolian government which underpin the mine's \$5.3 billion expansion by moving underground where most of the value lies.

It will establish OT as one of the world's truly great copper/gold mines. Production for 2019 is forecast at 156,000t of copper and 256,000oz of gold. Then the underground kicks in big time, lifting forecast production for 2025 to 622,000 tonnes of copper and 670,000oz of gold.

Between 2022 and 2026 when access to a particularly high-grade zone of the monster orebody is accessed, free cashflow is estimated at \$9.5 billion. OT then settles down in to a 500,000t a year copper producer (with gold) for decades to come, with expansion opportunities all the way along.

Having said all that, Mongolia has a habit of throwing up sovereign risk surprises every now and then and the great fear from a Rio and Turquoise Hill perspective is that the State might want more of the action as the move underground is derisked.

Time will tell on that score. What is more certain is that if Rio wants meaningful long-term exposure to the world's next best copper/gold mine, it is best to go in to any future argy-bargy with the State from a 66% partner position, and to do that it needs to buy the minorities out of Turquoise Hill.

\**Barry FitzGerald writes a regular column for [www.miningnews.net](http://www.miningnews.net)*



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