

# Q1 2017 Turquoise Hill Resources Ltd

## Earnings Call - Final

OPERATOR: Good day, ladies and gentlemen, and thank you for joining us today. Welcome to the First Quarter 2017 Conference Call. This call is being recorded and also will be available for later today on replay.

I would now like to turn the meeting over to Mr. Tony Shaffer. Please go ahead, Mr. Shaffer.

TONY SHAFFER: Thank you, operator. I want to welcome you to our results conference call. Yesterday, we released our first quarter 2017 results press release, MD&A and financial statements. These items are available on our website and SEDAR.

With me today is our CEO, [Jeff Tygesen](#); Steeve Thibeault, our CFO; and [Brendan Lane](#), Vice President of Operations and Development. We'll take your questions after our prepared remarks.

This call will include forward-looking statements. Please refer to the forward-looking language included in our press release and MD&A.

I'd now like to turn the call over to Jeff.

[JEFFERY D. TYGESEN](#), CEO AND DIRECTOR: Thanks, Tony. Over the past few weeks, we have seen our stock price and valuation come under pressure. We have had inbound calls from shareholders and analysts asking if they are missing anything. I'm not aware of anything significant that is causing this downward pressure.

In the first quarter, underground development continued to move forward and open pit operations performed well, despite known grade challenges resulting from the mining sequence. Our guidance for the year for metal production and our expectations for the start of underground have not changed. [Oyu Tolgoi](#) is still expected to be the third-largest copper mine in approximately 8 years when the underground reaches peak production. [Oyu Tolgoi](#) has one of the top, if not the top, growth profiles in copper space. Copper production is expected to grow by more than 320% between 2017 and 2025. The vast majority of the sector would like to be able to say that.

I don't believe the current valuation sufficiently reflects [Oyu Tolgoi's](#) growth profile. I am thrilled to be part of [Oyu Tolgoi](#) and believe it is, hands down, the best copper project in development. I am convinced at some point, hopefully soon, the market will realize the amazing quality of [Oyu Tolgoi](#) and our valuation will appropriately reflect its value.

Specific to the first quarter, I'm going to kick off with safety. [Oyu Tolgoi's](#) All Injury Frequency Rate was 0.42 per 200,000 hours worked. This was an increase over the rate at the end of 2016, which can be explained given the increase in the underground workforce. A number of the underground workforce of over 3,500 are new to [Oyu Tolgoi](#) and are being trained on [Oyu Tolgoi's](#) safety culture.

During the first quarter, [Oyu Tolgoi](#) continued to advance the various components of the underground. Lateral development remains on schedule. Work on Shaft 2 is focused on mass excavation off the 1,202 level. Shaft 5 progressed during the quarter, although at a slower rate

than planned. We now expect Shaft 5 to be completed in early 2018. Brendan will cover more underground development in detail later in the call.

We continue to expect production from the first draw bell mid-2020 and first sustainable production early 2021.

Cash basis underground CapEx was approximately \$140 million during the quarter, and there were further commitments of approximately \$875 million.

During Q1, [Oyu Tolgoi](#) signed several large contracts. The largest contract was for the decline material handling system.

Moving to operations. Q1 production was the first time we saw a full quarter of low-grade impact we have been flagging for the past year. For those new to Turquoise Hill, this is a function of the current open pit mining sequence, and production was as expected. Despite the low grades, particularly for gold, I was impressed with the performance of the concentrator and the various production elements [Oyu Tolgoi](#) has had to balance.

Revenue in the first quarter increased almost 6% over the fourth quarter due to higher average selling copper price and increased volumes of copper in concentrates sold. Operating cash flow for the quarter was almost \$90 million.

Last Friday, we announced that [Oyu Tolgoi](#) signed a new power purchase agreement for up to 6 years. This was a great achievement and allows time for [Oyu Tolgoi](#) to continue working with the Mongolian government to establish a domestic power source.

Overall, I was pleased with the quarter. Underground development is moving forward. Open pit metal production was as expected, and the concentrator had record performance.

That concludes my opening comments. Before I turn the call over to Steeve, I want to acknowledge that Steeve will be retiring from Turquoise Hill next week and this will be his last call. I want to thank him for his contributions and we wish him well in the future.

With that, over to you, Steeve, to discuss financial aspects of the quarter.

STEEVE THIBEAULT, CFO: Thank you, Jeff. The revenue for the quarter was \$237 million, an increase of approximately 6% over the fourth quarter of 2016. Average copper prices in the quarter increased by about 10% from the fourth quarter, from \$2.40 to \$2.65 per pound. Average gold prices for the quarter remained consistent with the previous quarter, averaging \$1,219 per ounce. Concentrates sold increased approximately 5% over the fourth quarter.

Gross margin for the quarter was approximately 18%, consistent with the fourth quarter. Cost of sales include an adjustment of \$5 million for a reversal of the provision against concentrate inventory, reflecting improved spot prices at the end of the quarter. Income attributable to Turquoise Hill shareholders in the first quarter was \$41 million.

The net realizable value of copper-gold stockpile at the end of the quarter was \$81 million, an increase of \$20 million for the fourth quarter due to the improved short- to medium-term price outlook that positively impacted the value of the medium-grade stockpile. A net reversal to the income statement of \$6 million was included within operating expenses for the quarter, after accounting for partial reversal of the medium-grade stockpile provision, together with the provision against the carrying value of material and supplies and other inventory adjustments.

In the quarter, we increased the total deferred tax assets recognized from \$296 million to \$339 million. The increase reflects additional Mongolian operating losses and interest charges incurred by Oyu Tolgoi in the first quarter of 2017 and taxable income projection driven by improved long-term commodity price forecasts.

Total operating cash costs at Oyu Tolgoi were \$168 million in the quarter compared to \$175 million in the fourth quarter, reflecting a reduction in administration expenses. At March, Turquoise -- at March 31, Turquoise Hill's cash balance was \$1.4 billion. Capital expenditure on a cash basis was \$148 million in the quarter compared to \$143 million in the fourth quarter and includes \$136 million for the underground development. C1 costs in the quarter were \$1.85 per pound compared to \$1.57 in the fourth quarter due to lower grade in recovery, partially offset by a reduction in administration expenses.

And that concludes my comments, and I'm going to turn the call over to Brendan.

BRENDAN LANE, VP OF OPERATIONS & DEVELOPMENT: Thanks, Steeve. During the quarter, the concentrator processed ore from Phase 6, Phase 4A and stockpile. Given the expected low grades this year, Oyu Tolgoi's objective is to maximize copper production and copper revenue. We plan to do this by using the highest copper grade available, which comes from Phase 6. This ore has nearly 50% higher copper grade than the next best available ore. However, Phase 6 is a complex ore body, and blending is required to meet shipping specifications, which, in turn, leads to several offsetting factors that need to be managed.

First, given the very low levels of gold in Phase 6, 0.08 grams per tonne [of lift], the Phase 6 ore sits right at the bottom end of the grade-recovery curve with inherently low gold recovery levels. And additionally, it can be subject to further variability to the downside at those levels.

The Phase 6 material also has high arsenic grades, and in order to limit the final level in the concentrate, it requires blending with other lower arsenic ores from Phase 4A and stockpile. These have lower copper grades.

Lastly, Phase 6 is also high in pyrite. And in order to produce concentrate at the correct grade, the pyrite must be suppressed in the concentrator. This, however, can also impact the gold recovery of the blending ores from Phase 4 and stockpiles that contain some gold.

Oyu Tolgoi is managing rather successfully, I think, a fairly complex blending process in order to maximize revenue from copper. With the softer ore from Phase 6 and improvements implemented in 2014 and 2015, the concentrator set a record for the first quarter ore treated and average daily throughput. This good performance is expected to continue through 2017 with the softer ores from Phase 6 Central zone and, eventually, the Hugo North Lift 1 block cave. We expect the concentrator to process approximately 40 million tonnes for 2017. However, there is a planned maintenance outage during the second quarter, so we will likely see a dip throughout the next quarter.

Moving to the underground project, overall development continues to advance, and the workforce has grown to more than 3,500 people. Since the project re-start in mid-2016, we have completed 2.6 equivalent kilometers of lateral development, including 1 equivalent kilometer in the first quarter. Shaft 2 mass excavation continued at the 1,202 level, that's the production level, during this last quarter. And as this level is finished, sinking will move on to the 1,256 meter level, the main access level. And then finally, Shaft bottom will be reached at the 1,284 meter level, a dewatering level. And this is expected to occur and be completed in 2017. Shaft 2 fit-out is then planned to occur over 2018.

Sinking of Shaft 5 has progressed slower than we expected due to a combination of an initial slower ramp-up and lower-than-expected average sinking rates to the end of quarter 1. Average sinking rates over the last month, however, have improved significantly, which we expect to continue going forward. We now expect Shaft 5 to reach its final depth in early 2018. We additionally expect that the lateral development rate we are seeing will provide a buffer to the longer-than-expected sinking of Shaft 5. And as such, we won't -- we don't expect this to materially impact the lateral development.

In the coming quarters, we expect to complete construction and commissioning of a higher capacity development crusher and a new underground dewatering system. This infrastructure, expected around midyear, will enable the ramp-up of additional development crews. A third crew is already training underground and is also expected to be deployed around midyear, with the fourth and fifth crews expected to follow later in the second half of this year.

We plan on providing more of an update on these milestones when we report second quarter results at the end of July.

Finally, we remain on target for production from the first draw bell in mid-2020 and sustainable first production in 2021.

That concludes my comments, and I'll now turn back to Jeff.

JEFFERY D. TYGESEN: Thanks, Brendan. In summary, underground development continues to advance, and our first production targets remain the same. The concentrator continues to set records and open pit operations are performing as expected given the 2017 grade challenges. We expect to be back in the high-grade gold zone of the open pit around middle of 2018, which should benefit both metal production and revenue.

As you think about Oyu Tolgoi's future, there are 2 key numbers to remember: 3 and 8. We expect production from the first draw bell in 3 years and significant cash flow for Turquoise Hill shareholders in 8 years. In my view, Oyu Tolgoi is the best copper project currently in development and has the best growth profile of any current copper mine.

That concludes our prepared remarks. Grace, we are ready to take questions.

Questions and Answers

OPERATOR: (Operator Instructions) And our first question comes from Matt Murphy from Macquarie.

MATTHEW MURPHY, ANALYST, MACQUARIE RESEARCH: Just a question on lateral development in Q4. What was the equivalent kilometers of lateral development the prior quarter?

BRENDAN LANE: In Q4? You asked for Q4 or Q3?

MATTHEW MURPHY: Yes, for Q4, because did you say it's 2.6 in total?

BRENDAN LANE: 2.6 in total. Yes.

MATTHEW MURPHY: And you did 1 this quarter? I'm just wondering if -- like trying to see if there's a ramp-up or if it's steady or what.

BRENDAN LANE: Our best lateral, consistent lateral development has occurred in the last quarter.

MATTHEW MURPHY: Yes, okay, so picking up. Okay. And then just had a question on the OT admin expense. Good to see it down to \$25 million. Just wondering how sustainable that is.

STEEVE THIBEAULT: Matt, Steeve here. Matt, the first quarter is always a bit tricky, because the level of expenses, I would say, that they're probably going to be a catch-up a little bit. But you should see expenses lower than last year. So in other words, what I'm saying is that there's always a question of timing with the first quarter. I would not book all the savings that you've seen, but I would not definitely put it at the same level as last year.

OPERATOR: (Operator Instructions) I'm not showing any further questions at this moment. I would like to turn the call back to Jeff Tygesen for any further remarks. I do see a question from Craig Hutchison from TD Securities.

CRAIG HUTCHISON, RESEARCH ANALYST, TD SECURITIES EQUITY RESEARCH: Just had a question on the IMF loans. Have you guys noticed any changes in country, any potential changes to your investment agreement or any sort of clauses potentially in their budget that may impact the Oyu Tolgoi project?

JEFFERY D. TYGESEN: Craig, thanks for your question. Recently, people might have seen some reference in the press to Budget Resolution 29 in Mongolia. That was issued in March and then approved -- or voted on approval in April. There was a clause added at the last minute that hadn't undergone review in comparison to existing laws and also the investment agreement. And I think it was on April 24, the IMF was having a board meeting to review the funding package and recognized that, that clause was in conflict. And subsequent to that Resolution 30, that clause has been revoked. So there is nothing that impacts Oyu Tolgoi's investment agreement or subsequent ARSHA or UDP.

OPERATOR: And I'm not showing any further questions at this moment. I would like to turn the call back to Jeff Tygesen for further remarks.

JEFFERY D. TYGESEN: Thank you for joining us today. I'd leave you with: we are continuing to advance underground productions and Oyu Tolgoi realizing its full potential.

OPERATOR: Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You may all disconnect. Everyone, have a great day.