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PRESENTATION

Operator

Good day, ladies and gentlemen. Thank you for joining us today. Welcome to the Q3 results call. I would now like to turn the call over to Mr. Tony Shaffer. The call is being recorded and will be available later today for replay. Please go ahead.

Tony Shaffer, Investor & Media Relations

Thank you, operator. I want to welcome you to our financial results conference call. Yesterday we released our third quarter 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.

Jeff Tygesen, Chief Executive Officer

Thanks, Tony.

During the third quarter the underground project moved forward. Oyu Tolgoi signed more contracts and by the end of the quarter had commitments of more than $750 million. By year end, commitments are estimated to be approximately $1 billion. At the end of the third quarter Oyu Tolgoi had spent approximately $105 million of expansion capital. For reference, the 2016 technical report, which was based on the 2016 feasibility study, assumed approximately $450 million of expansion CapEx in 2016. Our expectation is underground capital spending for 2016 will be approximately $200 million due to construction ramp up and the actual timing around contracts being signed. The difference of the planned spend versus actual will carry into 2017. We continue to expect production from the first draw bell in mid-2020 and sustainable first production in early 2021. During the quarter work began on Shaft #5 sinking and excavation of the convey-to-surface box cut. Construction of facilities such as the camp and mine dry building also continued during the quarter. Just for reference, this is a massive project and there are numerous parts that come together to advance the underground construction.

Now turning to current operations, Oyu Tolgoi achieved another quarter of outstanding safety performance. The year-to-date all-injury frequency rate for open-pit operations was 0.12 and 0.26 for the underground project. Both of these are per 200,000 hours worked. I continue to be extremely impressed with Oyu Tolgoi's safety culture and their industry-leading performance. During the third quarter, as forecast, we started seeing lower gold grades with mining in Phases 3 and 6. Phases 3 and 6 have copper grades similar to previously mined sections of the open pit but they can pay much lower gold. For those new to the Turquoise Hill story, I want to stress that this is not unexpected. The lower gold grades in these open-pit phases were anticipated in 2014 technical report. One high point to mention in the third quarter was a record quarterly high for material mined of more than 25 million tonnes. During the fourth quarter we will be processing stockpiled ore from earlier phases to balance Phase 6 ore. For Phases 3 and 6 the metal recoveries are lower when compared to earlier Phases 1 and 2 due to clay and pyrite levels. The Oyu Tolgoi team is actively working to optimize copper production from Phases 3 and 6 as well as minimize cost in order to be cash flow neutral for 2017 and 2018. Looking forward to the next high grade open-pit phase, stripping in Phase 4 is underway. The record high for material mined during the quarter moves us closer to higher Phase 4 grades. We don't expect to see increasing gold grades until middle of 2018 when Oyu Tolgoi reaches the high grade portion of Phase 4. We plan to provide 2017 guidance in the first half of December. Third quarter revenues decreased approximately 31 percent over the second quarter due to lower gold sales, which was the result of lower grades. We reported operating cash flow $24 million for the third quarter. This too reflects the impact of reduced gold production and sales.

Now turning to our 2016 technical report that was issued on October 21st, post approval of the 2016 feasibility study we've been working on the updated 2016 technical report. Two sections of the updated report focus on Oyu Tolgoi's production. The first is the reserve case that matches the feasibility report assumptions and timing. The reserves case in the technical report shows annual production information for the first 10 years to highlight increased copper production during underground ramp up. During this period underground copper grades are expected to be close to 2.5 percent. The second section covers more detail around upside resources cases. This section covers resource classified material has been expanded to provide more visibility with several alternative production cases that range from 50 million tonnes per year mill throughput to 120 million tonnes per year. These cases are preliminary and speculative in nature and do not meet the criteria for development at this stage; however, they do show Oyu Tolgoi's potential upside. We also provided year-by-year detail for the first 10 years for production and cash flow. Our intent was to provide more granular near-term details for modelling and hopefully assist with the understanding of Oyu Tolgoi's long-term value. The added information and the alternate production cases was to help you understand how the geologic resources could be sequenced and what the potential incremental value could be.

I'm now going to turn the call over to Steeve to discuss the financial aspects of the quarter. After that, we will discuss the highlights of the technical report and then take your questions.

Steeve Thibeault, Chief Financial Officer

Thank you, Jeff.

The revenue for the quarter was $226 million, a decrease of 31 percent over the second quarter. The decrease was mainly due to the reduced gold sales as a result of lower gold production. Average copper prices in the quarter were $2.17 per pound compared with $2.14 in the second quarter. Copper prices at the end of September were $2.19 per pound, the same as the end of June. Average gold prices for the quarter increased by 5 percent to $1,327 per ounce from $1,260 when compared with the second quarter. Gross margin was negative at 2.7 percent compared with the positive 28.1 percent in the second quarter. The decrease was a result of lower gold revenues.

Cost of sales for the quarter include an adjustment of $9.7 million against concentrate inventory, reflecting inventory costs including cash and non-cash, which exceed the estimated net sales revenues. We expect this situation to continue in 2017 and early 2018 while low gold phases are mined from the open pit as planned.

Net loss attributable to Turquoise Hill shareholder in the third quarter was $31 million. Due to continued low forecast metal prices, a medium copper-gold stockpile expected to be processed in more than one year are fully provided against. These stockpiles are expected to be utilized in the next few years as they are blended with higher grade stockpile and material from the open pit.

Total operating cash costs at Oyu Tolgoi were $187 million compared to $215 million in Q2 2016. The decrease was mainly driven by Oyu Tolgoi production volumes, administrative costs, and absence of management service fees incurred in the previous quarter related to the drawdown of project volumes.

At September 30th our cash balance was approximately $1.4 billion. Operating cash flow for the quarter was $24 million, down from $161 million in the second quarter due to the lower revenue and timing of payments to creditors. At September 30th, unchanged from June, an amount of $4.2 billion continued to be deposited with Rio Tinto and recorded as a loan to a related party in the balance sheet in accordance with the previously agreed cash management services agreement. Deposited funds are available for withdrawing as required for meeting the Oyu Tolgoi underground development and financing needs. While these balances are in deposit with Rio Tinto, we benefit from a reduction in the guarantee fee payable on the project finance debt. These payments are described in more detail in note 23 to the interim third quarter financial statements.

Interest paid of $16 million in the year to date relates mainly to the project finance borrowing. These interest payments are made annually in June and December. Capital expenditure on the cash basis was $74 million for the quarter, including $47 million for the underground expansion. Year-to-date capital expenditure totalled $183 million, including approximately $106 million for the underground development.

C1 costs in the third quarter were $1.56 per pound compared with $1.12 in the second quarter. The increase was mainly due to lower gold credit. Third quarter all-in sustaining were $2 per pound compared to a $1.55 in Q2. The increase in all-in sustaining cost was due to the same drivers as for the C1 cost.

An update on the financial guidance for 2016: We continue to expect 2016 operating cost to remain broadly in line with our previous guidance of $840 million and the copper and gold production guidance remains unchanged at 175,000 tonnes to 195,000 tonnes of copper and 255,000 to 285,000 ounces of gold and we are presently expecting to achieve the higher end of these ranges.

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

Brendan Lane, Vice President, Operations & Development

Thanks, Steeve.

I'd like to discuss the highlights of the 2016 technical report. To begin, the 2016 reserves case is based on the following assumptions: Concentrator capacity of approximately 40 million tonnes per year, which is 10 percent above nameplate capacity. The open pit will be utilized to top up the concentrator. Ramp up the full production from the underground, which is 33 million tonnes per year is expected to occur from 2020 to 2027. The highest grade underground ore will be mined first. Initial underground copper grades are expected to be approximately 3.5 percent. After 2039, open pit head grades will average around 0.45 percent copper.

We think there are several upside opportunities in the reserve case to consider as we advanced construction. The first is to see if we can reduce construction time to the first draw bell and achieve first sustainable production sooner than planned. The second opportunity is to see if we can reduce the ramp-up time to full production. And third opportunity is to determine if we can increase production levels beyond the 95,000 tonnes per day. Clearly we are only in the early stages of development and any of these opportunities are in number of years out. I only mention them to say that there are potential opportunities in both the start of production and the ramp up to full production.
As we now look to the preliminary economic assessments of the alternative production cases, the first thing the resources case, the amount of potential mineable material increases by approximately two billion tonnes. And thinking about the resource case, additional drilling is necessary initially to convert Hugo North Lift 2 and Hugo South from resources to reserves and both would require feasibility studies. Our immediate priority, however, is the construction of Hugo North Lift 1, but in roughly three or four years we will need to start drilling and planning the Lift 2 and Hugo South. In the resources case at 40 million tonnes per year, production from the open pit and Hugo North Lift 1 are the same as the reserve case roughly for the first 20 years. The resources case assumes this would be followed by Lift 2, Hugo South, and Heruga. Open-pit production would then ramp back up to fill the concentrator capacity through the remaining mine life in years 79 to 94.

The technical report includes a further three different alternative production cases in order to provide some early-stage analysis of the development flexibility that exists with later phases of Oyu Tolgoi deposits. The first is called Resources 50 and assumes concentrator capacity creep from 40 million tonnes per year to 50 million tonnes per year with little capital. The second, called Resources 100, assumes approximately in the year 20 a decision is made to expand the concentrator to 100 million tonnes per year. The third and largest case called Resources 120 alternatively considers in year 20 a decision being made on larger expansion of the concentrator to 120 million tonnes per year.

The technical report shows the potential capital NPV implications of these four alternative production cases and the technical report also analyzes for cost sensitivities for all the production cases and shows their potential NPV impact of those scenarios. As I said earlier, the resources case and the other three alternative production cases, including cost sensitivity, were designed to show the optionality that could exist in the development of Oyu Tolgoi and the long-term value possibilities. We do not think that the market fully appreciates Oyu Tolgoi's long-term potential value.

And that concludes my comments. I'll now turn back to Jeff.

Jeff Tygesen, Chief Executive Officer

Thanks, Brendan.

In summary, the open pit is performing as expected as it mines areas of low gold. Underground development is progressing and the project team is focused on construction of Hugo North Lift 1. The recently filed 2016 technical report provides granular near-term production and cash flow data as well as a number of upside cases that show Oyu Tolgoi's development optionality and long-term potential value. Oyu Tolgoi is hands down the best copper asset and development today.

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

QUESTION AND ANSWER SESSION

Orest Wowkodow, Scotiabank

Hi. Good morning. Two questions for you. The first one revolves around CapEx, sustaining CapEx excluding the Phase 2. I was just curious, um, when you started the year there was guidance of $300 million. I believe you cut it to $200 million. You're certainly tracking really low this year. Can you maybe outline what's changed there in terms of your plan from the beginning of the year 'til now in terms of why that's been kind of substantially below that original forecast? And then the second question just had to do with your guidance for operating costs on a dollar basis. When you say operating cash costs are supposed to be, I mean the original guidance was $800 million, can you outline exactly which components are included in that guidance in addition to production and delivery costs? Thank you.

Jeff Tygesen, Chief Executive Officer

Sure. Thanks for your questions. We've had a lot of questions on our start up. Just for reference, we got approval in May for notice to proceed and we had an estimate in two references, the one you referenced, the $300 million in the UDP, and also a reference of the $400 million number or $450 million in the feasibility study. We are a little bit slower and now we're saying the guidance for year end, and this is cash through year end, of $200 million, and that all relates to signing all the contracts initially.

I would like to mention there was a lot of time and effort by the procurement team to maximize the Mongolian content. That proved to take a little bit longer but I think in the long run will be beneficial for all parties involved. Our expectation, as I mentioned, we will carry that forward into 2017. There are, if you look at all the different parts and pieces, some are ahead, some are behind. Two of noteworthy being ahead is the lateral development, it's on schedule, and also the development of the convey-to-surface box cut is on schedule. We are a little bit behind on Shaft 2 but that doesn't start to hit critical path until next year, but the team thinks that they'll hit that as scheduled. So I would say in general why we're a little bit behind is the procurement team trying to maximize the Mongolian content.

Orest Wowkodaw, Scotiabank

Okay. But in terms of the CapEx sustaining for sustaining CapEx outside of the underground, that certainly looks like it's also tracking kind of well above your original guidance.

Steeve Thibeault, Chief Financial Officer

Orest, you're right; we're tracking lower on that one. Earlier in the year there was a change because we changed our mining schedule and there was a significant change in the deferred stripping. So that was the main change if you refer that back to the beginning of the year guidance, okay? The tracking now is lower. A couple of reasons. The first one is we expect to be higher than what we were in the beginning of the year on the deferred stripping so you've seen in Q4, a bit more on that one and the trend that we had in the first part of this year. Also what we've done, Orest, is we have reviewed, I mean the prices have been lower than what we were expecting last year on the copper and what we have asked the site to reduce and put pressure on their spending, okay, and we are expecting to have less expenses on the HME because, ah, on that area and the open pit, there was some project that we had dealing on that one. So overall I would say that we should expect to be less than what we had expected. But it's a question of managing the cash flow versus the prices that we had expected earlier in the year. That doesn't mean, Orest, that this will be necessarily next year. There are some changes that have been done to the forecast that not necessarily will impact or what we pushed in 2017, okay. But we'll give guidance for 2017 later on before the end of the year.

You also mentioned, Steeve, how can I reconcile that operating total, operating costs. Your best is the C1 costs. When you look at the operating cash cost, year to date, for example, you're at $600 million. That's a very good estimate for what you're going to have at the end of the year.

Orest Wowkodaw, Scotiabank

Okay. Thank you very much. Just actually could you give us then your estimate for cash capital expenditures for the fourth quarter of 2016 and for both sustaining and the underground?

Jeff Tygesen, Chief Executive Officer

The CapEx for the expansion will be about $100 million.

Steeve Thibeault, Chief Financial Officer

And I would say that—I hate to give guidance like that but I would say you should be, the final result should be less than $200 million that we have for guidance for the sustaining one, Orest.

Orest Wowkodaw, Scotiabank

Thank you very much.

Operator

Thank you. The next question is from Ralph Profiti from Credit Suisse. Please go ahead.

Ralph Profiti, Credit Suisse

Thank you and good morning, everyone. I have two more longer-dated questions. First one, Steeve, if the supplemental debt were to be brought forward, you know, say underperformance of metal prices case, how easy of a process would that be with respect to approvals, insurance, and things of that nature?

Steeve Thibeault, Chief Financial Officer

Okay. What we're doing, we're already working on that one. There are a couple of things that needs to be done, okay? For example, what we—I'll try to make a short answer here, Ralph. We're working already on the securing debt, so we have met with banks and we're moving on these ones. However, what we'll need, we'll need the approval of the OT board, okay? That will be required. We will have to move on that because they have to accept the project finance. There's definitely at the moment a change in government and we have re-update to these people.

The negotiations that we're doing with the banks, roughly we're talking exactly the same structure, so in terms of, ah, we're trying to duplicate in fact what we have in the project finance that we had before. So we don't expect from, ah, we're not restarting from scratch, because we're taking copies of what we had before and saying to the bank this is what we're proposing and we're having positive discussion around these ones. But it would be more, I would say that the process will be more around the approval and the go ahead with the Mongolian, the OT board, okay, and discussion with the government. The discussion I mean like updating the government because we have new directors there and they need to be updated. But it is something that we're looking for 2017 depending on the period. I mean I cannot say it can be that month but this is something that we are working on.

Ralph Profiti, Credit Suisse

Got it. Okay. Thanks.

Steeve Thibeault, Chief Financial Officer

Ralph, did I answer? Does that give you a broad view of where we are?

Ralph Profiti, Credit Suisse

That's excellent colour. Thank you, Steeve.

Steeve Thibeault, Chief Financial Officer

Okay, thanks.

Ralph Profiti, Credit Suisse

Brendan, in the early work done on the alternative cases in the PEA has there been any change in the block cave capability characteristics or the rock stresses around Lift 2, Hugo South, and Heruga? What I'm trying to get at is, is the mining and development risks the same in all of these alternative scenarios?

Brendan Lane, Vice President, Operations & Development

Yeah, there's been no change and they're considered to be the same.

Ralph Profiti, Credit Suisse

Okay. Great. Thank you.

Fraser Phillips, RBC Capital Markets

Thanks. Good morning. Steeve, I just wanted one question on the current project finance. If I recall correctly, it was a $4.4 billion facility. It looks like $4.1 billion is drawn. Is that right? And is there is there any reason or what's the process for the other $300 million?

Steeve Thibeault, Chief Financial Officer

No, no, Fraser, you know the accounting is always complicated, okay? What we have is that we drawdown $4.4 billion but because of the, ah, certain fees has to be amortized over the period of time, I think it is $218.3 million if my memory is right, they have to be amortized. It shows on the financial statement as this $4.1 billion. But what I would refer to you, go back to the last quarter financial statement and look at the cash flow line and I think that you're going to see $4.3 billion and we had another drawdown later on a little bit so you're getting your $4.4 million.

Fraser Phillips, RBC Capital Markets

Okay. I'll take a look. Thanks. And then the other question I had is with respect to the case where you consider creeping the concentrator capacity. What's involved, and I would assume that if that's a possibility of creep and expanding their capacity that you would pursue that but what's involved in terms of taking that opportunity over the next two or three years if it presents itself?

Jeff Tygesen, Chief Executive Officer

Fraser, this is Jeff. I'll start and Brendan will help me out if I miss a few of the steps within the plan.

We're already on the path. Nameplate is 100. We've had periods this year and I think our average year to date is about 103 to 104. So we're already doing that. And, as I was going to say, we've had periods of over a month where we've averaged a 120 to 125. During those periods of high material throughput what we found is some bottlenecks on the front end and the back end. We're going to address the front end crushing bottleneck with the underground production so we'll have two crushers, source one from the open pit. So that will have plenty of capacity married with the underground. The front end is taken care of.

On the back end what was identified is likely a need for another tailings thickener because you've got to be able to get it in and you got to be able to get it out. And then there are several parts in between which just come down to better operating efficiencies where the folks at site think they have upside in predictive maintenance as opposed to on scheduled maintenance. So that's what we think we'll be able to creep that capacity and we're already on that path.

Fraser Phillips, RBC Capital Markets

So it sounds like from what you said that the one piece of it that would be not available to you until you start up the underground is the crushing facility. Or are you talking about surface crushing?

Jeff Tygesen, Chief Executive Officer

No, the crushing is, the work that's been done so far at site is the crushing is capable of doing 125,000. It's getting all those other parts and pieces in. But if we want to get it up to the 140,000 that's where we'll be marrying the underground crushing so that will help out with that. So we don't need to add additional crushing at the open pit side because we'll have that crushing capability with the underground.

Fraser Phillips, RBC Capital Markets

Okay. That's great. Thank you, sir.

Jeff Tygesen, Chief Executive Officer

I guess a point on that, Fraser, would be to say that the original plant has some capacity left.

Fraser Phillips, RBC Capital Markets

Yep.

Operator

Thank you. The next question is from Matt Murphy from Macquarie. Please go ahead.

Matt Murphy, Macquarie

Hi there. I had a question on the Oyu Tolgoi administration expense. How should we think about that? Is there any element of that that is elevated because you're just getting going again on the underground or is that a fairly represented run rate?

Steeve Thibeault, Chief Financial Officer

That should be our run rate. What we're doing—there was a bit of, ah, excuse me the French, but the swing in these costs in the last couple of months, but what we're doing now, we are allocating the specific cost that we have for the underground are allocated to the underground. So that should be the run rate.

Matt Murphy, Macquarie

Okay, thanks.

Steeve Thibeault, Chief Financial Officer

You're welcome.

Operator

Thank you. This concludes today's question-and-answer session. I will now turn the meeting back over to Mr. Jeff Tygesen. Please go ahead, sir.

Jeff Tygesen, Chief Executive Officer

Well, I'd like to thank everybody for joining the call. I think we're well on our way to advancing and creating value from Oyu Tolgoi from the open pit. I would like to thank those shareholders and people of interest for hanging with us to get through the process we went through last year at (inaudible), project finance, and notice to proceed. But the future looks very bright for Oyu Tolgoi and Turquoise Hill. That concludes our remarks.
