CORPORATE PARTICIPANTS

Tony Shaffer
Investor & Media Relations

Jeff Tygesen
Chief Executive Officer

Steeve Thibeault
Chief Financial Officer

PRESENTATION

Operator

Good day, ladies and gentlemen. Thank you for joining us today. Welcome to the Q2 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, sir.

Tony Shaffer, Investor & Media Relations

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

Following Notice to Proceed approval in May, underground activities continued to progress. In early June, Oyu Tolgoi appointed Jacobs Engineering the EPCM contractor. In July, Thiess-Khishig Arvin were appointed the contractors for the development of the decline. I am pleased with how things are moving forward. There has been an increase in mobilization by several contractors and a key first step site-specific safety training of new and returning personnel. The Turquoise Hill management team is with our board in Mongolia and yesterday we visited site and saw firsthand was is taking place. The team at Oyu Tolgoi are very focused on advancing construction of the underground, with each day moving closer to underground production.

During the quarter Oyu Tolgoi drew down approximately $4.3 billion for the project finance facility. As stated previously, net funding was reduced to pay down shareholder loans to Turquoise Hill. Steve will talk more about this shortly.

We are working on our new technical report, which we expect to publish later this year. There are no material scope changes from the 2014 report. The primary purpose of the update is to align the production schedule to reflect our recent Notice to Proceed approval. We also plan to include several high level cases, including production schedules and economics. We think this will provide a more robust view of Oyu Tolgoi's optionality and allow for greater option visibility. With the development of Hugo North Lift 1 underway, we are beginning to anticipate the next logical steps in the long-term development of Oyu Tolgoi. Once Hugo North Lift 1 begins production we expect to undertake additional drilling for Hugo North Lift 2 and plan on converting it from resource to reserve.

Because Lift 2 is below Lift 1 we cannot begin large scale production from Lift 2 until Lift 1 is nearly complete, which is anticipated around 2038 to 2039. One of the benefits of the decline used to convey ore from Hugo North Lift 1 is that it passes, by design, near Hugo South. Once the decline is complete, additional drilling at Hugo South is possible and we hope to able to also convert it from resource to reserve. One of the production scenario options being reviewed is Hugo South could allow us to consider an increase in concentrated capacity, thereby increasing production. Clearly our immediate focus is on the development of Hugo North Lift 1 but we are already started to think longer term. One of the key aspects of Oyu Tolgoi is development production optionality, a parameter of world class assets.

Moving to current operations, Oyu Tolgoi has another outstanding safety performance during the second quarter with the year-to-date all injury frequency rate of 0.13 for 200,000 hours worked. The Oyu Tolgoi workforce continues to truly impress with their industry leading safety performance. During the second quarter we began to see an impact and reduced mining in Phase 2 of the open pit. We have been flagging this for some time, mainly because of the drop in gold production we expect in the second half of this year. Mining will occur in Phases 3 and 6 in the second half of this year. These phases have copper production consistent with previously mined sections of the open pit but they contain much lower gold grades. We don't expect to see gold grades increase until we begin mining Phase 4 or in mid to late 2018. For people who may be new to Turquoise Hill, this gold grade decline was anticipated in our 2014 technical report.

Second quarter revenue decreased 22 percent over the first quarter, mainly due to lower gold volumes. We reported operating cash flow of more than a $160 million for the second quarter, a decrease of approximately 17 percent over the first quarter, also reflecting lower gold production and sales. Both copper and gold production were lower in the second quarter compared to the first quarter as mining in Phase 2 was reduced. Copper production in the quarter was primarily impacted by lower head grade.

In summary, I am pleased with our progress on underground development. Gold production is pretty much as we expected due to reduced mining in Phase 2. OT remains focused on developing efficient cost structure in the next years as gold grades are low.

At this point I am going to turn the call over to Steeve to discuss the financial aspects of the quarter in more detail.

Steeve Thibeault, Chief Financial Officer

Thank you, Jeff.

I want to start off with an overview of the project finance drawdown that took place during the quarter. As Jeff mentioned, Oyu Tolgoi drew down $4.3 billion during the quarter. We are working with Oyu Tolgoi to finalize drawdown of the remaining amount. Oyu Tolgoi deducted $33 million for bank fees and used approximately $100 million of its own cash to pay additional bank fees. The net proceeds were $4.3 billion, which was used to pay down shareholder loans. We paid an additional $118 million in withholding taxes and placed $4.2 billion on deposit with Rio Tinto. This was in accordance with a previously agreed cash management services agreement. We will redraw these funds as required for Oyu Tolgoi underground development. While these balances are in deposit with Rio Tinto, we benefit from a reduction in the guarantee fee payable on the projects finance debt.

Projects finance borrowing and has been recorded as non-current debt. The $4.3 billion drawdown was offset on initial recognition by transaction costs of $218 million. The transaction costs are amortized over the life of the borrowing as a constituent of the interest charges. Amortization of transaction costs in the quarter since drawdown is approximately $2.1 million, resulting in balance sheet borrowings of approximately $4.1 billion. The amount of $4.2 billion deposited with Rio Tinto has been recorded as a loan to related parties in the balance sheet. As summary of the deposit terms together with the impact on the guarantee fee can be found on note 23 to the current quarter consolidated financial statements.

Revenue for the quarter was $333 million, a decrease of 22 percent when compared with the first quarter of 2016. The decrease was mainly due to the reduced volume of gold in concentrate sold as a result of lower head grades. Average copper prices in the quarter was $2.14 per pound compared with the first quarter $2.11. Copper prices at the end of June were $2.19 per pound compared with $2.20 at the end of March. The average gold prices for the quarter increased by 6.5 percent from $1,183 per ounce to $1,260 per ounce compared with the first quarter.

Gross margin was lower than previous quarter at 28.1 percent compared to 50.8 percent in the first quarter. The decrease was the result of lower gold revenue and higher unit costs on production due to lower grade and mill recovery. Income attributable to Turquoise Hill shareholders in the current quarter was $30 million. Due to continued low forecast metal prices, medium grade copper-gold stockpile expected to be processed in more than one year are fully provided against. A charge of $3.9 million was recognized in the quarter.

The operating cash cost at Oyu Tolgoi was $216 million compared with $197 million in Q1. The increase was mainly driven by Oyu Tolgoi administrative costs, including additional management services fee, or MSP, incurred in the execution of the project finance during the quarter. At June 30, 2016 our cash balance was approximately $1.5 billion. Operating cash flow for the quarter was $162 million, 17 percent below Q1, reflecting the lower gold sales. Capital expenditure on a cash basis was $53 million for the quarter, including $37 million for underground development and pre-start activities. The C1 costs in the first quarter were $1.12 per pound compared with $0.06 per pound in the first quarter. The increase was mainly due to the lower gold credit combined with the higher unit cost of production reflecting the lower copper grades. First quarter all-in sustaining costs were $1.55 per pound compared with $0.66 in Q1. The increase in all in sustaining cost was due to the same drivers as though having an impact on Q1 costs.

We have updated some aspects of our guidance for 2016. Copper and gold production guidance remains unchanged at 135,000 tonnes to 195,000 of copper and

255,000 to 285,000 ounces of gold. Sustaining capital expenditure or the open pit has been revised to approximately $200 million from $300 million previously. This is mainly due to reduced deferred stripping due to open pit optimization to reduce weight, bringing forward metal from Phase 4 and changes in strip ratio updated for the most recent reserved estimate. Operating cost guidance is now increased to approximately $840 million from $800 million. The revision is a result of the net impact from changes in deferred stripping and additional management service fee incurred in relation to project finance, partially offset by cost reductions.

So that concludes my comments and I am going to turn the call back to Jeff.

Jeff Tygesen, Chief Executive Officer

Thanks, Steeve.

In summary, progress continues on underground development. Due to reduced mining in Phase 2 the open pit is pretty much as we expected with lower expected gold production. OT remains focused on developing an efficient cost structure over the next few years as gold grades are low.

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

QUESTION AND ANSWER SESSION

Orest Wowkodaw, Scotiabank

Hi. Good morning. I was wondering if you could give us an idea on how the changes that you just talked about in terms of stripping and so forth impact the mine plan for 2017, specifically in terms of what that might mean in terms of copper and gold production.

Jeff Tygesen, Chief Executive Officer

Thanks for the question, Orest. What the team has been working on is a way to pull some copper forward, I guess in reference or comparison to the 2014 tech report, and how they've been able to do that, although we haven't given guidance for 2017, is by splitting Phase 4 into two halves and focusing on what the one half that has a shallower or lower strip ratio, and that's how we'll be able to pull that forward, in combination with having the experience or Phases 1 and Phase 2 and seeing how the rock is performing. There is some upside as far as the slope angles and being able to defer some of that waste.

Orest Wowkodaw, Scotiabank

The tech report that's going to come out, I assume sort of in the next two months or so, will it give us that kind of detail for what's left of the open pit or will it only look at the underground?

Jeff Tygesen, Chief Executive Officer

Oh, no, it'll be a refresh of where we're at today. What I wanted to avoid by having the updated tech report is have people try to match up what we said the production schedule open pit with the delay. So we'll show a new schedule going forward in 2017 combined open pit/underground.

Orest Wowkodaw, Scotiabank

Okay. And what's the expected filing date for the tech report right now?

Jeff Tygesen, Chief Executive Officer

I'm officially saying second half of this year. We're busily going through the review process. I don't want to commit to a date but it will be definitely be in the second half of this year.

Orest Wowkodaw, Scotiabank

Okay. And is this not subject to the sort of 40-day 43-101 requirements from a filing perspective?

Jeff Tygesen, Chief Executive Officer

No.

Orest Wowkodaw, Scotiabank

It's not. Okay. Okay, thank you.

Operator

Thank you. The next question is from Sasha Bukacheva from BMO Capital Markets. Please go ahead.

Sasha Bukacheva, BMO Capital Markets

Thank you. Jeff, you mentioned that once you had the chance to upgrade the resource at Hugo South you might be looking at an increase in concentrator capacity, so do you have an idea of what might be an optimal concentrator increase to support that? Would you have to do an assessment? How should we think about that optionality?

Jeff Tygesen, Chief Executive Officer

Sasha, thanks for your question. There is the option, and I've referenced that before. We will have to a feasibility study, because we have to review the cost of that development. And the timeframe for that, given the drilling, feasibility study, we'd be looking at the earliest around 2027 timeframe. But it could have the range of the 30,000 tonne to 50,000 tonne range depending on what the feasibility shows for Hugo South.

Sasha Bukacheva, BMO Capital Markets

30,000 tonnes to 50,000 tonnes per day?

Jeff Tygesen, Chief Executive Officer

Correct.

Sasha Bukacheva, BMO Capital Markets

Okay. And would it make sense, ah, is that something that might make sense to implement sooner and supplement it with the feed from the open pit before you transition into Hugo South?

Jeff Tygesen, Chief Executive Officer

Did you mean Hugo North Lift 1 transition?

Sasha Bukacheva, BMO Capital Markets

So, well, what I mean is make the concentrator bigger earlier, before 2027, before the feed from Hugo South becomes relevant, and put the open pit material through the concentrator to supplement the feed you are getting from the Hugo North.

Jeff Tygesen, Chief Executive Officer

I think we'll provide some clarity, not think, we will provide clarity in the upcoming tech report. So there's several combinations as you look at the, and I know you have, the 2014, and we're reviewing those right now, so those will be in the upside cases.

Sasha Bukacheva, BMO Capital Markets

Okay. Okay, sounds good. Thank you.

Operator

Thank you. Once again, if you have a question, please press star one.

The following question is from Craig Hutchison from TD Securities. Please go ahead.

Craig Hutchison, TD Securities

Good morning. Just a follow up on the development options that you are going to outline in the technical report. Can you give us a sense of which options you're looking at? Obviously you mentioned Hugo South and expansion there, Lift 2... Would Heruga factor in at all this point or are you just sort of looking at different options in terms of Lift 2 and Hugo South?

Jeff Tygesen, Chief Executive Officer

Craig, thanks for that question. Looking at Lift 2 and Hugo South in priority over Heruga at this point, primarily just because of location with respect to facilities and, more importantly, the grade. So Lift 2 has the higher grade behind Lift 1, followed by Hugo South, and then will still stay in the order of Heruga that we outlined in the 2014 report. So location is one, use of combined infrastructure and grade are the reasons for going in that particular order.

Craig Hutchison, TD Securities

Okay. But Hugo South will developed before Hugo North 2, correct?

Jeff Tygesen, Chief Executive Officer

From a timing standpoint, ah, I can't start drawing from Lift 2 until Lift 1 is mostly complete, just because it sits vertically below, versus Hugo South sits of to the side. So if the scenario looks favourable for Hugo South that could come on line before Lift 2.

Craig Hutchison, TD Securities

Okay. In terms of guidance for next year, can we assume we'll get some kind of a guidance when the technical report comes out? And just in terms of the underground development spending, when can we get a sense of what those numbers and budgets will be?

Jeff Tygesen, Chief Executive Officer

So, yes, you'll see guidance on 2017 going forward for production. And the second part was guidance for capital spend, I'm guessing that's towards the underground?

Craig Hutchison, TD Securities

That's correct, yeah.

Jeff Tygesen, Chief Executive Officer

Currently the group on site is about a 1,000 people and, as I mentioned, a lot of what's going on is refresher training, because that's a key component of Oyu Tolgoi's operating philosophy. And the plan is to end the year somewhere between 2,000 to 2,500, I say end the year, also start of next year, so it's a timing of when people are actually on site, and we'll have better clarity as that progresses, but the 1,000 people on site and the work that we saw occurring now is pretty impressive from my standpoint given the real short timeframe of Notice to Proceed and activating the contracts. So we have contracts for EPCM, the decline, underground development, and the two shafts, and it is getting all those people mobilized and on site to that. And the spending kind of lags a little bit behind that, so I think in the next quarter we'll be able to have better clarity on what that profile looks like.

Steeve Thibeault, Chief Financial Officer

Craig, the team is working very hard at this moment to put these numbers together. I would have wished to give you a number today but it was not a number I was comfortable with. When we started to pull different things, I mean we want to go on a cash basis, as we do usually, because I think it's more useful for you guys, and I was not comfortable with the numbers because there were different variances. So as soon as I have something I feel more comfortable, definitely we'll share the information.

Jeff Tygesen, Chief Executive Officer

And a key point on that, Craig, to follow up on Steeve's response, if it wasn't the year end it'd be an easier number, but because some might fall a little bit in December or January that's where, as opposed to if it was earlier in the year, it'd be an easier number to hit. And also at the start of these projects the ramp up is pretty steep and picking which month they fall in is different towards the end of the year.

Craig Hutchison, TD Securities

Okay. Maybe just one last question for me, just in terms of the metallurgical recoveries in the quarter. They came down a fair bit for copper and gold. I know some of that is grade related but is there something specific about Phase 6 ore? Is it higher oxidized material that's impacting those recoveries? And do you expect them to improve towards the back end of this year?

Jeff Tygesen, Chief Executive Officer

Well, Craig, as we stated before, Phase 6 does have different metallurgical characteristics than 1 and 2. 1 and 2 are really good. So they are relatively lower Phase 3 and Phase 6 compared to 1 and 2. But I wouldn't say compared to our plan they are materially different, but they are lower. But I think the biggest contributor from a copper standpoint is just lower head grades and pretty much by definition of all the deposits I worked in, the lower the head you usually end up with slightly lower recoveries.

Craig Hutchison, TD Securities

Okay. Thanks, guys.

Jeff Tygesen, Chief Executive Officer

I should maybe, as Steeve mentioned, we're staying on target for the copper guidance and we, last quarter we updated the gold guidance, so I'm still feeling comfortable with those.

Craig Hutchison, TD Securities

Perfect. Thanks.

Operator

Thank you. There are no further questions registered for the moment. I'd like to turn the meeting back over to Mr. Jeff Tygesen. Please go ahead, sir.

Jeff Tygesen, Chief Executive Officer

Well, thanks for joining us on today's call. As I mentioned earlier, it was an exciting day at the site and going through both the current operations and seeing the underground. 80 percent of Oyu Tolgoi's value resides in our underground reserves and, as I've stated recently and throughout this year, is, in my opinion it's the best copper opportunity in development today. Thank you.
