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Q3 2018 Turquoise Hill Resources Ltd Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Turquoise Hill Resources' Third Quarter 2018 Financial Results Conference Call. (Operator Instructions) As a reminder, this conference call may be recorded.

I would now like to introduce your host for today's conference, Mr. Tony Shaffer, Director of Investor Relations. Mr. Shaffer, you may begin.

Tony Shaffer *Turquoise Hill Resources Ltd. - Head of IR & Corporate Communications*

Thank you, operator. Welcome 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, Ulf Quellmann; and our CFO, Luke Colton. Brendan Lane, our Vice President of Operations and Development, is joining us from Mongolia, and he'll be available for us with Q&A. We'll take your questions at the conclusion of our prepared remarks.

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 Ulf.

Ulf Quellmann *Turquoise Hill Resources Ltd. - CEO & Director*

Thank you, Tony, and good morning to everyone. Thank you for joining Turquoise Hill's Third Quarter Results Conference Call. We're going to do things a little bit differently this morning. Luke will assist me later on in reviewing our third quarter results. But first, I'd like to talk to you about the strength of the TRQ story. I believe the true value of our company is under appreciated that our share price reflects exactly that.

As CEO of Turquoise Hill, I'm focused on creating shareholder value, and that means, we're going to improve how we market Turquoise Hill to the financial community and to all of our stakeholders. You'll notice that this quarter, for the first time on a Turquoise Hill investor call, we're making use of a slide presentation. The presentation is available on the homepage of our website. We think that visuals will help the financial community to better understand our company and how well positioned we are. We've also recently refreshed our website to help support telling the TRQ story. Now these are just some of the initial changes we've made. Going forward, we're aiming to further enhance visibility of Turquoise Hill to our investors so that they can better appreciate the attractiveness, we're convinced, Turquoise Hill represents.

So how is our existing operation performing? Well, we have a large long-life open pit copper mine and processing facility that has sold nearly 850,000 tonnes of copper in concentrate over its almost 6 years of operation. Third quarter results from open pit operations were strong, and as a result, we announced on October 15 that we've boosted the low end of our guidance range for copper production. We now expect to produce at least 140,000 tonnes of copper in 2018, up from the bottom range of our earlier guidance of 125,000 tonnes. The high end of our guidance range remains unchanged at 155,000 tonnes.



Our guidance on gold production remains unchanged with 169,000 ounces of gold produced year-to-date. We expect strong gold production in the fourth quarter.

If we turn to the underground and how that is progressing, OT is in the midst of a transformation into a true Tier 1 asset. We have a strong and uniquely-experienced operating partner in Rio Tinto. We did announce on October 15 that Rio Tinto now projects a 9-month delay of the start of sustainable production from the underground development. The work delays are, of course, not desirable, developing the OT underground blockade is a very large undertaking, and these types of delays are certainly not atypical in the mining industry for projects of this scale and complexity. Meanwhile, we're in the midst of a review of the project progress and status, and Luke will discuss our options and the path forward in greater detail later on.

If we turn to Page 4, I'd like to highlight the compelling value proposition of Turquoise Hill. At 66%, we are the majority shareholder in one of the most compelling mining assets globally.

Oyu Tolgoi is a fantastic resource body, which not only provides significant copper and gold production at low cash costs, but the asset has the potential to be in operations for multiple generations. Now importantly, while no major project is without risks, they're well identified. We are not new to Mongolia as we began construction there almost a decade ago, having been operating our open pit mine for over 5 years and we have extensive relationships with the Government of Mongolia. Personally, I've been to Mongolia many times in the last year and the team knows the assets well, and is experienced at both developing and operating world-class assets, such as Oyu Tolgoi.

The underground development is well into construction as over 1/3 of the estimated CapEx has been deployed. The underground expansion is set to ramp up to full production at the time when copper demand is forecast to grow and few significant copper assets are being developed. Ultimately, we believe that we have very important building blocks in place that allow us to manage the risks and deliver on our objectives.

Oyu Tolgoi is an impressive world-class mineral deposit. The resource has the potential to support approximately 100 years of operations. Today, with 140,000 tonnes plus of production, Oyu Tolgoi is already a meaningful producer with a cash cost position in the third quarter of the copper cost curve according to the research consultancy Wood Mackenzie. As the underground development progresses, Oyu Tolgoi will achieve its full potential, becoming one of the largest copper mines globally with cash costs in the first quartile and at the bottom of the global cash cost curve. This puts Oyu Tolgoi alongside other established world-class operations such as Escondida, Grasberg and Collahuasi.

If you turn to Slide 6, it looks at OT relative to other large-scale copper projects that are under development or approaching the completion of permitting. Our project is underpinned by a unique series of mineral deposits in terms of both high grade and large size. When compared to other projects and using third-party data, the development of OT underground has a low relative capital intensity profile. Capital intensity is the total development CapEx divided by annual production. With our high grade and significant scale, we require less upfront investment for each additional tonne of copper production capacity we build. Importantly, the capital intensity figures shown here for OT underground does not reflect the fact that we already spent over 35% of the capital to date for the underground expansion.

Turning to the next page. To be very clear, OT is not a greenfield project. The mine is well established and has been producing since 2013. The existing open pit mine has consistently achieved, and in some cases, surpassed expectations. Since 2014, the concentrator has improved operating practices and gained experience, which has helped achieve a consistent throughput of over 105,000 tonnes per day. For the past 3 years, Turquoise Hill has consistently met its production guidance. For this year, we've tightened the bottom end of the range for copper guidance just a few weeks ago, indicating our increased confidence in meeting the target production guidance for 2018, and of course, we remain committed to cost control. Our C1 cash costs have improved throughout 2018. This has been, of course, assisted by our increased gold production, but this is just one of the data points that helps demonstrate our track record in operational delivery.

Now the track record of delivery is not limited to the open pit operations. Equally, there's been significant progress with the underground



project too. Construction of Shaft 5, which is critical for ventilation was completed in Q1 this year and commissioning was completed in Q2. Shaft 2 sinking has also been completed in Q1 of this year. The underground lateral development progressed by 3 equivalent kilometers in the third quarter for a cumulative total of 15.7 equivalent kilometers since project restart. Finally, pre-sinking activity for Shafts 3 and 4 progressed during third quarter of this year as well, including a box cut, and sinking both shafts is expected to commence mid next year.

Let me review the third quarter. Luke will discuss the recent schedule in more detail. However, we felt it was important, also helpful, to illustrate pictorially how much progress has been made on the ground. Ultimately, a picture is worth a thousand words. Both management and the board were at site only a few weeks ago, and for those of you on the call who haven't been to site in a while, it is truly impressive to see the level of activity and the rate of progress that's being achieved. So for that purpose, Page 8 just illustrates some of the recent milestones achieved to date for you to see that the OT underground expansion is well on its way to production.

Turning to Page 9. Page 9 highlights the locations globally of important copper development projects. Increasingly, but certainly not surprisingly, few high-quality copper deposits are located in OECD countries. With the possible exception of Chile, the majority of copper deposits tends to be located in either South or Latin America, Africa or other parts of Asia. And Mongolia is certainly one of the countries that is endowed with an abundance of natural resources including, but not limited to copper, of course.

Let me just make a few comments about Mongolia. It tends to be a country with -- which many investors may not be particularly familiar. Mongolia is a peaceful democracy. The country has held 8 elections with 5 transfers of power since peacefully becoming a parliamentary democracy in 1990. The country continues to undergo rapid transformation with GDP growth of over 10% per annum over the last decade. And of course, just like in many other countries, the transition to a market economy, to a parliamentary democracy, it has had its challenges along the way. But if we want to develop first-class ore bodies, we need to be in a position where we can work with our Mongolian partners to achieve a mutually beneficial partnership so that we can operate successfully for decades to come.

If we turn to Page 10, we'll show how Oyu Tolgoi and, by extension, Turquoise Hill, has been a key engine and contributor behind the transformation of the Mongolian economy. Oyu Tolgoi provides employment directly and indirectly to its substantial workforce. And combined with contractors, the workforce includes more than 17,000 people at this stage. That would include jobs that have been created indirectly in the broader supply community. If one adds in the over 1,200 Mongolian companies that work with OT, the broader secondary and tertiary workforces would encompass over 45,000 people. As such, OT has been instrumental in supporting the local economy and supplier base, like procuring a substantial portion of goods and services from within Mongolia. We have spent more than \$2.6 billion on Mongolian procurement to date. We're, of course, a significant taxpayer, and we are committed to supporting the local community. In essence, we have a symbiotic relationship with our partner and stakeholders in Mongolia. We need to work well together for the good and the success of OT and TRQ, as well as for the people of Mongolia.

Turning to Page 11. Page 11 summarizes the risks associated with the development of Oyu Tolgoi, and I believe, it demonstrates the understanding and the well-developed strategies that we have in place to address these risks in a prudent manner. We've resolved our copper export challenges seen last year and have been able to export nearly 850,000 tonnes of copper in concentrate in our nearly 6 years of operations. Our financing plan is robust. We have \$3.8 billion of liquidity available, over 1/3 of the estimated underground development capital has already been deployed, and OT has the capacity to raise an additional \$1.7 billion in debt, which we call supplemental debt under the existing financing agreements.

The Government of Mongolia has been our partner for over a decade, and we are well advanced in developing a domestic source for power in Mongolia. We, in conjunction with Oyu Tolgoi and Rio Tinto, have been actively engaging with the government on a range of topics, including tax, power as well as the government's request to lower the interest rates, both on the shareholder loan and the equity carry loan. There's a genuine interest by all parties to reach a resolution, and when that is achieved, we'll of course notify the market in due course.

Resolving power is probably one of the more pressing issues that needs to be resolved within the four-year time line of the investment agreement. The decision in terms of location needs to be made soon in order for OT to be able to place orders for long lead time items as well as allow sufficient construction time to meet the current February 2022 investment agreement deadline. Following discussions with

the government, building a power station near the Tavan Tolgoi coal mine remains an important alternative option. Further discussions are underway, and we would need to reach an agreement with the government if that is the path we ultimately choose to take.

Turning to the next page, Page 12. It provides an outlook on the copper market. On the demand side, the outlook remains strong as copper is a commodity that's fundamental for economic growth in both developing as well as mature economies. Significant growth in both electric vehicles and renewable power are forecast and copper is a commodity used in both. Copper supply from existing mines is forecast to decline substantially over the next decade according to Wood Mackenzie data. And as copper grades decline, costs rise, copper prices are expected to rise in response. With the expected start of the supply gap in the early 2020s, Oyu Tolgoi looks well positioned to benefit from this dynamic as that will correspond with the anticipated start of sustainable production.

If we turn to Page 13. Page 13 shows the price to NAV, net asset value, multiples across the copper landscape relative to our own multiple. Despite the strength of our story that we've just covered, we trade on a substantial discount. And as I mentioned earlier, one of my priorities will be to communicate with investors frequently and with clarity. The TRQ story is compelling, but we clearly need to communicate, explain, demonstrate, and ultimately, deliver on the attractiveness of the business to our investors.

Now where are we taking TRQ? I'm certainly not planning to review my bio on this call in any great detail, but I want to highlight two critical points about the future of TRQ on Page 14. First, management is absolutely committed to delivering value for all of our shareholders. I believe, my incentives are fully aligned with TRQ shareholders. Second, Rio Tinto continues to be a critical component of our overall success story. I've got extensive relationships with Rio and understand their approach to projects and operations. We will continue to work closely with them and we'll be closely involved with key decisions and project reviews. Rio Tinto does have unique expertise in delivering large-scale block cave operations, with a strong balance sheet, and is committed to the highest level of safety and corporate social responsibility as the operator of Oyu Tolgoi.

Let me turn to Page 16 on safety. Page 16 demonstrates our excellent safety record. Safety is, as all of you know, a top priority for Turquoise Hill, for Oyu Tolgoi and for Rio Tinto as the manager of Oyu Tolgoi. We have consistently demonstrated excellent safety performance, and as a result, have one of the lowest injury rates compared to our peers. The All Injury Frequency Rate, or AIFR, is an indicator of workplace health and safety and provides insight into an organization's efforts to protect its workforce from work-related hazards. Beyond the obvious benefit to employees, this metric indicates a well-managed operation. We'd like to draw your attention to our AIFR of just 0.19 for the first 9 months of 2018, another improvement and down 24% from 0.25 the year earlier.

And with that, let me now pass the call over to Luke to discuss third quarter results.

Luke Colton Turquoise Hill Resources Ltd. - CFO

Thanks, Ulf. Page 17 provides a summary update on recent operations and operations guidance. Let me draw your attention to the 111% increase in gold production in the first 9 months of 2018 versus 2017.

On guidance, let me draw your attention to a 12% increase in the lower end of our 2018 copper production range. As Ulf mentioned, we now expect to produce at least 140,000 tonnes of copper this year, that's up from 125,000 tonnes.

Operating costs were \$196 million in Q3 '18 compared to \$162 million in Q3 '17, which is mainly due to higher maintenance costs arising from a planned concentrator shutdown in Q3 '18 with the comparable happening in the second quarter of 2017. Also, we saw lower capitalization of production phase stripping costs due to prioritizing movement of ore over waste.

Also, open pit and concentrator costs were impacted by higher input costs, such as fuel and tires. As a result, we have increased our cash cost guidance to \$800 million for the year. Nevertheless, our operating cash costs are down a bit in Q3 compared to Q2 2018, and our C1 costs are declining as we continue increasing gold production. C1 costs in the quarter were \$1.65 per pound of copper produced, which is a decrease from \$1.83 per pound of copper produced in Q3 2017, mainly because of the higher gold sales.

Please turn to Page 18 for a summary of our Q3 financial performance. Revenue for Q3 '18 was \$247 million, consistent with Q3 '17 as higher gold sales volumes were offset by lower copper and gold prices. Q3 '18 copper prices averaged \$2.77 per pound, which is a

decrease of 4% versus Q3 '17. Average gold prices decreased 6%.

Income attributable to TRQ shareholders in Q3 '18 was \$53 million versus \$65 million in Q3 '17. This is due to differences in the amount of deferred tax assets recognized in the two periods. Income attributable to TRQ shareholders adjusted for the impact of the DTA in these quarters was \$55 million and \$7 million, respectively.

Cash generated from operating activities in the quarter was \$76 million versus \$109 million in Q3 2017. The decrease was primarily due to the impact of higher vendor payments in Q3 '18 compared to Q3 '17. This is due to higher operating cash costs in Q2 '18 versus Q2 '17. The higher operating cash costs in Q2 '18 are mainly due to higher selling-related costs from higher copper prices, and also an increase in sales volumes benefiting from improved border logistics, which enabled accumulated inventory built up during the Q1 2018 force majeure to be sold during Q2 2018. In addition, operating cash costs and net cash from operating activities in 2018 have been adversely impacted by a reduction in the amount of costs capitalized as deferred stripping, resulting from a decision taken to prioritize movement of ore over waste.

On a year-to-date basis, the impact of timing of vendor payments is less pronounced and there is a resulting \$7 million increase in net cash from operating activities in 2018 versus 2017. The increase in revenue, driven principally by higher copper prices in 2018, has been offset by higher operating cash costs, which are mainly due to higher selling-related costs and higher deferred stripping expenses.

CapEx was \$329 million in Q3 2018 versus \$234 million in Q3 2017. This includes \$305 million in underground development CapEx. Since the 1st of January 2016, the total amount spent on the underground is approximately \$1.9 billion. In addition, OT had further capital commitments of \$1.2 billion at the 30th of September 2018.

Page 19 summarizes our underground development and related guidance. The underground CapEx range for 2018 remains unchanged as does our total underground CapEx estimate of \$5.3 billion. In terms of timing, the first draw bell remains on track for mid-2020 as well as construction completion for 2022. As you know, on October 15, 2018, we announced that Rio Tinto has informed us of the delay of up to 9 months in achieving sustainable underground production from around the start of Q1 2021 until the end of Q3 2021. This will delay revenue from the underground, and we are evaluating the impact of this on our funding requirements. We may have flexibility elsewhere to mitigate the impact of delaying revenue and minimize the need to source additional funding. The number of options and scenarios are being studied over the course of the next few months, and these will help us to more fully understand how best to mitigate the impact of the delay. For example, we might be able to accelerate production from the open pit or possibly defer spending on noncritical capital expenditure. The impact of these and other options could have a positive impact and may help to mitigate the negative impact of the delay. We are pushing ahead with the requisite urgency; however, these are complex matters that require proper analysis. We are still refining the exact date when the study will be concluded, but we think it could be near the end of Q1 2019. Whatever the timing, we don't want to comment prematurely before we have the benefit of fulsome study.

Ulf, that completes my comments. I'll turn it back over to you.

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

Thanks very much, Luke. So let me just summarize by reiterating that Oyu Tolgoi is a very strong asset and very strong project with a potential lifespan of approximately 100 years. We are in the midst of transforming Oyu Tolgoi into a true Tier 1 asset, and Oyu Tolgoi is one of the most compelling mining projects globally. This is a major growth story and I'm personally looking forward to every step of the journey.

So that concludes our prepared remarks. Operator, with that, we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

Our first question comes from Ralph Profit from Eight Capital.

Ralph M. Profiti *Eight Capital, Research Division - Research Analyst*

I want to come back to the 9-month delay in the context of the \$5.3 billion budget. Conceivably, we're probably looking at standby costs, increased contractor costs and a longer time to keep an elevated workforce. So is accrual to contingency the reason why we're not seeing more CapEx or is it largely because these sums are largely immaterial in your view?

Ulf Quellmann *Turquoise Hill Resources Ltd. - CEO & Director*

Thanks, Ralph, thanks for the question. Maybe the way to best answer your question, Ralph, is just to remind everyone, when we provided the update on the underground, and it's in the chart that Luke just went through, you'll see that a lot of the key data points that would've formed part of the re-forecast and the preliminary conclusions actually confirmed the existing assumptions. So costs, as you just referred to, stay the same. We're referring to the final completion date as well as the first draw bell. It's really the first sustainable production which has been pushed out. The work that we're doing at the moment to evaluate really looks at understanding exactly some of the drivers behind that because some of the delays that are incorporated are ones that already happened, in particular, in relation to Shaft 2, others are in the forecast period. And in that forecast period, so they haven't already happened, they're assumed to happen. And in that forecast period, it's a degree of contingency contained as well and that's probably the component where we need to focus in the review in particular as we look into mitigation options, as we look into where we find exactly what the extent of the delay is. So now where we're with the information that we've provided, we confirm the \$5.3 billion total budget, and it really requires us to complete the review before we're in a position to provide a specific revision to that number if you like -- if that is the case. And Luke was referring to the piece of work that's going on at the moment and will be completed early next year.

Ralph M. Profiti *Eight Capital, Research Division - Research Analyst*

Okay. As a follow-up, you talked about TRQ's independent review, and it implies that it's really to do with the underground only. But I want to maybe focus on the open pit, where we've seen some very positive reconciliation on unit operating costs versus the technical report but, of course, this quarter, you're citing things like fuel, tires, freight. I'm just wondering, in what study will the open pit unit operating costs be addressed, if any?

Ulf Quellmann *Turquoise Hill Resources Ltd. - CEO & Director*

Yes. Thanks for the follow-up question. I would say, the way -- if you look at the way we manage, how we operate and how we govern and oversee Oyu Tolgoi from a TRQ perspective, there's obviously a number of mechanisms, bodies in place that allow TRQ, just from a management perspective, to review performance, improve budgets, and that'll be done at the board level, at the committee level and that's regularly the ordinary course of operating. When you refer to independent studies, what tends to happen is in relation to the underground costs and shape of the re-forecast we just talked about, of course, we, as the TRQ management team, review the work and are working with OT and Rio to do that together, and then we avail ourselves at the same time of help and support by third parties. And that's what's going on at the moment and that's what allows us to have the incremental rigor for the underground review. I would say, when it comes to the open pit performance, I would characterize that much more as ordinary course business, which, we, as TRQ management, would review in the normal course of things. And we can decide if we want to call in third-party help, but that's not necessarily always the case, that's really our job to do.

Operator

Our next question comes from Orest Wowkodaw.

Orest Wowkodaw *Scotiabank Global Banking and Markets, Research Division - Senior Equity Research Analyst of Base Metals*

I was hoping, could you please give us some more color and context of exactly what caused the delay in terms of the underground ramp-up? And then also, what we could assume from a production ramp-up perspective versus the tech report in, say, 2022, 2023? And whether you think of this like a 9-month knock-on delay on the whole plan or is this something that you can recover relatively quickly back to the technical report ramp-up, say, starting in '22 or '23?

Ulf Quellmann *Turquoise Hill Resources Ltd. - CEO & Director*

Yes, thanks, Orest, and thanks these are good questions. In some respect, the second part of the question you're asking, Orest, whether or not this is a permanent delay, whether we can recover is kind of what Luke, in his answer, already referred to when he said, we're doing the work to understand the key drivers of the delay that already have happened, but as importantly, probably more



importantly, of what's the future knock-on effects, and therefore, they are in the forecast period, and therefore, still can be affected. And as a result of that, if you just take the impact of a straight 9-month delay, everything else being equal for sustainable production, of course, you have a negative impact. But as Luke was saying, this is something that we're looking at, and he gave you two examples, I think, for how much more of the ore from the open pit can be used to compensate for that. And that's a fairly straightforward answer, but we need to rerun the mine plan to optimize that obviously. And then we'll need to look at things like the CapEx spend profile to recognize that some items that previously may have been on the critical path are not necessarily anymore on the critical path, but that would just take a little bit of time. And that's why we are doing the work, that's why Brendan is in Mongolia at the moment and not with us on the call here to do exactly that work. And as much as we would like to tell you on this call now what the impact is, we're not really in a position to do that other than highlight some of these examples that we just pointed to. But ultimately, to be really in the position to quantify that, we do need to complete the work and finish that and come back to you. At this stage, the data we are looking at, I think, we have labeled it as such with a re-forecast and some preliminary findings. But because we felt it's potentially important and material, we obviously communicated to the market to meet our disclosure obligations, but the impact, and more importantly, the mitigation impacts, that's the work that's going on at the moment.

Orest Wowkodaw Scotiabank Global Banking and Markets, Research Division - Senior Equity Research Analyst of Base Metals

Okay. And just wanted to clear, do you have a seat at the table with respect to this -- the new study and the review? Or is this something Rio is doing?

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

Well, so Rio is the manager of the project, but TRQ certainly has a seat at the table. First of all, we have a seat at the table, we're on the OT LLC Board. So that's really where the first round of work really happens and takes place because the OT LLC Board of Directors obviously have to sign off on regular budgets, and certainly, that includes the underground. And then there are a number of other committees and you may be familiar, Orest, with some of the contractual arrangements that we have with the operating committee or the technical committee. So those are bodies and mechanisms that we have to obtain information. So those are the formal arrangements that are there, that we avail ourselves of. And then in addition, I would say, we think that we have a very good and a very productive working relationship both with the project team at OT itself as well as the Rio team that's going to start the project work. And as I said before, that's why Brendan is in Mongolia at the moment to go through the data, together with the external consultant to do that. So we're well positioned, Orest, to, as you said, have a seat at the table and to understand, review and provide input, and ultimately, sign off on the underground expansion.

Orest Wowkodaw Scotiabank Global Banking and Markets, Research Division - Senior Equity Research Analyst of Base Metals

Okay. And just as a final follow-up, when do you -- when does OT have to make a decision on the power plant in order to meet the, I guess, the start-up of the underground?

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

Yes. It's a good question, Orest. So if you recall, effectively, the time line that we have to meet is February 2022. That's a simple straight line 4 years from the termination of the power sector cooperation agreement earlier this year. So as we said on the previous call, the work is going on, has continued to go on to build the power plant at the OT site, and we talked about some of the processes to that effect earlier. We're certainly getting to the stage closer now, year-end, early next year, where we have to select an EPC contractor, we have to start to commit funds, and we would want to make sure that we only do so once we have good visibility as to where the power plant is going to be built, what the technical configuration is going to be. So there's no magic deadline as such, Orest, because things are -- you can manage these things, but we're certainly getting to the stage later this year, early next year where we would like to be in a position to finalize the location with the government where it's going to be so that we can optimize the capital expenditure that we have.

Operator

Our next question comes from Craig Hutchison from TD Securities.

Craig Hutchison TD Securities Equity Research - Research Analyst

I noticed that the bids are due from -- for the EPC contracts for power in Q4. How long are those bids good for?

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

We -- thanks for the question, Craig. So the bids have been received and they are currently being reviewed as we speak. That takes a little bit of time, but they've only come in, I believe, last week, Craig, and the review team is looking at them at the moment.

Craig Hutchison TD Securities Equity Research - Research Analyst

But I guess, how long those prices are affirmed for? How long will they hold those bids?

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

I couldn't tell you the exact date, Craig. This is something maybe we have to check and give you specific dates about.

Craig Hutchison TD Securities Equity Research - Research Analyst

So who ultimately makes the decision on power, is this a parliamentary decision?

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

Are you referring to...

Craig Hutchison TD Securities Equity Research - Research Analyst

In terms of the location?

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

Location? So it might be worth reminding ourselves. So the obligation to source power domestically is an obligation that OT has and the obligation really is to source power domestically. It doesn't prescribe where in Mongolia it needs to be. It also doesn't provide any rights to third parties to determine where that needs to be. So it really is up to OT to decide how it can make sure that it has access to long-term power at attractive prices. And if that turns out to be OT at the OT location, then it's certainly within the wherewithal of the OT Board to decide that. Having said that, as you can appreciate, we are a -- in a partnership with the Mongolian government. It has its equity stake in OT as well, and we would like to find a solution that is in the best interest of all stakeholders, particularly, if there was a location, say, at TT and it was beneficial to OT, right. A power station at the OT site clearly has its advantages in terms of security of supply being dedicated to OT and being ring-fenced, if you like. But it's certainly feasible to envision a scenario where a power plant at a different location, say, TT could also be very attractive to OT. And those are discussions that are going on at the moment. Lots of constructive dialogue. And we would very much hope that we'll get to a -- an outcome soon so that we can -- we will meet the deadline as per our IA agreement and we can commit to long lead time items. So that's the overall process and the mechanism of how that works. Does that answer your question?

Craig Hutchison TD Securities Equity Research - Research Analyst

Would you guys have the actual permit to build it at OT now if you got approval to go ahead and have the bids in, could you construct it based on your existing permits?

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

That's sort of part of the deliverable by the authorities. But it is something that is absolutely part of the overall development plan, but it does require us to decide where we want to build this, Craig. But...

Craig Hutchison TD Securities Equity Research - Research Analyst

Who signs off on it -- sorry, who signs off on that final permit?

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

Well, so, ultimately, OT needs to determine where it wants to build the power plant, and we are working hard in the discussions with the government to make sure that we get to a place where everybody is supportive of that decision and it's a right outcome. And assuming that, that's the case, and as I said, the discussions are very intense and constructive. Then things like the permitting should not end up being a gating item, if you like. I think that's what your question is targeted at.

Craig Hutchison TD Securities Equity Research - Research Analyst

Yes, okay. And then maybe just one last question, just on the financing, you guys added a note to your MD&A about the ability to kind of upsize your \$6 billion debt limit with an expansion facility to fund the power plant. And there's -- subject to certain -- fulfillment of certain conditions, are there any big kind of showstopper conditions or any environmental issues? Is there a size restriction on that power plant that can kind of like prevent the additional debt capacity being achieved for the project?

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

Yes. It's a good question, Craig. I think you identified one of the important aspects. So you're right. So we have a project finance agreement for \$6 billion. We've drawn down \$4.3 billion. So there's another \$1.7 billion we can raise without requiring lender consent. The expansion facility that you referred to, as you rightly point out, has been put in place to recognize that if OT builds a power plant rather than buying power, it needs to be able to fund it and that requires more CapEx, and therefore, should increase the debt ceiling. That's why that expansion facility is there. The key -- I'd say, the key requirements, Craig, that need to be met are in relation to Environmental Social Impact Assessment plan. That work is very well advanced with the lenders because that would be a key gating item from the timetable. So the study has already been well-advanced. The drafts have been provided to the lenders for review and sign off. And so that is already happening as we speak, well advanced. Because as you rightly say, that's probably one of the more important items to clarify. That is well in hand, well controlled, and we wouldn't expect there to be any hiccups in terms of lender approvals that we aren't able to get.

Craig Hutchison TD Securities Equity Research - Research Analyst

So you said the study is already with the lenders, it's completed.

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

Correct.

Operator

Our next question comes from Daniel McConvey from Rossport Investments.

Daniel McConvey

We've been watching the story for a long time, and so it's nice -- it's good to hear your perspective. The delay, I know it's being flogged a little bit, but it's -- the reason why it's a bit concerning is because there was a lot of effort put into the study, a lot of effort put in the work. The word estimate is not in the Mongolian language. So when that initial plan was put in place, there's probably a lot of conservatism that was put into it. And so having the delay a little bit is, it has to be concerning for shareholders and also for the government, for everyone. But I guess, the question is, we're still at 3 years to go, how concerned are you? I know there's a contingency in that 9 months, but how concerned should we be that this doesn't become something bigger and longer-lasting, turns into a power, border situation, where they were delayed a long period of time. My guess is, there's a lot of good people, lot of good work done, but -- and that's not going to happen. But just maybe help us get comfortable that this doesn't turn into something longer?

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

Yes. Thanks for the question. I mean, I think, in some respects, we may have covered some of the aspects that you are highlighting in the presentation. So -- but let me readdress them. We believe that we've got one of the best operators in the industry with Rio Tinto as the project manager of the open pit as well as constructing the underground mine. They've got a very strong track record, good experience, dedicating a lot of very, very strong people. And we think we've got one of the best world-class operators to be able to do this for us. We also think that the governance mechanisms are robust. Notwithstanding that, nobody likes to see delays. We don't like to see delays, you don't like to see delays. That is why the work that we referred to earlier, the review work is going on, not just to understand the reasons but also to come up with mitigation options so that we can minimize any potential delay from a timing perspective, from a cash flow perspective, and that work is going on. It's been taken very seriously. And rest assured, there is a high degree of urgency to complete the work and then report back to the market as soon as we can. In the big scheme of things, we think that the controls that are in place are strong. Given the size, the complexity of these projects, these things have happened in other projects and that's maybe why you're asking the question and that's why we're putting these safeguards in place to make sure that the concern that you have is absolutely minimized and doesn't happen. So at this stage, I think we explained what we're doing and it's incumbent



upon us, I think, to report back to you with rigor and with urgency to provide you and the broader market with the comfort that things are managed well.

Daniel McConvey

Okay. I mean, maybe when you come back with that review, it just would be comforting to say -- the word ground conditions is a very loose term. So kind of where the ground condition issues that were unexpected so far, was that weakness in one area that had to be reinforced and now its done? Or is it something that could be specifically identified to kind of to give us comfort that it's not going to be more of a chronic issue. I hear you, but just if -- is there any, from the government standpoint, I know the review is going on, that's my next question, but is there -- how much concern or how -- I'm sure there are people on the -- there's people in the committee, et cetera, from the government, but are they -- how alarmed are they at the delay?

Ulf Quellmann Turquoise Hill Resources Ltd. - CEO & Director

Yes. Look, I personally have not had any feedback or comment from the team in Mongolia that would suggest undo reasons for concern, if you like. The natural body I was referring to earlier for this to be reviewed and discussed specifically at the OT LLC Board, where obviously the government has a team of its representatives as directors. But I think, like all stakeholders, like all shareholders, we as TRQ, right, we very much view ourselves as the custodians, the stewards of your capital that you've invested. And therefore, we are highly motivated and determined to make sure we're looking after it well and the same will be true for the government representatives, right. So I think, ultimately, everyone is equally and highly motivated to make sure that this is managed well and that we are able to deliver this world-class project in a timely fashion and on budget. I wonder if Brendan, if you're there, is there anything that you maybe can add, just in terms of extra color of the ground condition question. Anything you can provide at this stage, I know it's early days where we are, but just to provide a bit of comfort around the nature of them and the extent of them?

Brendan Lane Turquoise Hill Resources Ltd. - VP of Operations & Development

Yes, Ulf. In the last quarter, there's been some mass excavation around Bin 11 that is part of the Shaft 2 infrastructure. And so that's -- that has caused that Bin 11 component to hold the client on schedule, but that's now in the past. So that's been -- that part of the ground conditions has been absorbed.

Daniel McConvey

Brendan, sorry, can you just repeat that, please? What was it?

Brendan Lane Turquoise Hill Resources Ltd. - VP of Operations & Development

In part -- in Bin 11, which is part of Shaft 2. But that's -- I guess, what I'm trying to say is some of these ground condition problems have happened in the past and some of that is behind us. Some of them are recognized. And some of the mass excavation is in the chamber and so that's being dealt with now for the PC 1 chamber. And then there is some small amounts in certain areas elsewhere, but it's -- from what we're seeing so far, and this is part of the review that will go on, is we will look at everything that's been done so far and take our own view on the extent of them, but it doesn't -- it's mainly in the footprint of mass excavation where some of the mechanical equipment is going to be installed.

Daniel McConvey

Is there any adjustments that are being made in the -- in development prospectively as a result of this, like more -- I don't know, more ground support or anything?

Brendan Lane Turquoise Hill Resources Ltd. - VP of Operations & Development

Sure. In some areas, like I said in the chamber, they are changing the ground support to encourage the ground support. But that's part of the review that we'll be doing going forward, looking at that. And so that's already been taken into account in terms of the delay that Rio Tinto noted, but we'll be reviewing that as part of the review.

Daniel McConvey

Great. Ulf, last question, just the parliamentary committee, are you expecting them to report before Christmas or?

Ulf Quellmann *Turquoise Hill Resources Ltd. - CEO & Director*

It's a good question. We believe so. Initially, the expectation was for it to be provided, I think, prior to the summer break. That obviously hasn't happened. The best indications we have today that it's in the autumn session. We're now into early November already. So I think the best expectations at this stage is that it'll be certainly by Christmas.

Operator

Our next question comes from Nick Linnane from Sefton Life.

Nick Linnane

I had a few. The first one, can you say how much contingency is still left in the \$5.3 billion CapEx estimate versus the amount of contingency initially provided for? The second one, which is maybe for Brendan, is could you give an update in general on how Shaft 2 fit out is going? And in particular, if you could sort of say kind of how many months behind schedule you are at this point in the fit out process? And if you can comment on when expected completion of Shaft 2 fit out is and what the key risks around that are and whether that relates to ground conditions or something else? And lastly, on the power plant, can you confirm if there is an -- a real issue that -- it's not just the location of the power plant at OT or TT, but it's more the issue that the government wants you to build a power plant that is big enough to supply Tavan Tolgoi as well as OT, and then wants you to pay in full for that or guarantee it? Those are my questions.

Ulf Quellmann *Turquoise Hill Resources Ltd. - CEO & Director*

Thanks. Brendan, maybe I'll start off with the last one first on power and -- if you don't mind. And maybe when it comes to questions 1 and 2 on the Shaft 2, we can come back to you, even though I think we're relatively limited to what we can say at this stage. But -- so on power, you're absolutely right, it's not just the location that is the question. Other things are tied up in that. And as you rightly say, clearly, there is an interest on the part of the government to have a broader power story, if you like, at TT that then is connected also to the Mongolian group. I would say, from a -- I touched a little bit on that earlier. From an OT perspective, if you look at what does OT really want? What does it need? And what is it obliged to do under the investment agreement? OT wants security in power supply and an attractive cost. And it needs to and is clearly willing to meet its obligation under the IA to have that in place by the beginning of 2022. The discussions around having a power plant built at a different location has obviously various pluses and minuses and will go beyond the scope of this call to really go into a lot of detail. And I'm very happy to have a separate conversation about that, but it does involve the question of, is it an islanded facility? Is it connected to the grid? And you can imagine everything else being equal, there's some attraction being connected to the grid because it would require to have less surface capacity. On the other hand, the security or supply may be less certain. So that's sort of a trade-off that will have to be made. Then there's a question of transportation, obviously. If it's at OT, one has to supply the coal, but there's no extra transmission line. If it's at TT, extra transmission lines are required, but the coal transportation would not be required. So there's a number of things, it's quite complex, and those are really the subject of the discussions that are going on to ultimately help come to a landing on what is the best outcome for OT given all of these considerations. Brendan, if I could ask you, please, maybe just to comment on questions 1 and 2 to the extent that you can. Are you okay to do that?

Brendan Lane *Turquoise Hill Resources Ltd. - VP of Operations & Development*

So I'm not sure about 1 and 2, but the question I got was about Shaft 2. And Shaft 2, our expectation was that the fit out would be done over 2018. So now the forecast, which is still under review from us is indicating that's going to move into Q1 of next year.

Nick Linnane

Brendan, can you comment on Shaft 2, there was a delay in getting to the bottom of the shaft. And I guess, that delay we can understand. Are there further delays in the fit out itself. Is it taking longer than expected? Or is it just -- there was a delay to sinking the shaft and that just carries over?

Brendan Lane *Turquoise Hill Resources Ltd. - VP of Operations & Development*

No, there's -- we've been experiencing some delays in the last quarter with the fit out, not just the sinking.

Nick Linnane

Okay. And can you give some sense of the magnitude of that, is that stuff that was meant to take a month, taking 6 weeks? Or it's meant to take a month and it's taking 3 months? And what...

Brendan Lane *Turquoise Hill Resources Ltd. - VP of Operations & Development*

Probably, I wouldn't be able to comment on that at this stage. That'll be part of the review, but we're talking -- supposed to -- the fit out was supposed to be complete at the end of -- everything combined, by the end of the year, now it's moved into quarter 1 as per the progress, but again, we're reviewing that from outside.

Ulf Quellmann *Turquoise Hill Resources Ltd. - CEO & Director*

I think it -- that's probably the level of detail we can give at the moment, right. I think, to me, the key takeaway of the delay that we talked about, and remember, this is before we've actually undertaken some of these mitigations, obviously, that we talked about earlier. Brendan covered Shaft 2, which is really what already happened. So that's the first component of the 9-month delay. Then there's a second component, which refers to the forecast period, so that's still to come, that's a little ahead of us. And that's the work that's going on at the moment and that's not something that we're in a position to really to provide you at this stage with detail as to what the components are. And your question of contingency, again, it's in there, but it's really up to us to look and review whether it's aggressive, whether it's conservative or whether it's appropriate. And until we've done that work, it wouldn't be prudent for us to give you a number now, only then for us to retract that later on. But those are the two main building blocks in terms of what really happened and what's expected to happen in the forecast period.

Operator

I would now like to turn the call back over to CEO, Ulf Quellmann, for any further remarks.

Ulf Quellmann *Turquoise Hill Resources Ltd. - CEO & Director*

Thank you very much, operator. I'll keep it brief because we've run a little bit overtime, but I take that as a good sign in terms of interest in the project. Thank you very much for joining the call, and we'll close the call with that. Thank you very much, and bye for now.

Operator

Thank you, ladies and gentlemen. Thank you for participating in today's conference. This does conclude today's program, and you may all disconnect. Everyone, have a wonderful day.

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