Investor call: Sierra Rutile Acquisition

Start of Transcript

Operator: Ladies and gentlemen, welcome to the Iluka Resources teleconference on the completion of the merger with Sierra Rutile Limited. I must advise that this conference today is being recorded. There will be a presentation followed by a question and answer session. I will now hand you over to your speaker today, Iluka's Managing Director, Mr Tom O'Leary. Please go ahead.

Tom O'Leary: Welcome to the call. I'm Tom O'Leary and I'm very pleased to be talking with you today, mainly about the acquisition by way of merger of Sierra Rutile. At the end I'll also make some general comments about my broader priorities for the business.

Before I begin though I'll introduce my colleagues with me here in Perth. I have Doug Warden, Chief Financial Officer and Head of Strategy and Planning, Robert Porter, General Manager Investor Relations, and joining by phone from Sierra Leone we have Steve Wickham, the Chief Operating Officer of Iluka, and Rob Hattingh, who is now Chief Executive Officer Sierra Rutile.

Because there's some question marks over the quality of the connection from site, we also have Dan McGrath, General Manager Eastern Operations on the line. Dan was heavily involved in the due diligence and was on site through October. Doug, Dan and I will talk to the slides, but all of my colleagues will be available for questions.

Slide 3 has an important notice which I'll take as read and move on. On 1 August the transaction was announced following detailed due diligence. Sierra Rutile shareholders subsequently agreed to resolutions for the merger with one condition to be met, and that was German anti-trust clearance.

On 5 September advice was received that the German authorities had decided to enter a phase two review. Then, on 23 November, German anti-truck clearance was received. In the interim, and following discussions with Sierra Rutile and the Sierra Leone Government, capital gains tax arrangements for the transaction were concluded as being a matter for Sierra Rutile shareholders.

You'll be aware that on 29 November Iluka called a material adverse change of consequence of concern we had around dam stability. As set on in Wednesday's release, and repeated in yesterday's, since that time we satisfied ourselves, having gone on both internal and external expertise, that the issues were not an impediment to proceeding with the transaction. I'll come back to that in a few moments.

Moving to slide 5, the financial parameters are set out. This was an all-cash transaction for a total final consideration of £215 million, or AUD375 million, which together with the assumption of debt and transaction costs comes to an all-in transaction value of AUD473 million. Doug will, in a few moments, take you through the debt, transaction costs as well as pro forma gearing as a merged group at 30 June '16 of 32%. We managed to effect the close of the transaction and take control on Wednesday afternoon Sierra Leone time. That has gone very smoothly.

On slide 6 I think you'll be familiar with these points from the 1 August announcement. This slide refers to much of what was said back then. I'll spend a few minutes on a couple of them though. First, the resource. The transaction addresses an issue that Iluka has had for a long time, and that is resource and reserve longevity. While the deposits Iluka's had access to have been very high assemblage, they've been relatively short lived. As you'll be aware, this has meant regular capital commitment to effectively sustain production.

Sierra Rutile, on the other hand, is a long life scalable deposit. We modelled the cash flows on a 20 year basis with resource still remaining so it may well be longer. In terms of longevity, this deposit transforms Iluka's portfolio. It provides the Company with a long life high quality deposit of rutile, and our expectation is that rutile will be increasingly challenging to find and replace.

Second, flexibility. The acquisition brings with it some flexibility in terms of the timing for the commitment to Balranald, in itself a rutile rich deposit. I plan to say more about the development pathway for Balranald, as well as the capital profile for the business more generally, at the full year results in February.

Finally, I especially want to talk about our forecast IRRs and returns generally. In this respect I'll be following the lead of my predecessor, in that I won't be providing any further colour on that score.

Moving to slide 7, this map is just to put the mine site in a bit of context within Sierra Leone. Sierra Rutile is important in a Sierra Leone context. It's a significant employer with 1600 people employed directly and more than 700 contractors. It's a significant part of GDP. We estimate around 2.4%. In the context of international investment in Sierra Leone, Sierra Rutile is significant, and Government continues to seek to attract international investment.

It's close to the coast and has its own port, which is key for product and heavier logistics because it's pretty remote. While that remoteness presents its challenges, it stood the operation in good stead during the Ebola outbreak in 2014. Country risk analysis was part of the extensive due diligence process. Since the end of the civil war in 2002 the country's had a democratic system with what have been observed as fair elections. Governments have been pro investments and the Sierra Rutile operation itself is recognised for its importance in terms of direct and indirect employment, as well as its wider economic benefits.

As with many African countries, issues of bribery and corruption are often raised. As you'd expect, Iluka has zero tolerance approach to these so, quite obviously, Iluka undertook a lot of research on these topics and engaged external advisors with capability in these areas. I visited Sierra Leone three times. The first time in the weeks leading up to joining Iluka, again in mid-October to meet the Government in Pala and the company in relation to capital gains tax and, more recently, to better understand issues around the integrity of the dams.

My two overriding impressions of the country - and they’ve been consistent with my first visit - are that (1) it's poor. As you might recall, it ranks at 181 out of 188 in the human development index, which seeks to measure both the education per capita, income and life expectancy. The second is that it's relatively safe. It ranks as the fifth safest country in Africa. I think while this is a complex issue and no doubt has a lot to do with very high levels of religious tolerance, it probably also has a lot to do with the lack of guns in the general population, as a consequence of several gun amnesty and buy-back initiatives.

In terms of relationships with Government, obviously, we're just beginning. I've met the Minister of Finance and I also met with the Minister of State Financial and Economic Development and also President Koroma. Other members of my team have met with some of the Government agencies responsible for mining, and we've found the regulatory processes reasonably transparent, and we've had productive and open interactions.

Moving to slide 8, on Sierra Rutile's resource base, this table is Sierra Rutile's resource reporting, and it's inclusive of all reserves. You’ve seen this information before. The key point is that as at September 2015 reported resources were 867 million tonnes of material containing 8.16 million tonnes of rutile with an in situ rutile grade of 0.94%. The rutile resource represents an 80% increase on Iluka's in situ rutile resources.

Moving to slide 9, as I mentioned earlier, Iluka called a material adverse change because of concerns around the integrity and safety of a couple of the tailings dam facilities at Sierra Rutile. While Iluka carried out due diligence in relation to the operations, including the tailings dam facilities, before the merger was agreed on 31 July '16, this was in the dry season and it was prior to the commencement of the Gangama dry mining operations.

During recent visits by Iluka management for the purposes of integration and planning, concerns arose in relation to the Gangama dam where there was visible seepage and leakage of water and, secondly, at the Lanti containment ponds, in relation to the amount of freeboard. Taking Gangama first, it's a dam built back in 1989/1990. There were two concerns with it.

First, leakage at the toe of the wall and second, seepage around two-thirds of the way up the wall. At the time we did due diligence, there was no evidence of either of these. However, with the commencement of Gangama operations, the dam is now holding more like 21 metres of water, rather than around 12 metres. Over the course of the last week, Sierra Rutile's technical people made additional information available to us, including as built drawings of the wall, such that our technical personnel were able to get comfortable with the condition of the wall, the fact that it was to facilitate some leakage at the toe and that the immediate risk of failure is low. We have a program of works to get on with though to ensure it remains robust for the long term. As for the series of Lanti containment ponds pictured in this slide, it was a different issue, with a heavy rain season having contributed to higher levels in the pond than we were comfortable with, and this was resolved through dropping levels in critical parts of the pond to ensure adequate levels of freeboard were reinstated.

In both cases, we've developed management plans to remedy the issues for the longer term and those plans have also been confirmed by Knight Piesold as appropriate. The total cost to implement the various long term fixes is relatively small and it's the nature of works we do in the ordinary course of sustenance CapEx, so material value impact. Moving to slide 10, at the end of the presentation, I'm going to touch on my key priorities over the coming period and Iluka more generally, but very high on that list is to ensure that this is a successful transaction. The first key priority is an effective integration. Integration in the first day, month and over the next year or two is key. Effective engagement with the people at the mine in Sierra Leone is also key and that has begun already. We had representation on site preparing for integration activities for the last two months, and I'm confident and we're ready. I don't see this as a turnaround situation. Apart from what I've mentioned on tailing dams, generally it's not a matter of fixing an operation that's not performing well.

I have and my team have been impressed with the capabilities and operational achievements of the people in Sierra Leone. Ensuring that continues and is followed by further operational enhancement is a major focus. Having said that, we do see areas of improvement. Clearly as in our existing operation, safety performance and the welfare of employees is key. We certainly have identified a range of initiatives we can take, some entailing capital, to improve safety arrangements. Some are minor, but key, for example, physical barriers around equipment, and these improvements will be accompanied by the sort of cultural safety improvement programs Iluka has implemented in its other operations. Rob Hattigh will be our chief executive officer in Sierra Leone. Rob has over 25 years' experience in the extractive and processing industry and major mineral sands producers and has been with Iluka since 2008. He's experienced in operating in Africa and has spent extended periods already in Sierra Leone.

We have a team of eight who will join with the existing Sierra Rutile team. Shane Tilka, who has run the Jacinth Ambrosia operation and worked at Narngalu and in the US operations will be chief operating officer. Other key technical personnel will be involved. Dan McGrath, who you'll hear from, and Gavin Swart, our key project person, will be responsible for the feasibility studies on expansion options. So Iluka health and safety specialists are also involved. Importantly though, a key focus will be developing talent within Sierra Rutile, including by providing training and career advancement opportunities through other Iluka operations. I'll now hand over to Doug to go through the financials of the transactions.

Doug Warden: Thanks, Tom. Just turning to slide 12 then. As we said back in August when we announced the transaction, we except the SRL acquisition will be EPS accreted in 2017 and thereafter. As Tom's already said, the transaction value of $455 million is the total investment, made up of $375 million of equity, $80 million of debt assumed plus in addition to that $455 million, as Tom's mentioned, $18 million of transaction costs, which include an account party fee of $8 million in relation to a deal contingent forward that we mentioned when we first announced this transaction. We had taken out to lock in the Australian dollar consideration for the equity component. Those transaction costs of $18 million will be expensed in 2016 accounts. Based on the 30 June 2016 balance sheets for SRL and Iluka, the pro forma gearing is around 32% and, as you're aware, the transaction has been 100% debt funded from pre-existing Iluka debt facilities as - which total just over $1 billion. Turning to slide 13, where we referenced a forecast capital over the next five years, Dan McGrath will cover this in some more detail later on in the presentation.

But what I would say, as you've heard us say repeatedly, that we are flexible as to timing on these expansion projects, as we are with our own internal projects and market conditions will be a key consideration in the commitment of capital. Slide 14, this was - this slide's largely the same as what was released in the half year results pack in terms of some forward looking statements in relation to SRL. It also provides some history of their production and unit cost performance, together with the previous management's guidance in respect of 2016. Just for a few points to note on this slide. We would expect cash production costs to average US$75 million to US$85 million over the next three years and with the development of Sembehun, you would expect to see those cash production costs increase to a range of $110 million to $120 million. Unit costs we expect to trend down by around 10% to 20% from the 2016 midpoint guidance referred to in the slide. Rutile production over the next three years is expected to be in the range of 160,000 to 175,000 tonnes per annum, which would increase to around 240,000 tonnes with the development of Sembehun.

As I said, the capital profile will be dealt with later in the slide presentation. Finally, just turning to slide 15, which addresses the fiscal regime, the royalty is self-explanatory. In relation to income tax, we pay the higher - or SRL pays the higher of 3.5% of turnover or 30% of taxable income post the utilisation of tax losses. As I've explained to you - some of you over recent months, I just would also point out in relation to the tax losses of $464 million referenced to the footnote, they cannot be applied when paying the 3.5% turnover tax. Importantly, if you are paying - if we're in a situation where we are paying tax under the taxable income methodology, they can only be applied at a rate of 50% per annum. So to take a simple example, if taxable income in any given year is $100 and the turnover tax does not apply, then we can only apply $50 of tax losses to that $100 resulting in 30% tax being payable on the resulting $50. With that, I'll hand over to Dan McGrath to take you through the operational aspects of SRL.

Dan McGrath: Thanks, Doug. If we move to slide 17, which is a conceptual sketch that outlines the mine through to ship overview of the Sierra Rutile business, there's a single dredge mine operation to the south of the plant site. Also a dry mine that treats the remnant ore, nearby the dread and ore from the Gbeni ore deposit. The new Gangama operation is to the northwest. There's large surface water flows in the area which provide fresh water supply to the dredge and also to the dry mine processing plants. Power is generated at the plant site, overhead transmission lines reticulate that plough to the mines. Concentrate and finished goods is moved around the site by road using trucks and the - and the port includes barges that support the - that provide - the - barges that move the finished goods to the ship's moored just offshore. To slide 18, the Lanti dredge operation, it has limited reserves remaining. They're currently scheduled for depletion in 2018. The dredge is a bucket loader. It's got an on-board scrubber plant, which is the beneficiation process that liberates the ore into its discrete particles of rock, clay and sand.

It has a floating concentrate of the trials, the dredger, which de-slimes the ore and concentrates the heavy mineral using gravity separation or spiral concentrating. The Lanti dry mine was Sierra Rutile's first attempt at dry mining. It's bucket excavators loading trucks, trucks hauling three kilometres currently to the concentrator site, where our ore is dumped, stockpiled and ore is reclaimed from these stockpiles for treatment by the dry plant or the fixed plant, sorry. The fixed plant has ore screening, then scrubbing and then gravity concentrations similar to the dredge. The Gangama dry mining operation is essentially the same, but it reflects improvements or learnings from the Lanti experience. It includes direct dumping of ore into an ore bin, so that only 20% of the ore is rehandled from a stockpile. The beneficiation plant or the scrubber plant has much higher energy, so ore recoveries are higher, and the spiral concentrators have higher efficiency and more robust spirals in the Lanti plant. The mineral separation plant has a feed preparation stage, which upgrades to 75% heavy mineral concentrate into the high nineties.

It also has a sulphide removal plant employing froth floatation. The dry plant is essentially a multi-size rutile plant. It uses screens, magnets and electrostatics and it makes two grades of rutile. A 95% standard grade for the pigment market and 95% low sulphur, low phosphorous rutile, which is finer and that's for the welding and metal markets. The MSP produces or has the capacity with current feed grades, assemblages and sulphide levels of producing around 175 kilotons per annum of rutile. Moving to slide 19, the operation is about 270 kilometres from Freetown or the airport. Two-thirds of that road is good quality blacktop seal. The last third is unsealed and access to the site for most goods and services is via this road. However, the Nitti Port has offloading facilities for large equipment and construction materials. The local workforce that operates the business, the majority can speak English. They are - several were employed or many were employed by the mine prior to the commencement of the civil war, so there's much knowledge retained within the business.

The Nitti Port storage and unloading facilities, there's three barges, 1700 tonnes capacity with about a 24 hour turnaround time to load offshore moored vessels. Shipment sizes range between 10 to 25 kilotons typically and can be compartmentalised for different products or different customers. The port also holds diesel and heavy fuel oil storage for mobile equipment and the power plant and this is trucked to the plant site when deliveries are not from Freetown. The accommodation, it's a 400 man camp. There's two kitchens and mess halls. The facilities for rec and relaxation are very good. The gen set’s seven megawatts. They're heavy fuel oil fired and there's an auxiliary generator capacity that's used occasionally to minimise spending reserve when the demand is not matched to that seven megawatt increment. They have excellent availability and power interruptions are limited to those related to electrical storms.

Moving to slide 20 on safety and operational improvements and the safety aspects of this scope recognise that Iluka must seek to achieve common standards across its business. There are some equipment standards that would not meet Iluka's current standards. The intent is recognise that when capacity or efficiencies can be improved, the target areas should be where these operational efficiencies can be improved along with improving equipment standards.

The main improvements that we are targeting is in the mining and concentrating area in the early days. That's about making structural changes to the mining cost by reducing the loading - reducing sorry the hauling, stockpiling and reclaiming and also the handling the oversize that's associated with having the beneficiation plant right at the concentrator. We intend to make in-pit ore receival plants and nearby beneficiation plants that enable a direct loading of the plant and avoiding any ore haulage.

The Lanti beneficiation plant as plant as well has some improvements that can be reached in terms of de-bottlenecking, moving the constraint downstream from the scrubber plant or the beneficiation plant to the concentrator where it should be, and there is also improvements in recovery - ore recovery through higher energy scrubbing circuits being employed.

In Gangama same concept. The difference being the recovery improvements incorporated in the current plant and there's less - the improvements are significant but they're lesser than Lanti because much of the ore is already direct dumped so it's only eliminating the haulage component. The costs for this is around $20 million expected over the next two years.

The throughput improvement in the MSP and along with the safety works reflect the prioritisation of expenditure that targets both efficiency by throughput and recovery increase, and in the areas where the equipment standards can be improved. So some of the MSP is modern that's been recently upgraded, but the core circuits and the secondary concentrating or feed prep stages are the original plant vintage.

The upgrades to this plant are required to facilitate the higher rutile outputs will eventuate from mine expansions, and they're also necessary to allow the treatment of future deposits with higher ilmenite assemblages such as Sembehun in a few years' time. So the upgrades target, the course, the feed prep circuits to achieve the higher outputs and can currently address equipment standards.

Moving to slide 21 production and expansion options, now there are numerous combinations and permutations for expansion of production and offsetting the depletion of dredge reserves. Lanti and Gangama are expansions, where not funding constrained, instead are examined for best life cycle returns suggest that the expansion of both of these to 500 tonnes per hour or above is preferable to smaller incremental upgrades that were proposed by the former ownership.

These options for increasing - there are also some options for increasing dredge reserves with incremental improvements that can adjust the timing of each of these projects or the total number of upgrades, and these will be examined through the definitive feasibility study process using Iluka's approach to resource development.

The Sembehun project is the next mine in the sequence and requires investment in road and power infrastructure and feasibility studies have been initiated by the operations already.

Moving on to slide 22. With Iluka's ownership the production and unit cost trends can be expected to continue in the same direction. The improvement in mining unit costs from using new methods, volume increases through expansion and improvements in overall equipment effectiveness, will deliver improvements over the current base with a prudent deployment of capital in targeted areas.

That's a suitable point for me to hand back to Tom. Thank you.

Tom O'Leary: Okay, thanks Dan. Moving then to the next step. They're laid out on slide 24 and are pretty self-explanatory. Before I make some comments about my priorities though, I've been asked that the incoming Managing Director whether I feel comfortable assuming a transaction negotiated, committed to and then announced by my predecessor.

The answer is that I feel comfortable with transactions that successfully generate value for shareholders and that success in this transaction will depend on a number of factors. It'll depend on an effective integration, it'll depend on ensuring a focus on the safety of operations, it'll depend on good quality execution to the plans Iluka has made to further develop the mines, make them more efficient and reduce unit operating costs.

It'll depend on good quality execution of the marketing plans for products, and it'll depend on building and maintaining good quality relationships with the local community, as well as with government. These are all matters I can and my management team can influence, and to which I'll be held accountable.

The Company has made an assessment that the acquisition is counter-cyclical and so you can take it that in addition to good quality integration, product expansion, unit cost reduction and all those things I've said, the success of the transaction will also depend on achieving higher pricing for product in years to come that has been achieved in the recent past; a period I think most regard as having been the low point of the cycle, and as many of you know, there has been a tightening in pigment market.

Finally, on side 25, I said I'd come back to broader Company priorities, so before opening up for questions a few comments on my own priorities over the coming period.

Having committed $473 million of Iluka's funds, the effective integration of the Sierra Rutile merger with follow through into operational improvement and delivery of product expansion and unit cost reductions is key. I'm working through the five year corporate planning process with the Board, and from this the 2017 budgetary settings and elements of these will flow through to guidance parameters with the full year results in February.

In part informed by those processes, I'm taking the opportunity to review the configuration of the portfolio and the assets of the Company more generally. This includes how we might run some parts of our portfolio to effect greater operational efficiencies.

I've also taken some time to look in detail at Iluka's existing production options such as Balranald. For Balranald, as I mentioned, Sierra Rutile may provide some timing flexibility so I'll be in a position at the full year results to discuss the pathway for that deposit.

I'm conscious that returns in the business have been suboptimal for a number of years. I'm also conscious that while the operational base of the Company has contracted, the associated support or functional cost base has not been adjusted. As such, a process has commenced and is well advanced on dealing with this. It entails a review of all non-production cash costs of the Company, and again I'll be in a position to provide you details of the impact of this sustainable business review in February.

Thank you. I'll now turn over to the moderator for questions.

Operator: Thank you. Ladies and gentlemen if you do wish to ask a question please press star one on your telephone and wait for your name to be announced. If you do wish to cancel your request please press the pound or hash key.

Our first question comes from the line of Clarke Wilkins from Citi. Please ask your question.

Clarke Wilkins: (Citi, Analyst) Hi, thanks very much. Just in terms - a couple of questions - first off I think the comment was the other accretion was in 2017. Can you - is it - in terms of the assumptions that accretion, is that based on current retail prices or your assessment of 2017? Also what sort of levels of DNA can we expect in terms of making that assessment? The other one was just I think the comment you made Tom was that you know there's not a turnaround situation, so clearly Iluka it plans to ramp up production further than what Sierra Rutile was planning. So how much of that is actually driven by the capital you're able to put in, or how much of that is actually driven by the expertise I suppose that Iluka has in terms of running dry mines and the efficiencies that it can bring?

Tom O'Leary: I'll hand over to Doug for that.

Doug Warden: Yes, so Clarke thanks for that. Look it's based on our 2017 view of prices which we haven't disclosed but that's the answer to your EPS question.

The next one was sorry?

Clarke Wilkins: (Citi, Analyst) DNA.

Doug Warden: Oh DNA? Oh look we'll provide some more colour around DNA once we've had the purchase price allocation audited. We're just in the process of going through that at the moment with the auditors, and obviously depending on where you allocate purchase price to current or further ore bodies in the - obviously there'll be some allocated to each, but the extent to which you allocate it to future ore bodies as opposed to current ones impacts on the DNA. So we won't provide that at the moment.

Tom O'Leary: I think you had a further question there Clarke about the additional tonnes that would be from new capital versus greater efficiency, but I think we'll provide a bit of colour around tonnage expectations next year, and perhaps we can provide a bit more colour at that time.

Clarke Wilkins: (Citi, Analyst) Thank you.

Operator: Your next question comes from the line of Peter O'Connor from Shaw and Partners. Please ask your question.

Peter O'Connor: (Shaw and Partners, Analyst) Morning Tom, thanks for the call. Doug some further financial follow ups. Just the tax position, you mentioned the details of that and what you can claim. Some of that wasn't on the Sierra Rutile balance sheet. Could you just explain the transfer of that from SRL to your balance sheet, what stays on what stays off balance sheet and how that influences what we see in the P&L and cash flow over the short/medium term?

Doug Warden: Are you talking about the fact that the losses were not booked as a DTA Peter?

Peter O'Connor: (Shaw and Partners, Analyst) Yes.

Doug Warden: Yes, look we're just going through that process with our auditors. We're comfortable and confident that we'll be able to use those losses on the basis that I described on the call, and you'll see that come through in our accounts when we release them in February.

Peter O'Connor: (Shaw and Partners, Analyst) Fine and just a follow up on currency sensitivity. What is the proportional split of currencies that we should think about when we're modelling the costs of Sierra Rutile? You were still on the local currency et cetera.

Doug Warden: Yes. Yes, look I think predominantly US dollar cost base. They obviously pay - not obviously but they do pay salaries in local currency, but the procurement of supplies and the external spend if you like, even if it is paid in local currency, it's always linked to the US dollar rate at the time. So for all intents and purposes the bulk of it in US dollars with the exception of labour Peter.

Peter O'Connor: (Shaw and Partners, Analyst) Okay, great, thanks very much.

Operator: Your next question comes from the line of Amber MacKinnon from UBS. Please ask your question.

Amber MacKinnon: (UBS, Analyst) Hi Tom and Doug. Good to hear the update from you today, thank you. A couple of quick questions from me. Firstly, Doug you might be able to help us with this. I think if I recall to your last annual report your effective interest rate on debt was approximately plus or minus around 2%. Can you give us a little bit of an indication as to what your costs of debt might change to once you've assumed the costs of funding - the debt that you've assumed from SRL as well as the costs of the acquisition price? Is there any guidance you can give us around how that might change?

Doug Warden: Look it'll change in relation to how the bank bills will operate or libor changes depending on whether we're drawn in Aussie or US, Amber. Our margins under our MOFA are what they have been and won't change until we go and refinance with our banks, so I'm not expecting - they will not change until that happens.

Amber MacKinnon: (UBS, Analyst) Right.

Doug Warden: We've got - we did a refinance at the back end of last year so at least two-third of that $1 billion in facilities is four year money. As at today it was five year money obviously when we refinanced, so no material change.

Amber MacKinnon: (UBS, Analyst) That's useful, thank you Doug. Tom, a couple of questions for you. I know that you guys will talk in more detail with the results with regard to your prioritisation and progressing the other projects potentially within the portfolio, obviously Balranald and Cataby. Can I just ask you from your perspective

at this stage is the Sierra Rutile project opportunities and the Balranald project - is that mutually exclusive or do you still think that they could be under the right conditions done at the same time?
Perhaps flowing into that - obviously in recent weeks - a secondary question linked to that we've seen Tronox announce another price increase in the last week. We're hearing that zircon prices potentially by one of your competitors are being lifted for the new year. Perhaps if you could give us a little bit of an update as to how you're seeing the market in the first half of 2017? That would be great, thank you.

Tom O'Leary: Look we've talked the fact that the acquisition provided us with flexibility. As you've obviously gathered that really is that given Sierra Rutile is a strong source of rutile and importantly a scalable source so that it can continue to satisfy its existing customer base but also increase production to fill the hole left when our existing Murray Basin rutile is exhausted. So it does give us some flexibility in terms of the timing but also the potential capital profile of Balranald. It's not to say that they're mutually exclusive by any means. They could both very much - we could still do Balranald, there's no question about that. It's still subject to technical and financial evaluation as I've said and I plan to be in a position to provide you with a proper update on that in February.

Amber MacKinnon: (UBS, Analyst) Yes. Thank you.

Tom O'Leary: That's fine. In terms of the outlook for the market for next year, in terms of high grade feedstock the market is tight. Matt Blackwell our Head of Marketing is going to be on the call today but he's stuck on a plane but…

Amber MacKinnon: (UBS, Analyst) Shame.

Tom O'Leary: I think the latest is that we're observing that inventories downstream of us are low and customers who experience delays are requiring alternative supply and we're looking to help those customers. So I think the market is looking tight and you've seen that our pigment prices themselves are pretty obviously going up. In terms of the zircon market, the year is playing out much as the team expected. The price rise in the third quarter has stuck to some extent and demand remains pretty stable. So I hope that helps you.

Unidentified Analyst: No, that's extremely useful. Thank you for that. I think those were my main questions from me. Thanks very much for your time.

Tom O'Leary: Thanks Amber.

Operator: Your next question comes from the line of Brenton Saunders from BT Investment Management. Please ask your question.

Brenton Saunders: (BT Investment Management, Analyst) Good morning Doug. Just one for you, just a logistical one. The divisional reporting for SRL will we get it in USD or just A dollars? Then secondly just at an operational level - if we could just get a little bit more detail on the 15%/20% unit cost out at SRL that's been mooted. If we can just try and understand exactly how that is to be achieved. Then maybe just a little bit of a discussion around some of the FIFO logistics for management. So I'd be interested in understanding which parts of operational management will be based on site and which will be based in Australia. Then how the ex-pat Aussie based management will interact with the site? Thank you.

Doug Warden: Thanks Brenton. I'll just handle the accounting question first. So we'll account for it in the same way that we accounted for the US operations. So it will get reported in our annual report and financial statements in Aussie dollars but in terms of just understanding the FX and how that's treated through the accounts, it will be booked through the Foreign Currency Translation Reserve. So any change in the movement of the SRL accounts will not go to P&L resulting from the US dollar/Aussie dollar conversion. It will go through Foreign Currency Translation Reserve in the same way that our US operations were treated through their life.

Brenton Saunders: (BT Investment Management, Analyst) The divisional accounts will be Australian dollars, is that what you're saying?

Doug Warden: Sorry Brenton?

Brenton Saunders: (BT Investment Management, Analyst) The divisional reporting…

Doug Warden: Yes.

Brenton Saunders: (BT Investment Management, Analyst) …will be in Aussie dollars.

Doug Warden: Correct. Same as we've done for the US. It will be exactly the same and we'll obviously disclose what exchange rate they've been converted as at balance date. Your other questions I'll…

Tom O'Leary: Yes perhaps Dan you could touch on those.

Dan McGrath: Yes okay. Well in terms of the unit cost, the improvements on the existing production base these are achieved through lowering the mining cost. So essentially the operation uses excavate, load, haul, stockpile, reclaim steps in the handling. We're going to eliminate many of those steps. So in the case of Lanti, ore will be directly fed into an in pit mining plant and it will be slurry pumped to a nearby beneficiation plant and field pumped three kilometres to the fixed plant concentrator. So what that does is it eliminates the stockpile reclaim, it eliminates the road or truck haulage of ore. So that's a substantial change in the unit cost of ore handling. Further, that's on the current production base. Now there are a large proportion of fixed costs in the business or large lot of the local labour costs are fixed. A lot of the other services have an element of fixed cost to them. So on the higher production base, the dilution of those costs through higher production rates move the unit costs in the right direction too. I hope that answers the question.

Brenton Saunders: (BT Investment Management, Analyst) Thank you.

Tom O'Leary: Yes Dan are you going to touch on the FIFO logistics as well?

Dan McGrath: Yes so the majority of the operational management will be on long term FIFO rosters. I think there's six or seven weeks as I understand it. So that's with the senior site operational personnel. The integration team will be in place for an estimated 18 months to three years - we haven't put a time on that. At which point that contingent of eight integration personnel from Australia will shrink considerably. The Chief Operating Office Steve Wickham, he is based in Australia. We have very good facilities for conferencing and also the management reporting structures will flow through using Iluka's current I guess current inputs and outputs. So it's a long roster, diminishing over three years in terms of Australian ex-pats. That's about all I can say about it.

Steve Wickham: It's Steve here if I could add?

Dan McGrath: Yes.

Steve Wickham: Is that Rob Hattingh the CEO will be based on site residentially so he has good interaction with the mine site and also myself I'll be travelling in and out of Sierra Rutile in the early stages in the area of about two weeks out of every six to seven weeks for a period of time to give support and ensure that we can support the operation with anything they require. One of the other things we've done is it is a seven/three roster that the ex-pat team will be doing. One week out of those when they come back from their break, they'll have their three week break and they'll spend about a week in Perth interacting with all the mining engineers and so on to ensure that we get very good flow information and quick decision making. So I think that will help with the integration as well. Thank you.

Dan McGrath: Yeah just to add one thing, Steve mentioned that Rob Hattingh is going to be based at site, so having the CEO at site is going to be quite a change for the operation. We're going to have a smaller presence in Freetown as well with fewer roles in Freetown. So the nerve centre of the operation is going to be at the mine site.

Brenton Saunders: (BT Investment Management, Analyst) Thank you.

Operator: Your next question comes from the line of Matthew Hodge from Morningstar. Please ask your question.

Matthew Hodge: (Morningstar, Analyst) Hi Tom. Just a question around the sovereign risks in Sierra Leone, how did you get comfortable with that and what do you feel like the key risks are and what are you going to do to mitigate those?

Tom O'Leary: Look I think I've talked quite a bit about sovereign risk already. So during due diligence we have done an awful lot of work and engaged externals on issues around country risk. Sierra Leone as I said has since the end of the civil war has had several changes of government and different parties of running the country. They've been largely peaceable transitions of power. So it's Africa obviously but I think it's a manageable risk. We've done a lot of research. I think the key mitigation in these sorts of risks is to ensure that we're maintaining good relationships at all levels from local communities through to various levels of state and central government. Also delivering on the commitments we make with the gross stakeholders.

Matthew Hodge: (Morningstar, Analyst) Okay, thank you.

Operator: (Operator instructions) Our next question comes from the line of Paul Young from Deutsche Bank. Please ask your question.

Paul Young: (Deutsche Bank, Analyst) Yes hi Tom, Doug and team. A few questions…

Tom O'Leary: Paul, just speak up, it's a bit hard to hear you.

Paul Young: (Deutsche Bank, Analyst) Yes I'll just turn it up, is that better.

Tom O'Leary: Not really.

Dan McGrath: Not really but we'll try.

Paul Young: (Deutsche Bank, Analyst) Okay I'll shout. So just looking at the operation itself, part of the reason this operation struggled or has been a bit challenged over the last couple of years from my observation is the HMC grade and also the VHM grade is in 50s and 60s - so well below your operations. So a lot of trash in the heavy mineral concentrate. Just curious about now you've spoken about the mining method and improvements potentially at a cost. Are the changes you're suggesting going to improve the HM grade which I think is running around 6% and then also the MSP recovery which has been running at 80% which is on an international standard is pretty low. So I'm just wondering if you can quantify what you think you can get the HM grade up to with the new mining method if it can be improved at all and also what you think you can do to the MSP recoveries just to give it some context and then I've got some questions thanks.

Tom O'Leary: Thanks. Well Dan I hope you heard that. I'll pass it to you.

Dan McGrath: Yes I did hear that. The HMC grade is about 75% HM which translates to about 35% contained rutile. In itself that isn't the factor that drives recovery. So it's a low grade heavy mineral concentrate from the mining plants such that it's not - the recovery is not sensitive to achieving a high grade concentrate or a high grade HMC. The MSP recoveries whilst they refer to recovery of rutile, the way we look at recovery is contained rutile in the feed and finished rutile produced as a yield number.

Because of the fact that the rutile isn't total 100% titanium dioxide, 100% purity and there is also some recovery of altered ilmonites or leucoxenes into the finished product. We are expecting some recovery improvements through the MSP, and they will be numbers starting with a 9 and not an 8. In itself, though, the HMC is not a driver, and it's about that current operating philosophy is mitigating the risk of recovery sensitivity to producing a high-grade concentrate.

Paul Young: (Deutsche Bank, Analyst) All right. That gives me context, thank you. Now, the second question about Sembehun. First of all, was the development of Sembehun in your base case when you looked at the transaction?

Dan McGrath: Yes.

Paul Young: (Deutsche Bank, Analyst) Okay. Right. Then secondly, this ore body is 30 kilometres away and my understanding is it is a higher strip ratio ore body, and I also know that they - that Sierra Rutile never disclosed a reserve at - certainly the JORC standard resource or the JORC standard reserve. Do you expect the head grades to improve with Sembehun?

Dan McGrath: The Sembehun resource at the moment has actually not been limited by essentially mineralisation running out. It's been limited by the extent of the drilling. We see a different development approach to that assumed by the previous ownership, and the overburden is - there is areas of overburden in Sembehun, but there are areas where the grade is similar, there are areas where the grade is higher, and there are areas where the rutile grade is lower, but we expect that resource to increase with further drilling and we expect the reserve to be optimised for its grade.

The major costs of development are the road and - significant costs in development are the road and power line infrastructure.

Paul Young: (Deutsche Bank, Analyst) Okay, great. Last question, just on sustaining Capex. I know Sierra Rutile, if I just go back to their accounts, have stated that sustaining Capex this year is only going to be around $5 million or $7 million, and they said it's actually been quite tightly controlled. So just really interested when this project with Sembehun is developed, conceptually, where do you see the medium- to long-run sustaining Capex levels levelling out for this business?

Dan McGrath: Do you want me to answer that, Doug, or are you planning to answer that?

Doug Warden: You go ahead, Dan.

Dan McGrath: We expect those sustaining capital numbers to be in that order of $7 million. Some of that will be included within some of the upgrade capital that's spent in future years, but essentially, as a long-term number, that's a reasonable number, and that includes minor improvements, and it also includes mine development capital, extra booster pumps, et cetera, pipelines and such affairs.

Paul Young: (Deutsche Bank, Analyst) Right, so even though you're doubling the mining rate, you think the sustaining Capex won't move, just as a function of less equipment and newer equipment? Is that the way I'm reading it?

Dan McGrath: Absolutely.

Paul Young: (Deutsche Bank, Analyst) Okay, right. Thanks.

Operator: Your next question comes from the line of Craig Sainsbury from Goldman Sachs. Please ask your question.

Craig Sainsbury: (Goldman Sachs, Analyst) Yeah, thanks. Morning, guys. Just two quick ones from me. On the Tailings Dams, have you taken out any more insurance, just given what you found, or has what you found sort of changed any of your insurance and continuing business policies? Essentially just any information around that would be good.

The second question, just to draw your time a little bit more on your views on what would make this transaction successful. Drilling down to sort of are we looking more at it's going to be sort of the margin expansion, cost reductions, developing, getting the volume out of the ground? Really just trying to get a bit more of a feel for what would sort of be a successful transaction in two or three years' time in your eyes.

Tom O'Leary: Look, the first question...

Dan McGrath: I'll handle that. Craig, just on the insurance, no, we haven't at this point. We've had a good look at the insurance policies through the due diligence process and as we integrate those into our insurance policies, we'll obviously have a weather eye to business interruption and suchlike, the trade-offs, obviously, between premiums and risk.

Tom O'Leary: Look, having been at the site and seen the issues around the dams and spent a lot of time on them, we don't see those as - we now don't see those as imminent risks, as I've said, and they can be repaired in the normal course per the sort of thing that we'd be doing on our dams all the time, sustaining Capex that needs to be spent. So I don't think there's any requirement there for changes to insurance.

But around success of the acquisition, I think, as I said, the success is going to be driven by a number of factors. All of the ones you've mentioned; margin, cost reduction, volume, they're all critical, but I also think it's - I meant what I said about the integration and engaging with the people on the ground in Sierra Leone. That's going to be really important, and also engaging with governments at a local level. Those sort of things, to gain acceptance, are incredibly important.

The company has a large profile in Sierra Leone, and the country is very proud of the company, so being accepted in Sierra Leone is going to be very important for Iluka.

But as I also said, there are things we can influence, and the ones I've just spoken about are the ones we can influence, and I'm confident we're going to deliver on those. We definitely have, I think, the right people to engage on those issues and deliver. Aside from all of that, though, our pricing is going to be key, and as I've said, the Company has made an assessment that the acquisition is counter-cyclical, and so success is also going to depend on achieving better pricing in years to come.

Craig Sainsbury: (Goldman Sachs, Analyst) Okay, thanks, guys.

Operator: Just a reminder that if you would like to ask a question, it is star one on your telephone. Our next question comes from the line of Peter O'Connor of Shaw and Partners. Please ask your question.

Peter O'Connor: (Shaw and Partners, Analyst) Two follow-up questions. Firstly, finished stock, Doug. What finished stock is sitting at Sierra Rutile? Is it like Iluka with a large bank of material that could be sold or is it quite typical at that place?

Then secondly, a question for Dan, just on the comments you made about cost at Sierra Rutile. I appreciate your answer and it sounded quite clear. The comments, having said that, sounded quite logical and quite obvious. Why were the previous owners not doing that? Even your earlier comments about how you thought they were running the business well. Did they just not have the capital or the time? What was the issue with not changing the mining plan previously to the areas you've set the cost out?

Doug Warden: Thanks, Peter. I'll handle the stock, obviously, and then hand over to Dan. Yeah, not like us. Like many participants in the industry, hand to mouth from an inventory perspective, really from a cash - to drive cash flows as fast as possible, so working stocks, we estimate around 10,000 tonnes of rutile at year end. Dan, do you want to cover off on the improvement question?

Dan McGrath: Yes, I can. The improvements that have been made by the operation, by the site team, in regards to the Gangama project, are significant, so they have improved their operation from moving from the first attempt at the dry mining operation to the Gangama operation.

I can't really speak for them to say whether it is a capital constraint, but essentially we are spending an additional $20 million to yield those savings. Now, whilst that has a high rate of return, it's quite possible that it was a cash constraint that drove the design, and also possibly the preference of the site for the lump sum turnkey contracting, which attempted to essentially outsource some of the process and design risks to third parties.

That never actually works. That risk is always borne by the owner. So I think those factors may have been the factors that have driven their selection of mining method and plant design.

Peter O'Connor: (Shaw and Partners, Analyst) Flipping it on its head Dan, is there anything you learned from what you saw there and lessons learned for Iluka back at home?

Dan McGrath: I think one thing that they have done well, essentially, is adapt their plant for the ore body. Not necessarily that's a learning, but that's just a recognition that they have recognised the differences in ore bodies. They're not all horses for courses, and that's something that we learn ourselves as a business regularly, so that's my generic vanilla answer to that one.

Peter O'Connor: (Shaw and Partners, Analyst) Thanks, Dan.

Tom O'Leary: Just to elaborate a bit on what I said earlier, I think what I was getting at was that I'd been impressed, and I think the team had been impressed, with the capabilities and the achievements of the people in Sierra Leone, and that is taking account of the circumstances they're working under. I think you mentioned was there a constraint on capital. I think it is very much there was a restraint on capital, but there's a lot of innovation and ingenuity shown by the people to deliver what they were able to within those financial constraints, so with a judicious use of capital I think we can generate some very positive returns.

Dan McGrath: Tom, just to add to that, these concepts that we have, that we are proposing, we have floated with the current Sierra Rutile workforce, and the feedback is that they are supportive of those and had they had the opportunity, they would have considered the same types of improvements themselves, in time.

Peter O'Connor: (Shaw and Partners, Analyst) Thank you very much.

Operator: Our next question comes from the line of Clarke Wilkins from Citi. Please ask your question.

Clarke Wilkins: (Citi, Analyst) Just a follow-up question on the debts. I think back when the acquisition was announced, it was talked about peak debt, I think, in terms of 2018, where it doesn't seem to be that sort of reference now. Is that sort of recognition around the Balranald CapEx effectively being pushed down? Is there any feed net debt in 2018 now? Sorry, net debt peaking in 2018.

Tom O'Leary: Look, I think, Clarke, that's fair. As I said during the presentation, as we've said ad nauseum, the way in which we decide to allocate capital remains in our control, so we just keep our powder dry, I suppose, on how the debt looks over the next couple of years, because obviously it's very much dependent on where we choose to deploy capital, in which part of the portfolio, and over what time frame.

Clarke Wilkins: (Citi, Analyst) Great, thanks.

Operator: Our next question comes from the line of Brenton Saunders from BT Investment Management. Please ask your question.

Brenton Saunders: (BT Investment Management, Analyst) Hey. Just a follow-up on the cost side. On the disclosure of the release yesterday or the day before, on the spreadsheet that was circulated, there's another $15 million, $17 million of what looks like largely operating costs that are not included in your unit cost, cash cost numbers. Could you just explain to me why and where those costs will end up in the Group?

Then the other thing is just quite simply is the operation making good cash flow, and if not, when do you expect it to be?

Dan McGrath: Sorry, Brenton, what slide are you referring to?

Brenton Saunders: (BT Investment Management, Analyst) I'm not referring to a slide. You guys circulated a spreadsheet yesterday or the day before, and on that you have three line items that make up $16 million or $17 million, depending on which years you're looking at, which is an aggregate of G&A, selling costs, and freight costs, that are not included in the cash production cash cost unit costs.

Doug Warden: Look, Brenton, essentially non-production costs, but some of the items that are incorporated in that include technical services, engineering services, insurance, security, camp costs, rent and mining leases, shipping operations, et cetera, et cetera. So it's similar to how we look at our own business in terms of what goes into inventory and what's treated as non-production.

Tom O'Leary: Brenton, just in terms of the forecast you're after on free cash flows, clearly that's dependent on pricing and a range of other things, so I wouldn't be wanting to be drawn on that now.

Brenton Saunders: (BT Investment Management, Analyst) Is it making money now?

Dan McGrath: Yes, it is cash generative this year.

Brenton Saunders: (BT Investment Management, Analyst) Thank you.

Operator: There are no further questions at this time. I would now like to hand the conference back to today's presenters for some closing remarks.

Tom O'Leary: Okay. Thanks very much, all, for joining the conference today, and look forward to telling you more about how the integration is going in February. Thank you.

Operator: Ladies and gentlemen, that does conclude our conference for today. Thank you for your attendance. You may all disconnect.

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