

24 July 2019

Quarterly Review June 2019 - Teleconference Transcript

Presenters/Speakers

- **Tom O'Leary** - Managing Director and CEO
- **Matthew Blackwell** - Head of Major Projects, Engineering & Innovation

Start of Transcript

Operator: Ladies and gentlemen, thank you for standing by, and welcome to Iluka Resources Limited June 2019 Quarterly Review. At this time, all participants are in listen-only mode. There will be a presentation, followed by a question and answer session, at which time, if you wish to ask a question, you will need to press star one on your telephone. I must advise you that this conference is being recorded today, 24 July 2019. I would now like to hand the conference over to our first speaker today, Mr Tom O'Leary, Managing Director. Thank you, please go ahead.

Tom O'Leary: Good morning. I appreciate you making the time today to join the call, in what I know is a busy period. We don't typically hold a call to discuss our June Quarterly, but given the detailed update we've provided, we thought a discussion on the key issues was warranted. I'll give a brief outline of the release, before opening up the line to questions. I've also got with me Adele Stratton, CFO, Matt Blackwell in his new role as Head of Major Projects and Innovation, and Melissa Roberts, General Manager, Investor Relations and Commercial. Unfortunately, Christian Barbier, our new Head of Marketing, couldn't join us for the call this morning.

To the result, as you'd have seen, we produced a total of 324,000 tonnes of zircon, rutile and synthetic rutile in the first half. That was slightly down on the first half of 2018, reflecting a number of operational changes, including the cessation of dredging mining at Sierra Rutile and the major maintenance outage at our kiln in the southwest of Western Australia. Offsetting those changes, we've commissioned the Cataby project and the Gangama mine expansion. At Sierra Rutile, we continue to implement a range of improvement measures at the Lanti and Gangama sites. I'm pleased to report that the Gangama mining unit and concentrator are consistently meeting design capacity, and output from the Gangama complex is broadly in line with expectations. At Lanti, we've continued to experience some issues affecting run time and throughput. Obviously, we have further work to do there, and we continue to progress initiatives to improve production stability from the Lanti mining area.

Sales in the first half were lower than the first half of '18. We're seeing conditions in the zircon market affected by ongoing trade tensions and geopolitical uncertainties, and this is now translating into lower demand.

We've also observed some shifting in demand from premium to standard grade zircon products, contributed in part by the influx of concentrate materials into China. As you're aware, zircon in concentrate largely becomes standard zircon, and obviously sells at a discount to premium. We've observed that discount expanding over the first half. We maintain the ability to release additional zircon in concentrate opportunistically to support demand, and we have the benefit of realising strong margins from this very low cost material for Iluka, which is not necessarily the same position for other producers of concentrate, and it's certainly not the same position for potential producers of concentrate who have capital to spend as well as OpEx.

In addition, we can support customer requirements for standard grade material through changes in our production settings at our mineral separation plant in Geraldton to produce standard grade as well as our premium zircon product. We'll consider whether this is warranted as we progress through the second half. As we've communicated before, the zircon reference price is set at US\$1580 per tonne through to September, representing 12 months of stable zircon reference pricing. We've also observed other producers of premium zircon maintaining stable pricing in the market.

Turning to high-grade titanium markets, they remain tight, and we continue to experience strong demand for our product. Pigment inventories have moved back to their normal seasonal level, and plant utilisation rates are higher. Encouragingly, in China, we see increased imports of high-grade feed stocks as domestic chloride pigment plants ramp up.

The other area I'd like to highlight is projects, as we've provided a number of updates. Today we've released a Mineral Resource estimate for the monazite stockpile we'll be recovering as part of the Eneabba project. The Resource has increased in size to a million tonnes from the previously disclosed 400,000. We've also provided some additional detail on the plant required to recover the material, which is a relatively simple process. We're progressing negotiations for offtake of this concentrate with an execute proposal planned to go to our Board shortly. The lead time for the project to then get underway is relatively short, and we aim to be in production next year.

The two expansion projects at Sierra Rutile are progressing well. As I mentioned, Gangama has now been commissioned and has been operating at design capacity since June. Lanti will be commissioned later this quarter.

Moving to Sembehun, we've announced today a delay to the start of the Stage 1 early works. This was previously scheduled to commence, potentially, later this year, and we've now delayed this beyond 2019. I would just like to step through this decision a little, to give some context. As you know, following the increased capital expenditure in mid-2018, we spent time optimising the scope and narrowed in on a development option of production capacity over time in excess of 300,000 tonnes per annum, potentially commencing in late '21. That option provided the best return at the time. As we've developed the detailed design on that scope and costed it, it's becoming apparent that the likely capital cost is higher. As a result, we'll revisit and broaden the value optimisation studies. These will consider and be open to changes to the targeted production rate, to the mining technique, and to the mine sequencing to minimise tailing storage.

The focus will be on determining a development option that's both fit for purpose and optimises the risk-return relationship. Once a clearer picture of the expected project capital cost is available, based on a revised development option, we'll provide additional guidance to the market. In the meantime, we'll focus on operational improvements and on the Gangama and Lanti expansion projects, such that these meet operational stability expectations. With that, I'll open up the line to questions.

Operator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. If you wish to ask a question, please press star one on your telephone, and wait for your name to be announced. If you wish to cancel your request, please press the pound or hash key. Your first question comes from the line of Paul Young from Goldman Sachs. Please ask your question.

Paul Young: (Goldman Sachs, Analyst) Morning, Tom, Matt and team. A few questions on the zircon market to begin with. Can I just step through a few things here? First question, maybe directed at Matt, is your comment about sales being second-half weighted. I'm just curious about why you think there'll be an improvement in sales, and what will drive the improvement in sales in the second half?

Matt Blackwell: Yes, sure, Paul. We've said that demand was lower in the second quarter than we had originally anticipated. The world has been uncertain, but at the moment, based on the work that we have done, we still anticipate sales in the second half being greater than the first half.

Paul Young: (Goldman Sachs, Analyst) What's driving that, Matt, is that property completions in China? What end segment is driving that, in what region? That expectation.

Matt Blackwell: As you know Paul, the market's quite complex. The ceramic market, as we have called out in the quarterly, has suffered from slower demand than other sectors. Other sectors continue to have demand, but property completions per se won't change zircon consumption within a really short period of time. There's a multitude of factors.

Paul Young: (Goldman Sachs, Analyst) Okay, all right. Just with the move to selling more standard and zircon in concentrate, has there been a structural change and move away from premium at current prices? Are you seeing a structural move from customers?

Tom O'Leary: No, I don't think so Paul. It's more that - what we see in the market is that there have been a lot of concentrates mobilised into the market in the last while, and as you know, those concentrates largely manifest in the marketplace as standard grade product. That's caused some level of surplus in that standard grade product arena, and some downshifting from premium. As we've noted, we're prepared to support our customers if there is a demand at the moment for standard grade.

Paul Young: (Goldman Sachs, Analyst) Yes, sure. Okay, so Tom, concentrate sales are 23% of your total sales, zircon sales in the first half. Where do you think that's heading? If you'd just help everyone out about what percentage you think the ZIC sales will be in the second half, and then, what is the discount now on standard zircon? I mean, it has increased due to some small players selling more standard grade zircon. But what's the discount now to premium, do you know?

Tom O'Leary: Yes. Well, I'm not going to guide on that, nor am I going to guide on the percentage split for the second half. We've given guidance in terms of our expectations of the second half, in terms of sales being second-half weighted. But beyond that, to go into splits, I don't think is helpful at this point.

Paul Young: (Goldman Sachs, Analyst) Okay. Then last thing on zircon, Tom, negotiations on the next premium benchmark pricing round, have they started already?

Tom O'Leary: Well, we don't typically negotiate the premium reference price. It's more an assessment that we make and announce at the appropriate time, and we'll update the market in due course on the last quarter.

Paul Young: (Goldman Sachs, Analyst) Okay, all right. Then maybe, last one from me, just moving on to Sierra Leone, just curious about the additional capital you highlighted. The last increase in CapEx of - I think it was 30-50% you announced last year; I think that you were pretty adamant that we weren't going to see an increase - a further increase in capital from that estimate. So, just curious, what's driving the higher capital outcomes now?

Tom O'Leary: Yes. Just to be clear, Paul, we're not saying specifically that there's going to be more capital associated with Sembehun. What we're saying is that we are coming towards the conclusion of the definitive feasibility studies and optimisation studies, and it's becoming apparent that on the scope that we've identified there and narrowed in on, is looking to produce more than 300,000 tonnes per annum with first tonnes in '21, that capital would be higher. So, now we're looking to reassess that scope with a view to it being open to reviewing the targeted production rates, the mining technique and the mine plan to minimise storage. So, we're not saying that we're going to spend more on Sembehun. We're actually saying that we're going to reassess.

Paul Young: (Goldman Sachs, Analyst) Okay, all right. Listen, I might come back, but I'll pass it on. Thanks.

Tom O'Leary: Thanks, Paul.

Operator: Your next question comes from the line of Rahul Anand from Morgan Stanley. Please ask your question.

Rahul Anand: (Morgan Stanley, Analyst) Thanks for the opportunity. First one is related to Sembehun. If you could help me understand - I understand you're working on optimisation studies, but it would seem from commentary that the 300,000 tonne per annum rate is potentially not warranting the amount of CapEx. Does that mean you're now starting to explore a smaller project, i.e., lower production in the future, and perhaps save a bit on CapEx? That's the first one. Then the second one...

Tom O'Leary: Yes, I think we've tried to be pretty specific in the release that we're open to that, we're open to a review of scope, in terms of production target. We're open to mining technique, and open to changing mine plan to minimise tailings storage CapEx. I guess the takeaway is that we're reviewing and revisiting, and broadening value optimisation. We're thinking pretty broadly about it.

Rahul Anand: (Morgan Stanley, Analyst) Okay, just as a follow up to that, then, Tom, if I may. Firstly, how does the World Bank deal work around a change in scope and optimisation? What is the optionality that they have, in terms of saying not to proceed with the project? And then, secondly, talking about the small issues that you've had at Lanti again, just wanted to understand, what's the nature of these maintenance issues? They seem to be recurring a fair bit, so I just want to understand those a bit more.

Tom O'Leary: In terms of the IFC arrangements, the IFC arrangements always contemplated a two-stage investment. So, the first stage has been completed, and a subscription has been made. The second stage is conditional on proceeding with early stage works on Sembahun, and there's no change to that. So, no change.

Rahul Anand: (Morgan Stanley, Analyst) Okay, understood. Then, just quickly on Lanti, before I move on to ZIC, I just had another one on ZIC, thanks.

Tom O'Leary: Sure. On Lanti, we have had some recurring mechanical issues on the mining unit, so what we are doing at the moment, we've put in a specialist maintenance team. I know we've talked about doing that, but as an indicator of sometimes the difficulty of operating in Sierra Leone, is that it's taken quite a while to get that maintenance team visas and the like to travel to Sierra Leone to begin their work. They are now underway, since the beginning of July, and will be there for a period now, both to focus on maintenance of the unit, and also to assist in training.

Rahul Anand: (Morgan Stanley, Analyst) Okay. The zircon-related question that I have is, if we look from top down, we're talking about more ZIC sales in the second half. So, from that, if there's more ZIC sales, does that mean the premium price also perhaps comes off? Then secondly, as a follow up to your answer to Paul, completions should technically start impacting zircon demand, you would think, if at some point the tile and ceramic inventory start to normalise. Is my thinking too simplistic there? What am I missing?

Tom O'Leary: Just to clarify on ZIC sales, I don't think Matt was saying there will be more ZIC sales in the second half. I think we're pretty specific about not guiding in terms of ZIC sales. But, Matt, I'll hand over to you in terms of completions, and also the comment on ZIC versus premium.

Matt Blackwell: Yes, there has historically been a difference in price between standard and premium, and the majority of ZIC that goes into the market is a standard grade product, so it's slightly cheaper. Customers have to process it, and there's other costs involved as well, such as the higher freight costs to get the product to a particular location. So, it trades at a discount on a ZrO₂ basis compared to premium. So, if you're a producer, or want to be a producer only of zircon in concentrate, you have to bear that in mind. But there is still a very good market for premium, and there are many applications that are premium-focused, premium-centric, or premium-only because of the quality requirements you need. So, we're satisfied with that.

On the second question - yes, for the completions, no, it's not simplistic. All I was just saying to Paul was that I wouldn't think about it as something that happens immediately. There's not an absolute - you can't say that there's a two-month lag, or a three-month lag. The supply chain's a little bit longer than that in China. I can't give you the exact timing. But you are right, as completions increase, and people fit out their buildings, tile construction will go up, tile demand will go up, and production must follow. So, no, you're not being simplistic, Rahul.

Rahul Anand: (Morgan Stanley, Analyst) Okay. I had a few more, but I might queue up again, so I'll pass it on, thanks very much.

Tom O'Leary: Thanks, Rahul.

Operator: Your next question comes from the line of Hayden Bairstow from Macquarie. Please ask your question.

Hayden Bairstow: (Macquarie, Analyst) Thanks, Tom. Just a couple from me. Firstly, just on the rutile market, it's looking reasonably better, I guess. Is there any way you can look at accelerating SR1, if you're pulling back a little bit, or delaying any potential growth out of Sierra Leone? Then also, just on the lower-grade zircon products, do you save much on cost by not chasing the higher grade, or does it actually cost you more money to do that? Some kind of indication of what that does on the cost side of things, please.

Tom O'Leary: Thanks, Hayden. On SR1, I don't really have an update for you. We continue to progress technical studies in terms of ensuring that once we have everything in place, we're able to accelerate that project and bring that kiln up as quickly as practicable. But, yes, the key for that remains to be sourcing feed stock, so we're continuing to push that. On the cost of standard, it certainly is cheaper to produce. I wouldn't say it was a substantial saving, but it certainly is cheaper to produce on a unit cost basis.

Hayden Bairstow: (Macquarie, Analyst) Okay. Just on that lower-grade market, then, is that some of the increased supply from Indonesia and elsewhere, are they just putting more heavily discounted lower-grade products in, and that's put - that's where the pressure has come from, or is it literally more of a customer thing, trying to lower costs?

Tom O'Leary: It's a little bit of both. There's certainly pressure from downstream users to reduce costs, but there always is. I think it's really a function of the additional concentrates that have been mobilised into the market, creating, as I said, a modest surplus in that standard grade product, which has put pressure on that standard pricing.

Hayden Bairstow: (Macquarie, Analyst) Okay, great, thanks for that.

Operator: Your next question comes from the line of Jack Gabb from Bank of America. Please ask your question.

Jack Gabb: (Bank of America, Analyst) Hi, Tom. Just two quick questions from me. Firstly, just in terms of your rutile guidance for this year, and the Lanti issues, is the 280,000 tonnes still intact? Obviously, second-half weighted, but just how confident you are on that guidance?

Tom O'Leary: The rutile guidance for 280? There's no change to our guidance, Jack, in terms of Sierra Rutile or otherwise. **[Previously disclosed February 2019 - Outlook – Group: 2019 Rutile Production: 210 kt (of which Sierra Rutile 2019 Rutile Production: 150kt)].**

Jack Gabb: (Bank of America, Analyst) Okay. Then, just on Sembehun, is there now - is it apparent as well that there's going to be a gap from when Lanti and Gangama finish, sort of 2022, 2023, and before Sembehun steps up? Also, just on Sembehun, are you looking at reviewing the carrying value?

Tom O'Leary: Yes. Just on the first one, no it's not apparent that there's going to be a gap. We're still working through our mine plans and the like. In terms of carrying value, we'll obviously assess that at the appropriate time, but I'm not anticipating at this stage that there'd be any sort of impairment.

Jack Gabb: (Bank of America, Analyst) Right. Thanks very much.

Operator: Your next question comes from the line of Paul McTaggart from Citigroup. Please ask your question.

Paul McTaggart: (Citigroup, Analyst) At the tails in monazite, because you're talking about potential first sales in Q3 2020, which is not that far away. In terms of the scale, I read some of the materials that were lodged with the WA government, and you were talking about Stage 1, a single concentrate, and the numbers that I recall were about 100,000 tonnes per annum. So, I just wanted to get a sense of the scale you envisage, and then, how do you think the

pricing might work for this? Will we get full value for the zircon and monazite? How should we think about the pricing of that product?

Matthew Blackwell: Paul, it's Matt here. So, a couple of things. First of all, the approvals document lodged relate to the size of the plant and its capacity. There aren't plans at the moment to run it at - every day for 24 hours, so the capacity will be less.

Paul McTaggart: (Citigroup, Analyst) Matt, my recollection was a 300,000-tonne plant, but the document said you were envisaging a 100,000-tonne plant. Is that right?

Matthew Blackwell: In that order, yes. In Stage 1. But in terms of where we are at the moment, and we're well progressed in securing offtake agreements for a significant portion, and certainly an amount that gives us a satisfactory, in fact a very comfortable return on the investment. What I'd say in terms of the pricing, without disclosing the mechanisms, we will get pretty close to full odds for the zircon, and in terms of the monazite, there is a pricing mechanism that we have developed with our customer that allows us to achieve a good return and fair value for the contained materials, bearing in mind that we are not taking it through to a finished product.

Tom O'Leary: We'll provide some more details, Paul, on that, in time, once it's approved.

Paul McTaggart: (Citigroup, Analyst) Yes, okay, all right.

Tom O'Leary: And finalised, yes.

Paul McTaggart: (Citigroup, Analyst) I just - maybe while I'm on the topic. So, that was Phase 1, and then Phase 2, and you were talking about separating out the concentrate. Does that require - I mean, is that a difficult process, or is it just relatively simple to do?

Matt Blackwell: Paul, we're focused on Phase 1 at the moment, and as Tom said, getting the final approval for that. Then we'll talk more about Phase 2 once we've locked in Phase 1. It's a simple process.

Paul McTaggart: (Citigroup, Analyst) Okay, all right.

Operator: Your next question comes from the line of Glyn Lawcock from UBS. Please ask your question.

Glyn Lawcock: (UBS, Analyst) Good morning. Tom, I was just wondering if you could remind us, what does Sierra Rutile look like without Sembehun? Let's assume you pushed out the study, just wondering what the production rates we can expect from the existing business, now that you've finished the projects there?

Then secondly, just with the delay, I note that the \$330 million of CapEx guidance for this year included early works for Sembehun, so do we expect to see some reduction in CapEx as well for this year? Thanks.

Tom O'Leary: Yes, thanks, Glyn. On the ongoing production rates from Sierra Rutile, we have a constraint going forward in our MSP, and that's really regarded as being capped out at around 175,000 tonnes per annum. So, that's probably the constraint going forward, following the ramp up of the Lanti and Gangama expansions. In terms of CapEx, with pushing out early works; that was, as you indicated, factored into this year's CapEx guidance, so there is a reduction, yes.

Glyn Lawcock: (UBS, Analyst) Okay, thanks. That's all.

Operator: There's no more questions at this time. Again, if you wish to ask a question, please press star one on your telephone, and wait for your name to be announced. 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) Hi Tom. Two things. Firstly, just to follow up on the monazite comment by Matt, did you say one customer only, you were in discussions with on monazite?

Matt Blackwell: I did.

Peter O'Connor: (Shaw and Partners, Analyst) So is that the limit of the customer pool out there, or is this the one you're focusing on with regarding to the current contracts?

Matt Blackwell: No, it's the one we're focusing on in relation to the current contract, Peter.

Peter O'Connor: (Shaw and Partners, Analyst) Does zircon - get past the utilisation and incentive pricing, what is the capacity utilisation in the zircon industry at the moment? You talked about it in rutile, pigment. Where is it...

Matt Blackwell: Say that again.

Peter O'Connor: (Shaw and Partners, Analyst) Capacity utilisation in the zircon market, at this time?

Matt Blackwell: If you're talking about milling, as the biggest consumer of zircon, there is significant overcapacity, but there has always been.

Tom O'Leary: It's not a driver of underlying feed stock consumption in the same way that it is - that pigment plant utilisation is in the high-grade feedstock market.

Matt Blackwell: It's a very different cost structure, you don't have fixed cost absorption issues.

Peter O'Connor: (Shaw and Partners, Analyst) So, it doesn't talk to productivity in the utilisations at that point, okay, got it. The ZIC issue, and incentive pricing, is the price of zircon generally incentivise the level of ZIC? So the ZIC incentive pricing levels in the zircon market, which has created that supply response?

Tom O'Leary: Yes, we have. We have created a response from ZIC, and there is more zircon in concentrates coming into China, and as I've said, that's contributed to standard grade product. I think, what will happen in the future is another question. A number of those concentrate producers that can produce concentrate have done so and put it into China. As we've said, we can produce that material from our own ZIC stockpiles for next to nothing, and with no additional capital. So, as a result, I'm not convinced that there will be much more concentrate coming into the market on a run rate basis, at least.

But you can't predict the future. To the extent there is more product, we'll act rationally in response to the market and competitor actions. What looks like a modest surplus, or a potentially modest surplus of standard product this year - there's some chatter on the line, if somebody could put that on mute, it would be helpful. Yes, as I say, I think there's potentially a modest surplus of standard this year, and that calls for a measured response, and that's what we're doing.

Peter O'Connor: (Shaw and Partners, Analyst) Okay, thank you, Tom.

Tom O'Leary: Thanks, Peter.

Operator: Again, if you wish to ask a question, please press star one on your telephone, and wait for your name to be announced. Okay, there's no more questions at this time. I'll hand back the conference over to today's presenter, please continue.

Tom O'Leary: Okay, thank you. Thanks again for joining us today. I hope you found that useful. I look forward to talking to you again on the release of our half year results on 21 August. Thank you.

Operator: Ladies and gentlemen, this concludes our conference for today. Thank you for participating. You may all disconnect.

End of Transcript