Turquoise Hill

Q2 2022 Financial Results

August 05, 2022

CORPORATE PARTICIPANTS

Roy McDowall, *Head, Investor Relations and Corporate Communications*

Steve Thibeault, *Interim Chief Executive Officer*

Luke Colton, *Chief Financial Officer*

Jo-Anne Dudley, *Chief Operating Officer*

CONFERENCE CALL PARTICIPANTS

Orest Wowkodaw, *Scotiabank*

Ralph Profiti, *Eight Capital*

Dalton Baretto, *Canaccord Genuity*

Craig Hutchison, *TD Securities*

PRESENTATION

Operator

Good morning, everybody, and welcome to today's conference call for Turquoise Hill Q2 2022 Financial Results. My name is Drew, and I'll be coordinating your call today.

I'm now going to hand over to Roy McDowall to begin. Please go ahead.

Roy McDowall

Thank you, Drew. Good morning. I'm Roy McDowall, Vice President of Investor Relations Communications. Welcome to our Second Quarter 2022 Financial Results Conference Call. On Thursday, we released our second quarter results press release, MD&A and financial statements. These items are available on our website and SEDAR.

With me today on the call is Steve Thibeault, our Interim CEO, Luke Colton, our CFO, and Jo-Anne Dudley, our COO. This call and presentation includes certain forward-looking statements and information. We refer you to the forward-looking statements section of the annual information form dated March 2, 2022, as supplemented by our MD&A for the six months ended June 30, 2022.

Now, I'd like to turn the call over to our Chief Executive Officer, Steve Thibeault.

Steve Thibeault

Thank you, Roy. Good morning, all, and thanks for joining us for our second quarter 2022 earnings call.

Turquoise Hill made substantial progress and achieved several significant milestones in the first half of 2022. Following the first quarter inflection point of the blasting of the undercut of the Oyu Tolgoi underground mine in January, we build a bond upon this positive momentum during the second quarter with the firing of the first drawbell ahead of schedule in June and have now fired the first three drawbells sooner than expected.

While we continue to forecast sustainable production in the first half of 2023, the timing of when we will achieve this key milestone is trending earlier.

Other first half 2022 highlights include: an All Injury Frequency Rate of 0.2 per 200,000 hours work; an increase in our gold production guidance from a range of 135,000 to 165,000 to 150,000 to 170,000 ounces of gold; on-site concentrate inventory returned to target levels; the force majeure declared to project lenders in March 2020 and the force majeure declared to customers in March 21 was lifted.

The 2022 cost and schedule update for the underground project was completed, confirming the total development capital expenditure expectation of $7.06 billion. Turquoise Hill and Rio Tinto agreed to amend their comprehensive funding arrangement to, among other things, provide interim debt funding from Rio Tinto to address the company's near-term estimated funding requirements and to extend the date by which Turquoise Hill is required to raise additional equity capital.

Turning to Slide 7. In the second quarter of 2022, Oyu Tolgoi produced 30,600 tonnes of copper in concentrate and 47,600 ounces of gold in concentrate from processing ore from the open pit, the underground and stockpile.

Second quarter production was in line with our expectation. As noted above, we have increased our forecast gold production for 2022. The mill throughput of 9.7 million tonnes in Q2 '22 was 1% higher than Q1 '22 and 3% higher than Q2 '21, again, in line with expectations. The open pit optimization works continues with final result expected in Q3 of this year.

COVID-19 cases identified at Oyu Tolgoi trended downward and have continued at low levels. As consequence, the testing regime has been eased, pre-site mobilization testing has eased and mask-wearing is now required in high-risk settings only. With the improvement in COVID case load, Oyu Tolgoi has been able to progressively increase on-site personnel numbers with the workforce in Q2 '22 approaching full capacity. Ongoing monitoring of COVID-19 cases continues and control will be reviewed as necessary.

Since the first blasting of the undercut on January 25, the underground team has been able to keep on or ahead of schedule despite the initial delays to the undercut, and we maintain our expectation to achieve sustainable production in H1 2023.

With that, I will now hand the call over to Luke Colton, our Chief Financial Officer.

Luke Colton

Thanks, Steve, and good morning to everyone. If you can please turn to Slide 8, I'll provide a summary of our key finance metrics for Q2 '22.

Starting with revenue. Revenues of $402 million in the second quarter of '22 were 21.9% higher than for the same quarter of 2021, and that's due to an 89.3% increase in concentrate sales with the easing of COVID-19 restrictions at the border, and also the use of double trailers to ship concentrate. Higher revenues also benefited from a 3.1% increase in average gold prices. On-site inventory levels have returned to target levels by the end of Q2 '22. The higher concentrate sales volumes were partially offset by a 1.8% decrease in average copper prices and by lower copper and gold head grades from the planned transition of mining to the next phase of operations and from processing lower grade stockpile material.

Cash generated from operating activities before interest and tax of $315.4 million in Q2 was 54% higher than the second quarter of 2021, and that's due mainly again to the impact of higher shipment volumes as a result of the easing of restrictions as well as the higher gold prices, partially offset by inflationary pressure on prices for critical supplies. Income attributable to owners of Turquoise Hill decreased from $0.51 per share in Q2 '21 to $0.41 per share in Q2 '22.

The higher revenues and tax benefits were more than offset by the impact of higher cost of sales as the higher volumes of concentrate shipped contained lower metal and concentrate, following the planned transition of mining from higher to lower grade areas of the open pit. Cost of sales was also impacted by inflation and higher input prices. A $9.8 million tax benefit was recorded in Q2 '22 versus a $19 million charge in Q2 '21. The recognition in Q2 '22 was largely due to an increase in temporary differences on property, plant and equipment.

Q2 '22 C1 cash costs and all-in sustaining costs were also impacted by higher cash operating costs and lower copper produced due to the planned transition of mining from Phase 4B to Phase 5A. All-in sustaining costs were further impacted by a $23.8 million increase in capital expenditure on surface operations, and that's due to higher maintenance componentization, higher deferred stripping from the planned change in mine sequence and commencement of the GSK road construction.

Expenditures on property, plant and equipment of $260.9 million for Q2 '22 comprised $218.2 million relating to the underground, and that includes $85.9 million in underground sustaining capital, as well as capital expenditure on service operations of $42.7 million. Q2 '21 capital expenditure was $227.4 million.

If I could ask you to all turn to Slide 9. You'll see our liquidity decreased from $0.6 billion in March 31, 2022, to $0.5 billion at June 30, 2022. The Company estimates—the Company's estimated base case incremental funding requirement at the end of Q2 '22 was $3.6 billion, and that's an increase of $0.2 billion from the March 31, 2022, estimate. That's impacted primarily by updated commodity pricing assumptions as well as increased LIBOR and inflationary assumptions.

Specifically, TRQ's base case incremental funding requirement incorporates metal price assumptions for copper and gold over the incremental funding period, and we did provide those in our latest MD&A; development capital of $7.6 billion as per the finalized cost and schedule update; the current forecast of sustainable production for Panel 0, which remains at H1 2023; the timing for Shafts 3 and 4 as for the finalized cost and schedule update; $1.8 billion of scheduled principal repayments, which the Company is attempting to reprofile. And the details of these and other items are given in more detail in our latest MD&A, which is available on our website, SEDAR and EDGAR.

The Company continues to focus its efforts on delivering the reprofiling of scheduled principal repayments as well as progressing the other elements of its recently amended funding HOA with Rio, and you can find that on our website, SEDAR and EDGAR as well. As Steve mentioned, the recently secured amendments provide among other things interim term debt funding from RIO to address the Company's near-term estimated funding requirements and to extend the date by which Turquoise Hill is required to raise additional equity capital.

The (inaudible) proposal to take the company private is currently under consideration by the Special Committee of the TRQ Board and its advisers, and related considerations could influence the order, nature, size and timing of the various elements of the funding HOA. Under current base case assumptions, the Company estimate it could still need to raise proceeds of approximately $0.4 billion in addition to the initial equity offering of $650 million contemplated by the funding HOA, and that assumes that the reprofiling SSD and co-lending are delivered successfully.

Any significant further delays to the underground project or nonfulfillment of any of the conditions precedent identified in the funding HOA could also have an impact on the Company's ability to fully implement its comprehensive funding arrangements and may increase the quantum of additional equity that would need to be raised.

Additionally, the Company continues to monitor, among other things, commodity markets, the ongoing impacts of COVID, the underground and drawbell progressions, as well as progression of the other key underground development milestones. So, the Company's liquidity outlook and estimated incremental funding requirement will continue to be impacted either positively or negatively by various other factors, many of which are outside of the Company's control.

With that, I will hand the call over to Jo-Anne Dudley, our COO.

Jo-Anne Dudley

Thank you, Luke. If we now turn to Slide 10. This quarter, finalization of the 2022 cost and schedule update reconfirmed underground development capital at $7.06 billion and expected commissioning of Shafts 3 and 4 in the first half of 2024. Q2 2022 also saw the firing of the first two drawbells with the third fired on July 29, all ahead of schedule. Personnel numbers continued to return towards target levels as we move towards a COVID-normal environment.

For underground development, we've continued on materials handling infrastructure to support the underground mine post ramp-up of Panel 0, and on the sinking of Shafts 3 and 4, which on July 3, had reached depths of 193 and 298 meters below ground, respectively. Underground operations completed 26.1 kilometers of undercut drilling and over 2 kilometers of drawbell drilling in the quarter. Q2 also saw over 8,000 square meters of undercut blasting with materials hoisted from Shafts 1 and 2 above expectations.

Turning to exploration, 2022 field work included mapping, sampling, and a magnetic survey was completed in Q2. At the bag license, field work is scheduled to be completed in Q3, including the drilling of two diamond drill holes. I expect to be able to share updated results of note from the field work in the second half of 2022.

If we turn to Slide 11, we can see the key near-term milestones for Panel 0 as well as the critical activities to enable the ramp-up of production to 95,000 tonnes per day. Important milestones for 2022 include the first drawbell firing in Panel 0, which was completed in the second quarter. Sustainable production for Panel 0 is still expected in the first half of 2023, trending earlier within that timeframe than previously expected.

The cost and scheduled reforecast reconfirmed the expected commissioning dates for Shaft 3 and 4 in the first half of 2024, approximately 15 months later than the definitive estimate. Changes in mining scope as well as COVID-19-related work restrictions impacting both Shafts 3 and 4 as well as underground development progress are expected to cause delays in the commencement of Panels 1 and 2.

Now that the cost and scheduled reforecast has been completed, work to confirm the timing of the first drawbell in Panels 1 and 2 is now underway. But the shaft delays are not expected to result in equivalent delays to Panel 1 and 2 given the current underground development approach and further mitigation opportunities under investigation. The impact of the additional shaft delays on the commencement of Panel 1 and 2 is under assessment and expected to be known during Q3 2022.

With that, I'll now hand the call back over to Steve.

Steve Thibeault

Thank you very much, Jo-Anne. As I stated in my opening remarks, we made significant progress in the first half of the year for the benefit of all Turquoise Hill stakeholders. Following the positive trends we set of our relationship with the Government of Mongolia and the blasting of the undercut in Q1, we have confirmed the cost and schedule of the underground project, we have begun firing the drawbell ahead of schedule, we continue to forecast sustainable production in the first half of 2023, we have raised our 2022 gold production guidance, our on-site concentrate inventory level had returned to target levels and we have amended the TRQ Rio Tinto funding arrangement to provide interim debt funding and extend the date by which TRQ is required to raise additional equity capital.

Oyu Tolgoi is progressing on many fronts and delivering against the milestones we have set out, and we look forward to ramping up the underground and becoming one of the largest copper producer in the world for the benefit of all stakeholders.

With that, I would like to turn the call back to the Operator for questions.

Operator

Thank you. Our first question today comes from Orest Wowkodaw from Scotiabank. Your line is now open.

Orest Wowkodaw

Hi. Good morning. Jo-Anne, I was wondering if we can get some color on what this new mine plan coming out in Q3 is going to contain. I'm wondering specifically, if at all, if it will disclose year-by-year production ramp-up type expectation for both in the combined open pit and underground along with things like sustaining capital on a year-by-year basis. I'm wondering how much detail this report is going have for us.

Jo-Anne Dudley

Thanks, Orest, for your question. So, we regularly see updated plans, and it's certainly a regular occurrence as we understand more of how the plan for the mine comes together when—as things change. So, we continue to see the mine design refinements, the list when coming together. As we stated, we're working on understanding the impact of the updated timing of Shafts 3 and 4 as well as some mine design refinements of Panels 2 and 1, aiming to reduce risk to the ramp-up.

So, over time, we will see parts of that plan, those changes in design, move into the plan. Now, Q3 won't contain all of those updates. So, we'll need to make a judgment at the time and engage with our team to understand whether we would provide a detailed understanding of ramp-up over a longer period, but we certainly will provide the most accurate information at the time that we can.

Orest Wowkodaw

Sorry. Does that mean that it may not contain kind of an outlook for the next couple of years for things like sustaining capital and production?

Jo-Anne Dudley

Yes. So, we usually would provide—we have a timetable, obviously, to provide that information. For example, guidance in January of each year. So, we have a cadence that we work to on some of those things. Just in particular, in terms of ramp-up, we still are continuing those mine design refinements into 2023, so some of Panels 1 and 2. As a result, we're still working out the details of those sequences, for example, for those areas of the mine. So, we'll provide the updates that we can, and we are providing a current update in Q3. We expect to see updates to the mine plan, as you would regularly see on a project like this and of this magnitude.

Orest Wowkodaw

Okay. Okay. Thank you. Just one more, if I may. And Steve, this one's for you. It's been—we're coming up to almost five months here since the proposed plan of arrangement was disclosed by Rio Tinto. Where do we go from here in the sense that I'm surprised just the length of time has passed here? How should investors sort of think about what the next steps are here for the special committee? I mean, can this just go on indefinitely?

Steve Thibeault

No. I mean, Orest, I'm sure it's a question that a lot of people have, okay? But, you understand that the special committee, I mean, they're involved in a substantial and detailed process involving a very complex Tier 1 asset, okay? That's a long life of mine. It's a lot of different characteristics, okay? I'm confident that the special committee is taking the time it needs to have all the information and data it requires to make the right decision, and that's in the best interest—for the best interest of our minority shareholders, okay?

But that being said, the special committee, I mean, when they will—like they said before, okay, they will provide further comment when disclosure is required or appropriate, and I'm sure that when they will have a material development, that the special committee will advise the market and our shareholders on a timely basis.

Orest Wowkodaw

Okay. Does this new mine plan that's coming out in Q3, is that—do you think that's part of the analysis or perhaps something that the special committee is waiting for in terms of trying to establish the appropriate valuation for the company? Or are they not related?

Steve Thibeault

No, I would say, Orest, they're not related because we're looking really for the overall long term, okay? I think the mine plan will be reshuffling a couple of elements about what will be the impact. I mean, some elements will be considered, but I wouldn't say the key element is not to wait for that one. I want to be clear, it's not to wait for that one for—in order to make a decision or discussion, okay?

Orest Wowkodaw

Okay. Thank you very much.

Steve Thibeault

Thank you, Orest.

Operator

Our next question today comes from Ralph Profiti from Eight Capital. Your line is now open.

Ralph Profiti

Great. Thanks Operator. Good morning, Steve.

Steve Thibeault

Good morning, Ralph. How are you?

Ralph Profiti

I'm well, thank you. I have two questions. One for Jo-Anne and one for Luke. Maybe I can start with Jo-Anne. Presumably, Jo-Anne, you do have a drawbell schedule to get you to the 16 to 21 drawbells, and I'm wondering how we should be thinking about that. Is this sort of something that's linear? You know, one every, say, three weeks or so? Or, does the increase that come with this geotechnical assessments to allow you to increase the rate of drawbell initiation between now and the first half of 2023?

Jo-Anne Dudley

Thank you Ralph for your question. So, we're just at the beginning of undercutting and drawbell construction, and the teams are both learning about our ground conditions and how to best optimize our progress, as well as understanding our geotechnical conditions. We expect that, over time, the rate of drawbell construction will ramp up. Initially, it is expected to be a steady rate, averaged over more than, say, three weeks due to the geometry of the ground.

So, we have seen good progress. We saw the first drawbell side in Q2 rather than in Q3. We will continue to see progress and a very steady ramp up in the rate of drawbell construction over time out to sustainable production. By the time we're out of that sustainable production, we should be at a fairly regular rate of construction over every month or two. Hopefully, that's helpful.

Ralph Profiti

Yes. Thank you. Okay. Luke, maybe one for you. This additional $400 million in equity proceeds, it appears to be sort of a plug that happens outside the timing framework of the HOA. I was just wondering, in your analysis to get to that number, should we be thinking about that as sort of a 2024 number?

Luke Colton

Yes, I'll do my best to help you answer that question because it is an important one. I think the first thing to mention is, as everybody knows, we do have an obligation to raise $650 million in equity by the end of this year, and that hasn't changed. So, that's still the plan. We did obviously update our funding gap number, and you're right, as we think about how we fill the $3.6 billion, we do believe that there's going to be a need for around $400 million that would come into play given the increase to the funding gap.

But, the exact timing and quantum of that, call it, trailing equity raise is going to be dependent on the other elements of the funding HOA and how they've progressed. So, that would be the things like the advances from Rio Tinto, the reprofiling, the co-lend, the discussion with the lenders around additional supplemental senior debt. All of those things will play into our ability to fill the funding gap and then what the quantum of any final equity raise would be.

You will see from our financial statements and MD&A that we believe when you take into consideration those other elements of the funding HOA, and this would be before any trailing equity raise, we think we have liquidity that will get us until at least June 30, 2023. So, I wouldn't expect that trailing equity raise to happen prior to that. The exact timing, whether or not it's 2020—late 2023, 2024, we still need to—we don't know yet. We need to see how the other things progress. And we need to obviously monitor progress and update our estimates, etc., which we'll continue to do. But hopefully, that gives you a bit of a flavor for what we're thinking and kind of where we're at, at the moment.

Ralph Profiti

Yes. That's exactly what I was looking for. Thanks very much.

Steve Thibeault

Thanks Orest—sorry, Ralph.

Operator

Our next question today comes from Dalton Baretto from Canaccord. Your line is now open.

Dalton Baretto

Great, thanks. Good morning Steve and team.

Steve Thibeault

Good morning, Dal.

Dalton Baretto

I'll start by following up on—I'd like to start by following up on what Ralph was asking there. So, that trailing $400 million, give or take, two questions on it. Number one, like Luke said, it's predicated on that $3.6 billion number. I'm just wondering. You've signaled that you could possibly see sustaining first production earlier in H1. What timing is that $3.6 billion number based on? Does that factor in you coming into sustainable production earlier or not?

Luke Colton

Yes. Listen, I'll try and answer that question and then Steve and Jo-Anne may have to correct me. But our estimate for sustainable production is still H1 2023. We do think there's a possibility for that to trend a little bit earlier within that six month period, and obviously, the calculation of the $3.6 billion takes that into consideration. But that's where we're at, at the moment, and we're not quite in a position where we can be more specific than H1 2023 yet, but we obviously continue to monitor that. If we get to the point where we can be more specific as things progress, and the guys on the ground actually doing the blasting get us a bit more comfortable with the processes, etc., then we'll obviously look to update people.

Let me stop there and see if I misspoke, and if Steve and Jo-Anne want to correct me.

Steve Thibeault

No, the only thing I would add, Dalton, is that definitely, if we're progressing in the sustainable production (inaudible) sooner, okay, that what we—and we said it's progressing in the right direction, definitely, that would have an impact or—it could have a favorable impact, okay? But, to what extent, I'm very careful because we're too early in the process. But this is one variable that could be positive. So, at the moment, we probably took a more, how can I say, I don't want to be conservative, okay, but we took a mid-range approach with the calculation for the $3.6 billion. But it could be positive, but we don't know the magnitude. So, I'm just careful with the—what the—but that could be something that could bring some positive element to that funding.

Dalton Baretto

Understood. Okay. Then maybe switching gears. I mean, we—while the special committee does its thing, we are steadily marching towards December 31. I'm just wondering, while they are deliberating, are you guys proceeding full steam ahead on the debt reprofiling and the incremental senior secured debt? I'm just wondering if we can get an update. Where are you in that process? Is that dependent on the special committee at all? How comfortable are you that you'll meet the December 31 deadline?

Luke Colton

Yes. That's a really good question, and the short answer is we are marching ahead with all of that, right? So, we're not delaying our consideration of the funding HOA and its various elements while the special committee is negotiating the proposal with Rio.

In terms of the specific elements that you mentioned, yes, we are progressing the reprofiling. We're in a sort of regular cadence of sharing information with the lenders and discussing things with the lenders and negotiating with the lenders. So, all of that is progressing at the moment. I would say that—I believe that things still look very positive to be able to complete that reprofiling in advance of that December 15, I think it is, principal repayment. So, quite encouraged there.

Yes, we are definitely in discussion with bankers and lenders and advisers around—and Rio Tinto as well around the other elements of the HOA that needs to be progressed in the short term. So, all of that continues at a very important and as rapid as we can pace.

Dalton Baretto

Great. Thank you for that. Then just one last one for me. Are you free to draw down the full $400 million from Rio while the special committee is still contemplating the proposal?

Luke Colton

Yes. So, that $400 million is not contingent on a proposal outcome. I mean, there are some other conditions precedent. You can kind of see those in the funding HOA that's on our website. But yes, our deliberations and our finalization of that sort of $400 million early advance is progressing well. There isn't anything in the proposal per se or the other elements of the HOA that we're progressing that would prevent us from drawing down on that $400 million or beginning to draw down on that $400 million when we think we're going to need it between now and the end of the year.

Dalton Baretto

Great. Thanks Luke. That's all for me guys.

Luke Colton

Great. Thanks Dalton.

Operator

Our next question today comes from Craig Hutchinson from TD Securities. Your line is now open.

Craig Hutchison

Good morning guys.

Steve Thibeault

Good morning, Craig.

Craig Hutchison

Just a follow-up question on the updated mine plan. I think there was—you guys were looking at doing some optimization work with respect to the open pit and I think moving some metal forward. Will that be included in the updated mine plan? I guess the second question, could we expect an update in terms of the funding gap when you guys release that update?

Jo-Anne Dudley

Okay. Craig, I'm going to take the first part of your question there. So, in terms of the upside mine plan, there will be a full update across the underground and open pit mines as we would always do on an annual basis. There is always optimization we've done. And you're very correct, we did note that there would be optimization work coming, and that will be included. There will be a number of changes, both with the underground and the open pit mine as we always see. As these things come together, then we get to see what the combined outcome is. So, there is optimization work built in across the underground and the open pit, and we're waiting to see what the outcome is of that once the work is complete.

Luke Colton

On the second part of your question there. I think the short answer is that is something that we would be looking to do. It always takes a little bit of time for the mine plan to make its way into the sort of underlying models that we use for calculation of liquidity, calculation of funding gap, etc. So, that might take a couple of weeks. But the intention would be as soon as we can, obviously, and it's probably going to be in conjunction with our Q3 release. But if we're able to do it earlier, that's something we would consider. But yes, the intention would obviously be to update the funding gap for the outcomes of that optimization work and the updated mine plan.

Craig Hutchison

Okay. I mean as a follow-up, the funding gap went from $3.4 billion to $3.6 billion, it's now—the additional plug is $400 million. Can you just talk about that differential there? It looks like there's a couple of extra hundred million dollars of equity. Can you talk about maybe why that is and why wouldn't it be just sort of $200 million of additional equity? Thanks.

Luke Colton

Yes, sure, Craig. Listen, the short answer is it's just refinement of assumptions, right? So, you had the $200 million increase in—and these are all rounded numbers, right? But you have the $200 million increase in the funding gap, and that's off the back of increased—sorry, sorry, this updated commodity pricing assumptions, updated assumptions around LIBOR, updated assumptions around inflation, all of those are the reasons for the sort of first $200 million.

Then when you're talking about the rest, it's just really refinement of the various assumptions as we have more information around how the other different elements of the funding HOA will be delivered and the benefit that each of those different elements will be delivered. So, as we go through the process, we have more information, we're able to refine those assumptions, and that's what's going into—effectively the differential between the $200 million increase in the funding gap and the possible incremental equity raise of—it would round up to $400 million.

Craig Hutchison

Okay. Is there any contingency left on the budget for completing the underground? Or, is it basically down to zero now?

Luke Colton

So, in terms of the contingency, so we've just reviewed all our costs as part of the 2022 cost and schedule update, and there certainly does remain contingency within that updated estimate to project completion. So yes, there is still contingency remaining.

Craig Hutchison

Okay. Thanks guys.

Steve Thibeault

Yes. Thanks Craig.

Operator

Thank you. That does conclude today's Q&A. Therefore, we're concluding today's conference call. That concludes the call for Turquoise Hill Q2 2022 Financial Results. You may now disconnect your line.