S&P Global
Market Intelligence

Antofagasta plc LSE:ANTO

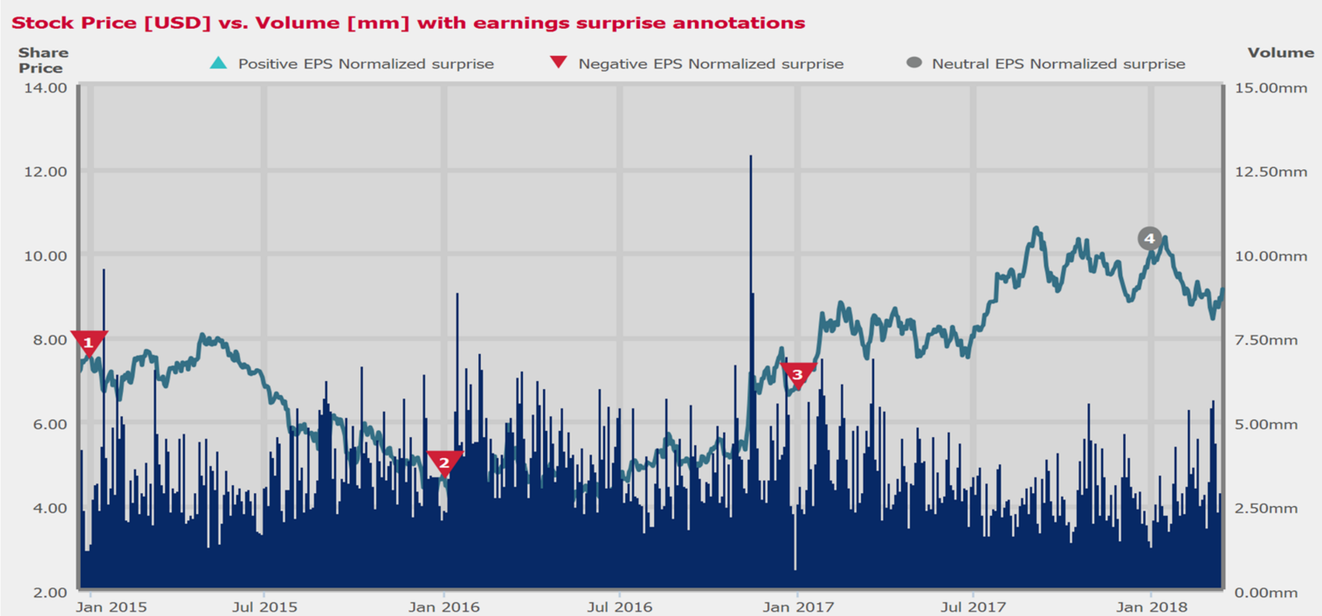
FY 2017 Earnings Call Transcripts

Tuesday, March 13, 2018 9:30 AM GMT

S&P Global Market Intelligence Estimates

	-FY 2017-			-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.76	0.76	0.00	0.92
Revenue (mm)	4714.40	4749.40	0.74	5238.93

Currency: USD
Consensus as of Mar-13-2018 8:13 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FY 2016	0.36	0.35	1 (2.78 %)
FY 2017	0.76	0.76	2 0.00 %

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Call Participants

EXECUTIVES

Alfredo Atucha
CFO and VP of Finance & Administration

Andrew Lindsay

Iván Arriagada Herrera
Chief Executive Officer

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Presentation

Andrew Lindsay

Okay, good morning, ladies and gentlemen. Welcome here to our year-end presentation. I'm Andrew Lindsay. I run the office here in London, as you all know, I think. We have Iván Arriagada, our Chief Executive; and Alfredo Atucha, our CFO, who will take you through our results. Everybody who's on the webcast or the audio conference, you can -- you will be given the opportunity to ask questions at the end of the presentation. Thank you. All right.

Iván Arriagada Herrera
Chief Executive Officer

Thank you, Andrew, and good morning to all. It's great to be here.

So we'll start with the results. I will first like to start with a brief overview of our performance for last year and then our priorities for 2017 (sic) [2018]. Alfredo will take you through the financial performance and results. I then want to talk a little bit about the copper market, how we're seeing the copper market and what's the outlook going forward in our view with a focus on our projects and value creation and return. And finally, I will close with our guidance for the year, and then I'll open it up for questions.

So let me start then by drawing your attention to some of the important achievements that we had during 2017. We think we've had a strong performance last year, and that's one of the highlights of our results, strong momentum which we expect to carry on into this year.

So first of all, I would like to say that we have in '17 achieved our goal of 0 fatalities and have had no serious accident for almost now 2 years, 24 months. This is our first priority, and therefore, this is something that we have been working very hard to maintain as a record. And we'll continue to be very focused on continuing to sustain this very good performance.

We had a solid performance financially. Our EBITDA was up 59% against last year to $2.6 billion. Our margins were up to 54.5%, which is our highest margin since 2012, when the copper price was about 30% higher. Operating cash flow, at $2.5 billion, was 70% up compared to the prior year. This is on the back of higher copper price, higher sales volume but also tighter cost management. Our unit cash cost was $1.25 per pound. These allowed us to reduce our net debt by $615 million, which brings our net debt-to-EBITDA ratio down to 2.2x -- 0.2x. And if you exclude subordinated debt from the calculation, we are, in fact, in a positive cash -- net cash position. So we have effectively fully de-geared our balance sheet in the course of last year.

We also completed, in respect of our projects, the Encuentro Oxide project last year, which, at the cost of $605 million, was, in fact, $30 million below our budget. So that, I think, is also something to point out.

We are committed to keeping our financial discipline and delivering shareholder returns. And we will only pursue [value-accretive] growth and return any excess cash to shareholders. In line with this, the board has recommended a total dividend for this year of $0.509 per share or $502 million, which corresponds to 177% increase on last year's dividend.

So in summary, a strong operating performance in 2017; and financially, something which we plan to sustain the momentum through this year.

Let me now go back to capital allocation -- or talk about capital allocation because this really drives our decision making. So I will take you very briefly through our capital allocation model. We've seen this before. Cash generated is first applied to maintaining our operation, which includes spend in sustaining CapEx and in mine development. And it's then allocated subsequently to pay dividend according to our minimum committed payout ratio of 35% of underlying net earnings. We then consider capital investment in development options with a strict focus on returns, with any excess cash returned to shareholders, typically, by paying a larger dividend. And this is what we're doing this year by paying a total dividend of just over $500 million, equivalent to a payout ratio of 67%.

Let me talk about the outlook and what we're seeing for -- going into this year, 2018. I think the first thing is that we plan to maintain our strong momentum achieved last year. Safety is always our first priority, and we will work hard in ensuring that our fatality-free record continues. We regard delivering on guidance one of our main target. This year, we expect to see a 3% increase in production, and therefore, this is the focus of our operational performance. Grade will reach a low point in quarter 1 2018, with a full year being the same as last year, and then grade will increase next year, in 2019. We're focused on managing our costs with a target reduction of $100 million for this year on top of what we have achieved already. And by the end of 2017, just to mention, our cost saving or cost improvement adds up to $525 million from 2015 (sic) [2014] to '17. Therefore, we are adding another $100 million this year, and this is important to compensate some of the cost pressures that we've seen.

Innovation will play a key role in transforming our company going forward. And to this end, we have developed a technology road map with clear accountability for the delivery of results. Next year -- or this year, sorry, in 2018, our special focus will be on further enhancing our digital collaboration platform that we have established with employees, contractors and suppliers, where many productivity and cost improvements have already come from. This has been an important source of new ideas, which has helped us to reduce costs and improve productivity, and we want to strengthen and keep that.

And in addition, we're stressing the adoption of autonomous trucks in Esperanza, assessing the adoption of autonomous trucks in Esperanza Sur pit, which we expect to begin work, too, in 2018. So technology innovation will play a key part in our productivity journey going forward.

We have one final -- then moving on, we have one final labor negotiation to complete this year, and I will refer to it later.

Finally, during the year, we expect to take the Los Pelambres incremental expansion project to be approved by the board, adding 55,000 tonnes per annum of copper while also reducing mine's cost.

On Centinela, we're considering 2 alternatives for expansion and evaluating their respective returns and risk profiles before deciding which one to take to the next stage of assessment. So organic, brownfield expansion in the medium term, we think, is important for our company, but we will undertake those projects only to the extent that they meet our return criteria, otherwise, we will return that cash to our shareholders.

Finally, then at the end of the year, we will determine the level of our excess cash based on the factors set out in our previous slide, we talked about our capital framework -- capital allocation framework, and then distribute this to shareholders. However, as I've stressed before, we'll always place value and profitable growth over volume in deciding on which projects to invest.

So that's a bit of the outlook and how we're seeing 2018. We want to keep our strong operating performance momentum this year. We have a first quarter with a lower grade, but that's going to turn around, and we see increased grades in the year so that the year will end up with a similar grade as last year. And we're preparing for a higher grade in 2019.

I will then pass it now over to Alfredo, who will talk about our financial performance during last year.

Alfredo Atucha
CFO and VP of Finance & Administration

Thanks, Iván. Good morning, everybody.

Well, firstly, I would like to quickly recap on our solid operating performance in 2017, which were announced in January. While we reached our production guidance for the year, we exceeded expectation on net cash cost. We are particularly satisfied with the Los Pelambres performance. Throughput was up due to its sustained high plant availability. And despite lower grade and higher input prices, we reduced our net cash cost to $1.02 per pound. Additionally, Los Pelambres proposed and agreed a compliance program with the environmental regulator to resolve the charges made in 2016.

Antucoya has its first year operating at full production. And combining with improvement made during the year, this has brought cost down by 8%. We also achieved the completion test on its project finance during the year.

Okay, let's move on our financials, and let's start by looking at our revenue, which rose by 31.1% to $4.7 billion for the year. This increase was primarily due to the increase in the realized copper price, which averaged $3 per pound during the year, 29% higher than in 2016. Higher sales volume mainly at Antucoya also boosted revenue. The moly price was also strong in 2017, and it's currently trading at about $13 per pound, which is a good time to bring the Centinela moly plant onstream.

Now turning to costs. The top graph shows the movement in our cash cost before by-product credit by mine. Cash costs compared to last year are up $0.06 per pound. Los Pelambres increased group cash costs by $0.04; and Centinela, by $0.02, as grade decreased at both concentrate operations. By-product credits were $0.35 per pound for the year, slightly higher than in 2016, which brought our net cash cost to $1.25 per pound.

In the bottom graph, you can see the driver of the changes in our cash costs. Our successful Cost and Competitiveness Programme reduced costs by $0.11 per pound during the year, which offset 65%, 65% of the other cost increases, most notably the impact of the exchange rate and input prices.

Over the last 4 years, while we have been running our Cost and Competitiveness Programme, we have reduced our gross cash costs by 13% despite our average grade declining by 16% during the same period. This is a saving of almost $525 million of annual mine-site cost.

For 2017, we set a target of $140 million, and we exceeded that target, achieving $166 million, which is equal to $0.11 per pound in saving and productivity improvement shown in the previous slide. To date, Antofagasta's positioned in the second quartile of the cash cost curve, and we are committed to continue working to improve our cost position.

Effectiveness of our Cost and Competitiveness Programme is represented in this graph, which show our cost position with and without our program saving against the 2017 industry cost curve. The program has a target for this year, 2018, of $100 million saving.

Now returning to our financials. EBITDA rose by $960 million or nearly 60% to $2.6 billion in 2017. This was driven primarily by the higher copper price. Mining costs have also increased because copper sales volume have increased. Additionally, in 2017, we have spent $25 million more on exploration and evaluation. Our associate and joint venture have also contributed to the increase, with EBITDA $52 million higher than in 2007 -- '16, mainly due to Zaldívar. As Iván mentioned earlier, in 2017, our EBITDA margin has increased strongly and has returned to over 50%, and we aim to maximize this margin.

Total CapEx for the year on a cash basis was $899 million, in line with the $900 million guidance for the year. This will increase to $1 billion this year as sustaining CapEx capital increases by $150 million, explaining by a concentration of scheduled mine fleet replacement and tailing dams with [enlargement costs]. On development, about $100 million is expected to be spent on Los Pelambres incremental expansion.

When controlling sustaining capital expenditure, we use sustaining CapEx per tonne of copper produced as a key metric. And although we quote this figure on an annual basis, it is more appropriately considered, on a rolling average basis, our sustaining CapEx is irregular year-on-year. So over a 5-year period, we expect it to average around $400, $450 per tonne; and for the 5 years to 2018, the average is $430. This figure do not include Zaldívar as it is accounted for as a joint venture. But capital expenditure there, on an attributable basis, was approximately 5 -- $51 million in 2017.

Moving on to cash flow. As mentioned earlier, higher EBITDA contributed very strongly to this year cash generation. Our cash balance at the end of 2017 was $204 billion higher -- $204 million (sic) [$203 million] higher than last year after paying nearly $500 million of scheduled debt repayment and $900 million in capital expenditure plus various other outflows.

The strong free cash flow has further strengthened our gross net debt position, reducing it to slightly over $450 million at the end of the year, over $600 million lower than at the end of 2016. If we exclude our subordinated debt, which is gross equity, then the group has a net cash of $85 million.

On a gross or consolidated basis, our net debt/EBITDA is 0.2x, down from 0.7x at the end of last year. On an attributable basis, the net debt position is even stronger as most of our debt is shared by our subsidiaries, which have minority partners. And most of our cash is held at the corporate level.

Value and profitable growth over volume. So let me conclude by summarizing the 3 pillar which underpin our investment case. These are our large copper asset base, our focus on costs and our capital discipline. We have a large resource base in 2 mining districts in Chile, Los Pelambres and Centinela, which are the source to -- of over 80% of our production. This lie at the heart of our business and offer us a significant range of options. This is the root of our organic growth.

We have rebased our costs and concentrate on improving our operating efficiencies and our margin through the combined application of our Cost and Competitiveness Programme and, in the longer term, achieving further savings and productivity gains through innovation. For example, we are working with innovation start-ups, partnering with them on the development of novel solution for some of our key challenges, for example, using AI to reduce operating variability in key plant equipment, including water recovery optimization from tailings.

We are committed to maintaining our financial discipline. We have low debt levels and have a flexible and robust balance sheet. Discipline in everything we do is key, and we have discipline.

I would like to pass you back to Iván. Thank you very much.

Iván Arriagada Herrera
Chief Executive Officer

Thank you. Okay, so I will move on now to talk a little bit about the outlook on the copper market and some other topical issues, including labor relations and growth.

So on the market, I think -- I mean, 2017 was a good year for the copper market. We saw -- or have -- and are seeing synchronized global growth, especially in the major economies and continuing growth in emerging economies, particularly in China, which is very important for the copper demand. China, as we know, with its reform, it's rebalancing away from investment into consumption-led growth. And for copper, this is an equally strong trend as copper is widely used in consumable and durable goods, which is the fastest-growing category as average income rise and discretionary spending increases. We expect that copper demand in China will grow at rates between 2% and 3% annually from the very large base of consumption today. And I think if you look back at 2017, probably physical copper demand in China did surprise us to the upside. We were expecting growth rates similar to this 2% to 3%. The information on data we've gathered so far in the field is that's probably been closer to 4%. So that's been a good piece of good news.

Additionally, copper is a key commodity in a low carbon emission world and particularly in electric vehicles and renewable power. And this is something that has been talked a lot recently how fast adoption of clean transport will happen is something that we don't speculate too much about. But obviously, these numbers can be significant. Today, around 200,000 tonnes of copper go into clean transport out of a market of around 20 million tonnes. And conservative estimates would suggest that this can actually increase to around 2 million tonnes by 2030. So it's a tenfold increase in a tight market that's quite significant. So on the supply side, we expect to continue to see a constrained market.

Another feature of copper which we know well is a declining grade, which means that an equivalent of a mid-sized mine actually is taken out of production every year despite that everybody continues producing, and therefore, this is an element which is important in our industry cost curve and has been in the past. And then in the short term, there is potential for disruptions in failed labor negotiations in Chile and Peru and the impact of constraints in post -- on the import of some categories of scrap into China and the weaker dollar. So as a result, the outlook for 2019 and beyond for copper, we think, looks more positive today than it did a few years ago.

Labor relations. Here, I would like to say that there is a concentration of labor negotiations in Chile in the course of 2018. With respect to Antofagasta, we have basically completed our labor negotiations for most companies except Pelambres. So we did them for Antucoya, Zaldívar and Centinela. And in the case of Pelambres, we completed the negotiations for the plant union. The one that we are undertaking today is the one at the mine. And what's happened there is that we have submitted a contract proposal; and after some negotiation period, it has been voted against; and therefore, where we're into now is a period of mediation, which involves a further space for negotiation and agreement. And we're working then in the course of this week and next week through that mediation period. I don't want to preempt the outcome of that process. Obviously, if there is agreement, then we will enter into a new contract at the end of that period. If there is no agreement, then there is the possibility of there being a strike at Pelambres. But that's the process that we have and are undertaking now. And I think without, as I say, preempting the outcome of that process, we have a history of good labor relationships in Antofagasta. And I think that's on what we're building for as we enter into these discussions and conversations. So that's on labor relations, and I'm happy to take your questions further on this point.

Moving on to the growth and investing through the cycle, I'd like to take you a bit more into a historical perspective here. In 2015, we acquired 50% of Zaldívar. And I can refer to that further, but we're pleased to where Zaldívar is going. We have reduced cost and are working very hard on improving recoveries, which we think are achievable in Zaldívar.

In 2016, we finished the construction of Antucoya, our newest greenfield project, which is now producing at full capacity. On 2017, this past year, Encuentro Oxides came into production below budget. We were $30 million below budget. And we will soon be also benefiting from the new moly plant at Centinela, which is coming into production now and as a second source of molybdenum production to our portfolio while also reducing Centinela unit costs. These recent investments through what has essentially been the downturn of the cycle will now account for about 25% of our total production and will make a significant contribution, therefore, to our business.

At the same time, as we have been investing in mining projects, we have been divesting of some of our non-mining assets. In 2015, we sold our water division for close to $1 billion. And in 2016, we disposed of our interest in Alto Maipo, reducing the cost of its long-term PPA with the Los Pelambres. We're now also monetizing the value of some of our transmission line infrastructure and equity investments in minor power assets. Remaining focused is a part of our strategy; and on our mining assets, our core activity. Looking forward, we have the expansion of Los Pelambres and Centinela, and let me now take you through that in a bit more detail.

So in the case of Pelambres, let me start with Pelambres. We have the Phase 1 of the incremental expansion, where we will seek to maximize throughput within the existing tailings and waste disposal permits. This will involve investing in new grinding and flotation circuit to counter the increased hardness of the ore. We will also, as part of this investment, construct a 400 liter-per-second desalination plant, which is sized to serve the needs of both Phase 1 and Phase 2 plant expansion but also to serve as a backup facility for the existing operation in the case of continued or severe drought. The EIA for the project was approved last month. We're pleased with that, and this expansion will increase Los Pelambres production by 55,000 tonnes per annum. The project capital estimate has recently been updated with current pricing projection, advanced detail engineering and a project execution plan to a revised estimate of $1.3 billion. This figure includes both the concentrator plant expansion of $780 million and the desalination plant and water pipeline of $520 million. The project is robust with strong returns on our most profitable asset. This is the first phase to unlock further value at Los Pelambres, which is a low-cost, expandable, world-class asset with close to 6 billion tonnes of resource equivalent, 3x the current mine plan. So a great asset, we think, which we will start developing further into the future.

Now what we're doing in Pelambres is that we're focusing on some ancillary permits that we need to get, so we can take the project to the board for approval in the second half of this year, but this is without affecting our first production, which is still scheduled to commence in 2021.

Subsequent to this, the Phase 2 is a further throughput expansion to 205,000 tonne a day, which will increase tailings and water dump capacities, extending now the mine of a life (sic) [life of mine] by about

15 years and adding 35,000 tonnes of copper a year. So Phase 1, within the existing waste and tailings dam permits; Phase 2 will extend the mine life on what we think is one of the best in the world.

Let me talk about Centinela. So in the case of Centinela, we have 2 alternatives for expanding Centinela. The first alternative is to build a second concentrator with a 9,000 tonne-per-day throughput capacity, which would produce about 180,000 tonnes of copper equivalent a year. We have decided, however, to look into an alternative of just expanding the existing plant instead of building a new concentrator plant. We think this would be a lower CapEx and lower construction and project execution risk project. We're now completing the studies for this option, and we expect to be able to decide on which alternative to proceed by the end of this calendar year. If we decide to proceed with the expansion of the existing plant, we will then need to complete a full feasibility study before taking it to the board for approval, which we think will take some 18 months.

So that's on our projects. As I say, we will continue committed to profitable growth over volume and be very return focused on our choices in deploying capital.

Let me now just go to guidance as -- to finalize the presentation. In terms of guidance, we announced these figures last month with our quarterly production report. But just to recap, in 2018, we are expecting a 3% increase in production -- in copper production against last year, 2017. In terms of net cash cost, we expect to be close to $1.35 per pound, largely reflecting a local -- a stronger local currency; although in the first quarter, they're also impacted by lower grade at Centinela. During the year, you will see our production start low -- on lower grades and grow quarter-by-quarter. And at the same time, our costs will decrease to reach the annual figures I've just given. In the first half of the year, we expect to produce about 45% of the full year production, and this is something that we've -- we want to give guidance on. So our profile during the year, we are expecting for the full year a 3% increment in production. But as grade increase throughout the year, geared towards the second half, so expecting the first half approximately 45% of annual production.

So going back then to this year's priorities, we want to sustain our strong operating momentum in this 2018. Zero fatalities comes first, and therefore, achieving 0 fatalities and keeping that record is paramount in our business; delivering on guidance, a 3% copper production increase against 2017; achieving more gains in productivity and savings, we think, irrespective of where we are in the price cycle productivity and safety is something we will never stop working and focusing on; successfully completing labor negotiations at Los Pelambres, as we've said, we've got that ongoing at the moment and mediation; advancing both the Los Pelambres and Centinela expansion projects to the next decision points; and then distributing excess cash to shareholders according to our capital allocation framework. We will always place value and profitable growth over volume when deciding on whether to invest in our projects.
So with that, we finalize the sort of formal presentation, and I'm happy to take questions from the floor. As I say, in summary, we think we've had a good performance -- strong performance last year and expect to continue keeping that momentum.

Question and Answer

Daniel Edward Major
UBS Investment Bank, Research Division

It's Dan Major from UBS. Three questions. Firstly, on tax, your cash tax is quite a bit lower than the P&L tax during the second half of the year. Can you give us any guidance on the outlook there and if you expect that to reverse? The second, on the Los Pelambres labor contract negotiations, can you give us a sense of what the key sticking points and the key parts of the negotiation are focused on? And then finally, just a question on your comment on monetizing the power assets, can you give us more guidance there? And can you make a comment on whether the rail business still definitely remains core within the portfolio?

Iván Arriagada Herrera
Chief Executive Officer

Okay, let me take the second 2 questions, and you take the tax question, Alfredo. I mean, on Los Pelambres, I think what we want is to achieve a fair outcome but also preserve our competitiveness and the health of the business in the long term. So that's the aim that we have in this negotiation and in the conversations that we're having with the union. We're not contemplating cutting back on benefits or conditions, so this is all about new conditions going forward. And as I say, we remain focused on achieving a fair outcome but also preserving the long-term health of our business. The specific points of the negotiations, I mean, I couldn't comment on those. That's the matter of the mediation that's taking place now. And therefore, we are working, hopefully, towards an outcome which will be beneficial for both parties, but I can't comment on the specifics. On monetizing our power assets, I think we've got some transmission lines, and we've been thinking about them. Some of the sections of those transmissions lines are actually used by third parties as well, which pay a fee for the use of them. So they're open to use by other parties, and therefore, we've thought of them as being eligible for, therefore, disposals so that someone else can use capital, basically, in that type of more infrastructure-like investment. And that's what we're doing. They're not significant in terms of, I would say -- or material, in terms of amounts or dollars, but it does signal our willingness to keep focus on our capital in our core business. With respect to the rail, the rail is doing very well. It's as -- it's an -- a business which is very much tied to the origins of our company; good results in 2017. Linked to mining, a lot of what the rail does is transport inputs and cathodes and concentrate for the mining industry in the North, so we -- it remains core to our portfolio. So Alfredo, you want to take the tax?

Alfredo Atucha
CFO and VP of Finance & Administration

Yes, of course. Well, about the tax cuts, we received a $130 million tax refund during 2017. At the end of 2016, we had in our balance sheet almost $200 million tax receivable. $130 million of them were received effectively during 2017, of course, offsetting part of the tax cash outflow for this year. We have another 6 -- $70 million that we expect to receive during this year, 2018. So also, this figure will have some impact in the tax cuts in 2018, but this is basically the reason behind.

Iván Arriagada Herrera
Chief Executive Officer

And our guidance, if I'm -- I mean, the guidance on tax rate remains at the same level as before between, what, 35% and [indiscernible].

Alfredo Atucha
CFO and VP of Finance & Administration

Yes, effective tax rate is in the region of 35%, and we don't have any extraordinary or special event or factor affecting the tax situation of the company.

Daniel Edward Major

UBS Investment Bank, Research Division

So just to be clear on that, is that $70 million less P&L versus cash flow tax in 2018 on a like-for-like basis? Is that fair?

Alfredo Atucha
CFO and VP of Finance & Administration

The tax cash for '18 should be stabilized in terms of the tax ratio. But the only impact of this is the expectation to receive another $70 million, $75 million tax refund.

Izak Jan Rossouw
Barclays Bank PLC, Research Division

Just Ian Rossouw from Barclays. Just 2 questions from me. Just firstly, on the labor negotiations, could you maybe just provide some guidance on -- I know you've provisioned for some of the costs already last year. We can expect that cash flow to be spent this year. Maybe just some guidance on that. And then secondly, just on working capital, I mean, you've done a good job at sort of squeezing working capital out of the business in the last few years.

Alfredo Atucha
CFO and VP of Finance & Administration

Yes.

Izak Jan Rossouw
Barclays Bank PLC, Research Division

There was -- there were quite a big -- big swings in, actually, inventories and receivables. Overall, it wasn't such a big impact on the '17 numbers, but maybe just give us some indication for your expectation for this year.

Iván Arriagada Herrera
Chief Executive Officer

On -- I'll leave the working capital to you.

I mean, on the costs side, the question was around the labor negotiation impact on cost. That's the focus?

Izak Jan Rossouw
Barclays Bank PLC, Research Division

Yes, the -- I guess, the cash cost guidance, I think some of it was already in last year, but the cash impact of that expectations for this year.

Iván Arriagada Herrera
Chief Executive Officer

Yes. As I said before, most of the payments associated to our labor negotiations have been reflected in 2017, except for this one that we're undertaking now, and I think that's factored into our guidance for this year that we've released. So it's $1.35, and that includes labor negotiations which are scheduled to take place this year. So that's the response on that bit. And then on working capital?

Alfredo Atucha
CFO and VP of Finance & Administration

Yes. Well, you know that we are committed to maintain our financial discipline, and working capital management is essential, this is an important part to get it. You know that over the last couple of year, we have been working hard in optimizing specifically inventories level and stabilizing the payables, the creditors, at a 30-days payment term. So this is a focus for us. We are very focused on optimize gradually year-by-year our working capital level. And subsequently, the result in this year is in a direct consequence of this program. This is [existing].

Izak Jan Rossouw
Barclays Bank PLC, Research Division

But what's your expectation for big swings in working capital for '18 because there were big swings in the numbers in '17?

Alfredo Atucha
CFO and VP of Finance & Administration

Well, in terms of inventories and payables, I think that we will be in the region -- in the range of the 2017 year. Probably we can obtain some additional optimizations in the inventories. On receivables, you know that, that depend on the sales volume and the copper price evolution because all of our receivable terms continue to be exactly the same, no change in this space.

Jason Robert Fairclough
BofA Merrill Lynch, Research Division

Jason Fairclough, Bank of America Merrill Lynch. Just 2 quick ones. Just in terms of the CapEx increase at Los Pelambres, could you talk about the extent to which that is project specific? Or should we be thinking about read across to other projects? Second one, Anglo is looking for a partner at its Quellaveco project. Could you discuss if that makes sense -- something like that might make sense for Antofagasta? Why or why not?

Iván Arriagada Herrera
Chief Executive Officer

Okay, on the Los Pelambres, I think what we've done is really worked, over the past few months, hard on de-risking our capital cost estimate for that project. So yes, I think most of it is project specific. It relates to the fact that we've advanced the lever of engineering. We've done a lot of front-end loading on the project with respect to the engineering, which is almost fully complete, the detailed engineering. So all aspects of design, quantities and the like are almost frozen. In terms of the project execution risk, with the construction, we've also worked hard at looking into that and built the contingencies into that estimate. So the work that we've done in the Los Pelambres, which had led to this update, is primarily, I would say, or mostly related to de-risking the execution of this project. There is an element of price update as well, but I would say that most of it has to do with the fact that we de-risked the execution, advancing the engineering and doing the front-end loading. We think Pelambres, I mean, it's our greatest asset in terms of our portfolio. The last expansion at Pelambres occurred 10 years ago, roughly. And we think if we put Pelambres back on track to unlock value in this asset, which is really world-class, we'll get significant benefit. This is a strong project, and therefore, we're very keen on getting this off the ground. We're also very keen on meeting our guidance, as we've done in production and cost, and therefore, we think of our estimate update in those terms as well to be in line with what we communicate. And therefore, we are expecting to take this to the board before the end of the year. We've got the environmental permit, which I think is good. That's something that we take for granted, but in fact, it's not easy for projects to get the environmental permit. And in fact, in this case, it was unanimously, they voted in favor, so I think -- which means also that from a community point of view, we think we're in good shape to undertake the project. So we're dealing with some ancillary permits which we need to complete. Some of them are sort of new out of the changes in the law but nothing of a major concern. So we will continue to move ahead. And the date of first production is unchanged. So we're still expecting to get copper off the ground from the Pelambres expansion by 2021, as was the plan originally. On Quellaveco, I mean, I can't comment on that specifically. I would only say that, obviously, we are interested in developing our portfolio further. We would look at options in their own merit, but we'll remain very focused on returns. And I think we would look at these options as we look at our own brownfield expansions. Is this a good choice for capital deployment? Will it meet our required returns? And if we have hesitation around that, we will not embark on those projects, but we will actually, according to our capital allocation framework, return that to shareholders. So we're not going to deviate from that principle, and we'll look at different options in their own merit as they come.

Tyler Anson Broda

RBC Capital Markets, LLC, Research Division

Tyler Broda from RBC. Two quick ones from me, just extending on Jason's questions. In terms of the Pelambres expansion, the changes at the CapEx, does that change the cost profile, in your view, at this point? And then secondly, will there be more -- any more requirement for more water for an eventual Phase 2? Or will this now, with the excess capacity, cover this?

Iván Arriagada Herrera
Chief Executive Officer

Okay. In terms of cost profile, we've also done an update on the cost profile, and we're not seeing any significant change in costs going forward. In terms of water, the -- this project combines more grinding capacity at the plant but also, as we've mentioned in the past, building a desalination plant. And that desalination plant is sized such that it will serve the needs for water of Phase 1 and Phase 2 and also, eventually, as a backup facility for the existing operation in case there is a drought or continuing drought or severe drought. So we don't anticipate -- and in fact, this is intended to serve water requirements of both phases and the existing one as well, if required.

Jatinder Goel
Citigroup Inc, Research Division

Jatinder from Citigroup. Two questions, please. On Centinela expansion alternative, are you able to give any indication of potential scale if you expand the current concentrator? How does it compare to the 90,000 tonne Phase 1 of new concentrator? And you mentioned 18-month feasibility study time line. Does that eventually delay the first production from expansion if you go through that route? Or will that still be achievable in 2022 because it will be a much quicker project to ramp up potentially? And secondly, just on Reko Diq, you mentioned about the multibillion dollar potential claim. Any progress or anything that's moved on that part?

Iván Arriagada Herrera
Chief Executive Officer

Sorry, I didn't get the last one.

Jatinder Goel
Citigroup Inc, Research Division

On Reko Diq, you mentioned about a potential multibillion dollar claim. Is anything moving on that side at all?

Iván Arriagada Herrera
Chief Executive Officer

Yes. Okay, on Centinela, I think we are certainly looking at an alternative. As was mentioned, that involves expanding the current concentrator because we believe that there might be an option there, which is it involves less front-end capital, and it has lower risk for the equivalent return or better return. The scale is -- as an expansion to an existing plant, we think, will be smaller -- slightly smaller. So the second concentrator was contemplating on adding around 90,000 tonne a day of processing capacity. We think this might be closer to around 60,000 tonnes per day. But we think why we want to look at this and clear this throughout this year is because we believe this might be, as I say, a better option from a risk-adjusted return perspective. One of the main enablers of this, just to mention, is the fact that we can use the tailings deposit that we have today, so we can synergize with existing infrastructure, avoiding, therefore, incremental investments that we would otherwise have to make in the second concentrator. The second concentrator is expected to be built, when it's built, around 7 kilometers away from the existing plant and, therefore, needs also a tailings deposit to be constructed. This avoids that investment, and deferring that carries a significant value, we think. So the scale, however, would be different. In terms of start date, I think that's part of the review that's taking place today. We think that you are right, I mean, this being an expansion to the existing plant, the time line may be a bit more compressed to building a full-blown concentrator from scratch. Now whether it's exactly in 2022 or thereabouts is something that we should be able to answer as we complete the studies in the course of this year. We've done our first pass as -- at those studies, and those are favorable. I mean, they look at this case being attractive. And we really want to focus then on clearing any flaw which may exist so that we can then move this into a proper feasibility in the course of the end -- by the end of this year. But we're excited about this option. I mean, we're seeing this as an option that's got less front-end capital for the development of the district, and therefore, it ties in well with our principle of using capital as efficiently as possible. With respect to Reko Diq, that happens that there haven't been any further news to the ones that you probably know. I mean, this is under international arbitration. And the outcome of the first phase of that arbitration was favorable to the company, claiming that the permits had been taken without -- or in -- not in accordance with the contracts. Now this has moved into the second phase, which is establishing or assessing the potential compensation for that. But that's still in process, and we have nothing further to report at this stage on that.

Luke Nelson
JP Morgan Chase & Co, Research Division

Luke Nelson, JPMorgan. Just a question -- a couple of questions. Firstly, on cash costs, can you just outline what gives you comfort in reiterating your cash cost guidance this year, particularly given the Chilean peso underpinning your assumptions is significantly stronger on spot prices and also what we're seeing in terms of widespread broad cost inflation pressures already? And then secondly on that, just if you could provide a breakdown in terms of sensitivity to the Chilean peso. And finally, in terms of CapEx guidance for this year, the $1 billion, could you provide a bit of clarity in terms of what proportion of that is domestic versus international cost base and, again, any sensitivity around strengthening of FX?

Iván Arriagada Herrera
Chief Executive Officer

Yes. So we -- when we look at costs, I mean, if you look at our performance last year, we did see inflation exchange rate and input price pressure. That's why we're focused on continuing with our cost improvement program. Around 65% of those pressures we were able to compensate through cost reductions. So we keep very focused on counterweighting those pressures as we continue to see them. And we believe that at a 60% rate, we're being effective, and we can continue to do more on that space. The exchange rate in Chile has fluctuated. I mean, it's come back again. But in terms of sensitivity, we consider that CLP 10 in the exchange rate involves roughly $0.01 per pound in our cost on a completely -- I mean, everything else being equal. But that is an assumption that one needs to consider because, obviously, to the extent that we see appreciation in the exchange rate, which is putting pressure on our cost, we will redouble our efforts in terms of looking at things which we can do to compensate for that. But on a straight arithmetical basis, $0.10 -- CLP 10 per dollar of appreciation is $0.01 per pound in our cost. Now that's the sensitivity. With respect to CapEx for this year, how much of this is dollar-based, this year, our sustaining CapEx is going up, as you would have noticed. This has got to do more with the fact that we've got a concentration of mine fleet replacement this year, which will not recur. We don't change the fleet every year, and therefore, this year is a year in which we've got more CapEx to that; and also, because we're doing some work raising the wall of some of our tailings deposits, which is done normally every 4 or 5 years. Now I would -- my estimate is that in -- I mean, the fleet replacement is all dollar-based. All the work on the tailings dam is mostly peso-based. So I think as in our costs, that around 45% is -- probably to 50% is dollar-based, and the rest being pesos. That's roughly the split. So that's the points that you've read in.

Luke Nelson
JP Morgan Chase & Co, Research Division

Just a follow-up question on the question earlier about Quellaveco. Obviously, Anglo has taken operatorship role of assets, and yourself take operatorship role of assets. Given your comment around that, that you would focus on returns, does that mean, going forward, you would be happy to take a non-operatorship role in re-sharing projects?

Iván Arriagada Herrera
Chief Executive Officer

As operators, we bring something to the table. And I think in the case of Zaldívar, costs have come down. That was an asset which was running before at $1.85. We're now at $1.60 to $1.65. We've got a lot of technology on recoveries which we're extrapolating. So we value our role as operators, I think, generally. However, we will look at options, including ones in which we may not be operator on their own merit based on return. But generally, our preference is to operate.

Edward Christopher Sterck
BMO Capital Markets Equity Research

Edward Sterck, BMO. Just a couple of questions. Firstly, on the balance sheet, obviously, you've put these pressures up more or less into a net cash position now. What is an appropriate level of gearing? And can you speak to this in the context of financing Los Pelambres Phase 1 and maybe Centinela over the next few years? And then the second question is, just going back to the Los Pelambres expansion CapEx and the desal plant there, should we assume that there's no CapEx requirement for the desal plant in Phase 2 as things stand at present?

Iván Arriagada Herrera
Chief Executive Officer

On the second one, the answer is yes. Yes?

Alfredo Atucha
CFO and VP of Finance & Administration

Yes.

Iván Arriagada Herrera
Chief Executive Officer

Well, you can...

Alfredo Atucha
CFO and VP of Finance & Administration

In terms of financing, the...

Iván Arriagada Herrera
Chief Executive Officer

Balance sheet.

Alfredo Atucha
CFO and VP of Finance & Administration

Our balance sheet, well, we -- the -- basically, our balance -- cash balance is enough to support and to phase the project and -- in our portfolio. And basically, in terms of the [Enco], Pelambres has enough cash generation capacity to finance [Enco]. But however, of course, leverage optimize the shareholder returns, so -- and considering the debt capacity from Los Pelambres, we probably will structure a financing -- a corporate financing for -- or corporate loan for the [Enco] project. So with this, we will continue maintain -- to maintain our cash balancing in the region of $2 billion; and the debt level, in the -- in this similar level as today, with a 0.3x, 0.4x net debt/EBITDA as a ratio. So the cash capacity of the company is enough to support the project. However, of course, we are going to take advantage of the favorable financial conditions today prevailing at the market.

Iván Arriagada Herrera
Chief Executive Officer

And I mean, just to complement what Alfredo was saying, I think we've regarded always are the strength of our balance sheet as a key strategic element of a company. And we are at a point in time in which we've managed to de-gear fully almost. And we talked in the past that we see flexibility to potentially -- or theoretically, if you want to, I mean, borrow maybe up to 2x net debt to EBITDA. Probably as we're seeing things today, that -- we think that's probably high, and therefore, we wouldn't go that far. But that's the sort of flexibility that we see in our balance sheet, but we want to keep the strength of our financial condition as a key cornerstone of the strategy of this company because that has served us well through good times and bad times. Don't forget that during the downturn, and memories is -- we've managed to continue to grow our businesses through the Encuentro Oxide; Antucoya, we purchased; Zaldívar, and we're benefiting from that now. 25% of today's production come out of projects which we undertook and completed during the downturn when people were struggling with their balance sheets. So that's part of our strategy, not to be caught in that position.

Alon Olsha
Macquarie Research

It's Alon Olsha from Macquarie. I just had one question on grade variability. It's been maybe a bit of an issue at the company over the last few years, particularly at Centinela, where the grade can fluctuate quite aggressively year-over-year. Are you comfortable with the level of great visibility you have going forward? And you speak about 2019 grade improvement. Could you provide a bit of an indication as to what that may come out at?

Iván Arriagada Herrera
Chief Executive Officer

Yes. I think each ore body has its own features. Pelambres has a very stable great profile, which is a key feature of that asset. In the case of Centinela, there's geological variability in grade, and that's a feature that Centinela has. And therefore, a lot of the work that we've been certainly doing has been acquiring information to be able to have the sort of visibility that you're suggesting is necessary. So we've had a great improvement in terms of where -- what we see in terms of grade variability over time in the case of Centinela. I think we've guided -- you remember when we had the site visit, this must have been 1.5 years or so ago, that directionally, we would see an increase in grade at Centinela in 2019. So that consistency in the message comes from 2 years ago when you guys -- or some of you were able to visit Centinela or our site, so that is the same directional story. I can't provide or -- specifics now. I think that will be the subject of the guidance that we provide for next year in '18, but directionally, we expect to see in our mine plants include increases in grade for Centinela Concentrate, which will put us in a good position next year, we think, which is good at time which we're expecting to see better prices. So directionally, we haven't changed, and yes, there's consistency in our messaging there on grade. And specifically, what grade will we then be expecting is something that we will release as we release the guidance for next year.

Alon Olsha
Macquarie Research

And just more generally, beyond 2019, should we expect, again, a fairly lumpy grade profile, up 1 year, down 1 year? Or is there a -- just kind of a tighter range you could...

Iván Arriagada Herrera
Chief Executive Officer

Yes, I would say in the case of Pelambres, it's quite smooth in terms of performance. In the case of Centinela, the visibility we have with respect to grade beyond 2019 is of more stability. So as -- and one of the reasons being is that one of the things that we're doing this year is that we're opening up Esperanza Sur. So in our base case, we have another pit, and therefore, there will be an additional feed source into Centinela. And that will contribute to be able to manage the stability of the grade beyond 2020. So we see more stability on grade as a result of being able to have an additional ore feed from that year onwards, so expect less variability from there onwards as a result.

Daniel Dominik Lurch
Exane BNP Paribas, Research Division

Daniel Lurch from Exane BNP Paribas. Just one quick question on your cost guidance. So you mentioned a lot of -- there's a lot of cost inflation, which you're facing in a number of -- on a number of levels. There's one key part of your cost -- I mean, TC/RCs, however, are trending down. Is this an area in your cost forecast or in your cost expectations that you potentially can save more this year than you expect because spot TC/RCs are weaker than kind of benchmark levels? Is this an area where you can say they're more on spot? Or are you here locked in into longer-term contracts?

Iván Arriagada Herrera
Chief Executive Officer

The TC/RC gets restated every year, and we have not changed that practice. So we expect basically them to be updated annually, and we've not locked into fixed terms for TC/RCs for longer periods of time. Now I think what we're seeing is that the balance of concentrate, especially in China, is such that we think there will be shortage of concentrate. And that means that, going into the next season of TC/RC negotiations, if that plays into the market conditions, then we should see some improvement on TC/RC. And that's been the case over the last couple of years, as you've seen. And as you rightly point out, to the extent that some of our production goes into the spot market, rates have been even lower, and some of that we're benefiting from. Yes.

Daniel Dominik Lurch
Exane BNP Paribas, Research Division

Can you -- sorry, one follow-up. Can you give us an indication how much is going to the spot market of your sales?

Iván Arriagada Herrera
Chief Executive Officer

That varies from time to time. It depends on what the quantity is committed, which get designated on a quarterly basis is -- so I mean, the bulk goes into contracts, which are term contracts, even though the TC/RCs get reset every year. But we've seen an increase in the percentages to the spot market, but it's still not the majority.

Fraser Rowat Jamieson
JP Morgan Chase & Co, Research Division

Fraser Jamieson from JPMorgan. Just one question on Los Pelambres versus Centinela. I mean, just purely looking at the, well, scale, cost profile, et cetera, Pelambres is currently a much, much better asset than Centinela. And yet it seems like certainly on Phase 2 of the Los Pelambres expansion, you're kind of pushing that out a bit, and Centinela expansion options certainly seems coming before Phase 2 of Los Pelambres. I'm just wondering about the kind of thinking of management and the board around that because just on those pure statistics, it looks like you should be going hell for leather expanding Pelambres as far and as fast as possible and pushing out Centinela a little bit.

Iván Arriagada Herrera
Chief Executive Officer

Look, I think we certainly consider Pelambres to be a great asset, as you point out. I think we see a big opportunity to release value out of putting Pelambres back on a growth trajectory. The way that we've sequenced them is the shortest time to be able to, we think, reasonably do undertake Phase 1 and Phase 2. Phase 2 is a lower investment, but it's a bit more complex from a permitting point of view because it does involve more tailings and waste space. And therefore, we need -- which we're not doing in Phase 1, and therefore, we need to go through a process of consultation and more broader permitting at the time, and therefore, we are allowing time for that to happen. But I think if you -- if we progress according to our time line, we probably will be facing the choice of Phase 2 at Pelambres and Centinela alternative case at a similar time. And I think it will depend on the feasibility that we see at that stage of undertaking one against the other, which will dictate what we'll do. And certainly, in the ranking, Pelambres remains better.

Okay, well, thank you very much. Any questions from the...

Alfredo Atucha
CFO and VP of Finance & Administration

The line.

Iván Arriagada Herrera
Chief Executive Officer
The line, those on the phone or -- okay, with that then, we will close the presentation. Thank you very much, and we'll see you during the day. Thank you.