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## NATIONAL SUPPLIER DEVELOPMENT POLICY

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## Introduction

### 1. Policy Number

This document is known as **PR-07: National Supplier Development Policy**.

### 2. Purpose

This policy is established to facilitate Oyu Tolgoi LLC's (OT) commitment to working with and developing national suppliers.

Specifically, this policy provides a clear understanding of:

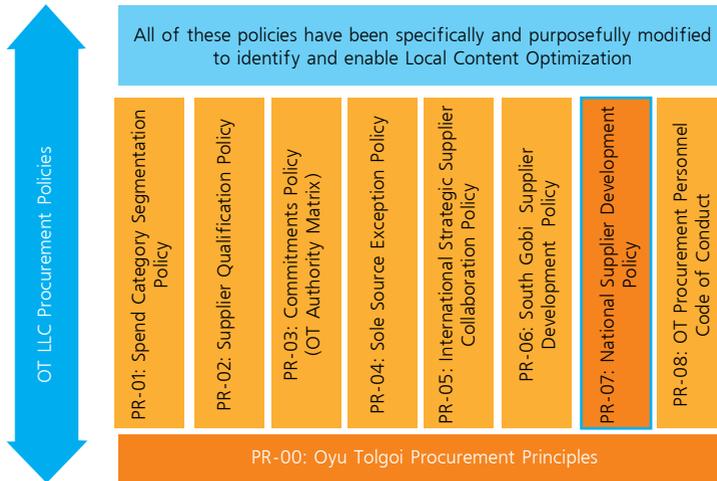
- the eligibility criteria that must be established to qualify as a national supplier;
- the OT initiatives created to facilitate the development of national suppliers in accordance with globally recognised best practice resource sector requirements and expectations; and
- the reporting requirements for OT employees.

This policy assists OT in realising the dual objectives of:

1. meeting the commitments of their Investment Agreement with the Government of Mongolia with respect to the development and facilitation of local suppliers; and
2. providing support for the development of a long term, sustainable, localised supply chain to meet wherever practicable the life of mine requirements of OT from within Mongolia.

As outlined in Figure 1, the OT National Supplier Development Policy is one of eight core policies underpinning OT's overarching procurement process and philosophy.

FIGURE 1: Core policies governing OT Procurement



### 3. Application

This policy applies to:

- all OT Employees;
- all Suppliers meeting the eligibility criteria of a National supplier status (as outlined in Section 1 below).

### 4. Commencement

This amended policy applies from November 20, 2012.

### 5. Authority and Management

The OT Board of Directors approved this amended policy on November 20, 2012 .

It will be reviewed annually or on an as required basis.

The Vice President, Procurement and Infrastructure Development, Oyu Tolgoi LLC is the custodian of this policy. Any requests for changes to this policy must be addressed to this person and will be subjected to the appropriate review and approval processes.

## Policy

### 1. Eligibility Criteria

For the purposes of this policy, a National Supplier refers to a supplier of goods or services rendered, within the territory of Mongolia.

Those suppliers who can establish that the goods they supply or services they render meet the above definitional requirements, will be eligible for participation in the support programs and enablers outlined in the following OT policy.

To be eligible for classification as a National Supplier, a business must:

- be a Mongolian Registered Company; and
- more than 50% owned by Mongolian citizen ;

OT will review this policy annually to reflect current market changes and renew accordingly to support local suppliers to advance along the latter of maturity level as outlined in the Figure 2.

### 2. Characteristics of National Suppliers

While national suppliers are typically more mature than South Gobi suppliers, they are still largely unfamiliar with the requirements and expectations of the resource sector, and in many instances this has prevented their effective participation in competitive tenders for OT's requirements.

The following policy is designed to address those areas where OT can provide targeted enablers to fast track these suppliers ability to make the necessary adjustments to ensure greater alignment and compliance with the requisite resource sector and industry standards moving forward.

To address this, OT has identified some typical characteristics or challenges faced by National suppliers for diagnostic purposes, in ensuring the policy provides the correct support to facilitate their on-going preferential engagement.

Mongolian national suppliers are often:

- acting in the capacity or role of "middle men" or distributors for imported products or products largely sourced outside of Mongolia (such as Original Equipment Manufacturer OEM representative agents by way of example);
- predominantly operators in the services sector or associated service industries;
- still developing manufacturing capabilities;
- more accustomed to forms of engagement (contractual terms and conditions) that are more exhaustive and comprehensive than those South Gobi operators may have encountered, but still insufficient from a best practice perspective;
- capacity constrained, especially in the construction services and manufacturing sector.

- possessed of some logistics capability, that is still developing in terms of full supply chain security and capability; and
- cash constrained or have difficulty accessing the required capital to underwrite business expansion and development.

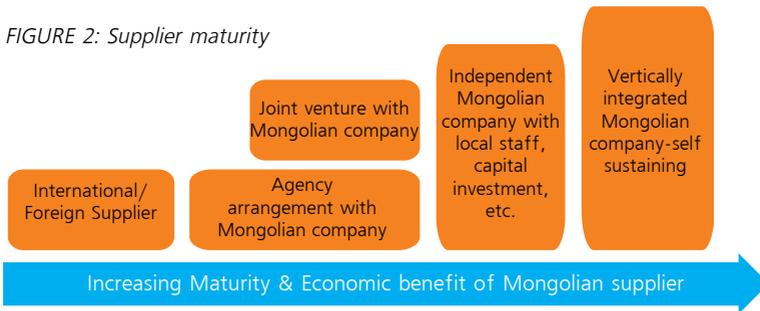
Figure 2 below identifies a typical Supplier development curve within developing economies such as Mongolia. The intent of Figure 2 is to identify that the National Supplier maturity will over time develop from one that requires large amounts of International/Foreign Supply support to one that is increasingly independent and self-sustaining, and in some circumstances even more integrated. Examples of each category exist today in Mongolia and for illustrative purposes are noted below:

- Stage 1 Development – International / Foreign Supply – This is typically where an industry sector is new to Mongolia or has recently been introduced through large capital development programs. For OT this can readily be seen in the sectors of large integrated Engineering, Procurement and Construction (EPC) firms, large project based construction companies or other sectors such as structural steel manufacture and supply simply due to the sheer size of the infrastructure and development program of the OT Project.
- Stage 2 Development
  - ▷ Agency arrangements are common in the area of trading of goods or services. This is typically where a National Company will see the business sector growing and works with a Foreign Company to become an Authorized Dealership or a representative of this Foreign Company for the purposes of providing these goods and services within the territory of Mongolia. Numerous examples exist such as major equipment companies in the mining sector. Other examples simply are trading companies who find a market for foreign goods and serve as a middle man between the customer and the manufacturer, but without any exclusivity of representing the manufacturer. Careful consideration on a case by case basis must be provided for the value this middle man working in the space of a trader is providing to the Mongolian economy.
  - ▷ Joint Venture Mongolian Companies are also common as a foreign investor can bring intellectual property to Mongolia, but has no readily available access to the market place. This is a higher development than a typical Agency arrangement and is a natural progression for an Agency to mature to over time. Examples within OT exist in the logistics industry, construction and large mining equipment sectors. The Joint Venture Companies can carry significant value to the Mongolian economy if there is a commitment of the JV Company to large national employment and investment in national based assets.
- Stage 3 Development - Independent Mongolian Company – This is typically where the intellectual property now has been transferred to within Mongolia or already exists and all aspects of services and products are engaged by local staff. This stage 3 development often may be restricted

by scale of the operation as compared to a JV phase 2 principally due to the initial capital investment, scale of project and uncertainty of a sustainable development. Numerous examples on OT exist such as SME's in catering, construction, engineering, logistic clothing, furniture, consumables, etc.

- Stage 4 Development – Self Sustaining Mongolian Company vertically integrated – This would typically be a manufacturing company who sources its own raw materials from an international or domestic market place and provides all channels to the customer in terms of sales, marketing, product development, logistics, etc. and has its own capital available. Hurdles on initial capital investment have been overcome typically and there is a sufficient domestic demand to ensure sustainable development. Examples reside within Mongolia in cement, consumer products as well as in the service sector in airlines, transportation, health, security, etc.

FIGURE 2: Supplier maturity



If all things are equal, OT will prefer suppliers with higher maturity level in order to increase real economic benefit to Mongolia.

### 3. National Supplier Development

To facilitate the growth of national suppliers within Mongolia, OT utilises a range of tools:

1. **Qualification support:** Many national suppliers are still developing in terms of capability. In many instances local suppliers require learning and development support and greater education regarding resource sector requirements and expectations. Therefore, OT has committed to educating national suppliers on the supplier qualification process, in areas such as health safety and environment; commercial development; quality assurance; and service provision. This enables national suppliers to be more competitive relative to the capabilities of their international suppliers. OT will throughout this qualification process identify gaps that national suppliers must resolve to remain OT suppliers and will work collaboratively to provide the correct incentives in place to ensure this development occurs.
2. **Categorisation of spend and suppliers:** OT will be transparent on its 12

month spend profile by category and, where possible, spend targets for national suppliers. This categorisation and transparency allow suppliers to better target their capability and services to meet OT's needs. Additionally when available, OT shall provide three year spend curves to facilitate longer term plans by the national suppliers to facilitate self-investment and have a better understanding on the sustainable supply opportunities within the mining sector.

3. **Post award monitoring:** OT will provide feedback to suppliers who do not succeed in being awarded tenders. This will educate suppliers by providing feedback on areas that they can improve so that they may become more competitive in any future tenders for similar requirements.
4. **Competitive bids:** all goods or services greater than USD\$20,000 in value, will be tested in the market with (if available and subject to market factors) a minimum of three qualified suppliers. This competitive testing facilitates the development of national supply; the promotion of supplier diversification; equitable spread of wealth across Mongolia and the development of competitive supply chains in Mongolian companies. Stringent sole source constraints exist to vastly limit the circumstances where competitive testing is not pursued as the default position. These constraints ensure OT's shareholders remain committed to competitive testing and the demonstration of market engagement in meeting the operation's ongoing spend requirements.
5. **Supplier recognition program:** OT has developed a supplier recognition program, whereby OT rates and awards their key suppliers for their effectiveness and satisfactory performance against key contractual deliverables.
6. **Category Targets:** OT will identify category targets for National Supplier spend. All targets will be advertised to the public annually and made available on the OT procurement website. In the spirit of maintaining the competitiveness there will never be a target greater than 80% for national suppliers.
7. **Master supply agreement:** OT will provide forward agreements to national suppliers, where applicable, so that they do not need to continually bid for one off or singular tender requirements. This provides assurance to national suppliers giving them support to invest and expand their businesses.
8. **Reduced Terms and Conditions:** OT will provide simplified terms and conditions for local suppliers. For goods over 100,000 USD and for construction services over 10,000,000 USD, terms and conditions remain to international standards.
9. **Preferred supplier status if all things equal:** when two or more tenders are technically sufficient and all components of the tender are equal, apart from a small price differential, national suppliers will be chosen over international suppliers on a preferential basis and subject to satisfactory compliance with health, safety and environment requirements.
  - OT shall fully recognize that should national suppliers meet the criteria here in item 9, that a preference to suppliers that are more advanced in the Supplier development curve in Figure 2 will be recognized.
10. **Right of reply:** a national supplier will be given an opportunity to revise their bid price in the following circumstances:

- if the bid is greater than \$100,000;
- if the goods or services are technically sufficient; and
- if the price difference between the international supplier and the national supplier is within 10%.

## 4. Reporting Requirements

OT will commit to a reporting and performance management regime with key stakeholders including but not limited to;

- monthly reporting to management;
- quarterly reporting to the Board; and
- annual internal auditing.

Reporting will measure, as a minimum;

- spend profile penetration;
- percentage spend by South Gobi, National and International supplier;
- Target versus Actuals.