A PROGRESS REPORT ON KEY AREAS OF INTEREST

APRIL 2013
Oyu Tolgoi and its operations are of key interest to everyone in Mongolia including the Government, residents, the media, other stakeholders and the public.

Over recent weeks, there has been much debate among politicians and in the media about the best way to make Oyu Tolgoi a success for Mongolia. As we prepare for commercial production, it is entirely understandable that people pay close attention to Oyu Tolgoi.

Whilst significant progress is being made to achieve our vision of developing Oyu Tolgoi, we are working hard in partnership with the Government and other stakeholders to further address a number of specific areas of interest.

This booklet provides an update on a number of areas of activity, where progress has been made and where more is underway. It is one part of a wider programme to achieve an objective, accurate and consistent understanding of the project amongst everyone involved. We hope that it proves useful.
PROJECT FUNDING AND FINANCE

Capital expenditure

Oyu Tolgoi is being built in two phases. The first phase – the open pit and concentrator – is almost complete, while the second phase will begin construction of the underground section of the mine, where most of its value lies.

Greater understanding of the capital expenditures required to build Phase 1 is essential for everyone involved. Oyu Tolgoi strives for transparency about capital costs, providing ErdenesOyu Tolgoi, through which the Government owns 34 per cent of Oyu Tolgoi, with monthly construction reports with detailed descriptions of all construction progress and total spend.

The initial capital estimate of nearly $5.2 billion USD ($5.7 billion when indirect costs are included) was documented in the July 2009 Oyu Tolgoi Feasibility Study, approved by the Mongolian Mineral’s Council in March 2010. This estimate was developed before construction began.

An updated estimate of $6 billion USD (that includes indirect costs) was completed in November 2010, six months after construction mobilization commenced. This was provided to the Board of Directors in December 2010. It is international practice to provide a “control estimate” shortly after commencement of construction.

Today, Oyu Tolgoi’s total capital expenditures are within 3 percent of the $6 billion USD “control estimate.” This is effective cost management for a project of this size – initial estimates were made a long time before our current operational status. Industry-wide cost increases during the same time period averaged about 18 per cent per annum or 60 percent over three years for comparable large projects. The average annual Mongolian rate of inflation between the approval of the Feasibility Study in March 2010 and December 2012 was 10.8 per cent.
In relation to future capital costs, a draft of an updated Feasibility Study covering aspects of Phase 2 is at an advanced stage. In line with our aim to offer the highest level of transparency the draft is currently being subjected to a stringent review process, which includes members of the Government Working Group Steering Committee. Value maximisation and cost minimisation reviews are continuing before the OT Board will approve the draft. The draft will ultimately be submitted to the Mongolian Minerals Council for discussion.

*Note:* Turquoise Hill Resources reports total capital expenditures as $6.2bn; Oyu Tolgoi LLC reports $6.49bn as of 31 December, 2012. This is due to different accounting treatments of exploration and non-direct project costs.

**Project Finance**

To date, international investors – Rio Tinto and Turquoise Hill Resources – have provided 100 per cent of the funding to build the Oyu Tolgoi business [without receiving any return]. So far the Government of Mongolia has elected not to inject any cash into the business. Between 2009 and 2011, Rio Tinto and Turquoise Hill also made tax prepayments of $250 million USD to the Government, at the Government’s request, to help it meet its short-term funding requirements.

Currently, the international investors are organising to raise project finance, as contemplated by the Shareholders’ Agreement, from international banking and financial institutions to enable the next stage of development – Phase 2 for development of the underground mine, which under some models represents 80% of the project’s potential value.

Recently, with the Government of Mongolia’s endorsement, the boards of the International Finance Corporation (IFC) and the European Bank for Reconstruction and Development (EBRD) approved their involvement in the project. This is an important step forward in securing long-term project financing for the development of Oyu Tolgoi.
This project financing is the largest ever in the global mining industry and requires close co-ordination between Oyu Tolgoi and its shareholders. Project finance provides benefits to all shareholders, including the potential for a lower cost of capital that will mean a lower burden on the Government and Mongolia for bearing interest on its share of project costs.

Considerable efforts are in place to continue to be fully transparent about the approach to project finance. It is worth noting that since December 2010, Oyu Tolgoi has held more than 50 meetings, workshops and presentations about project finance, in addition to other regular updates. That effort continues today. In addition, ErdenesOyu Tolgoi has full access to a vast amount of transaction documentation and information about the project finance. Examples of these interactions include:

- Regular briefings with Ministers’ staff and Erdenes Oyu Tolgoi lawyers.
- Briefings with Mongolian banks and ErdenesOyu Tolgoi executives to explain details of the proposed project finance.
- Workshops to explain transaction and contractual overview, due diligence, finance plan, syndication process, and term sheet, among other topics.
- European Bank of Reconstruction & Development meetings in Mongolia with various Government of Mongolia ministers and Erdenes Oyu Tolgoi representatives to discuss the merits of project finance.
- Most recently, on 25 January 2013, Erdenes Oyu Tolgoi participated in lender site visits and meetings.

Oyu Tolgoi also has provided funding for Erdenes Oyu Tolgoi to retain the international law firm of its choice to independently advise them on project financing and to report only to them.

Beyond Project Financing, specifically, Oyu Tolgoi satisfies – and exceeds – both Mongolian and international reporting standards for a private company.

- The Government receives Oyu Tolgoi’s annual budget and audited accounts for every year.
• Oyu Tolgoi reports on a quarterly basis, not just to the Government, but also to the Board of Oyu Tolgoi and the shareholders including Erdenes Oyu Tolgoi LLC.
• Quarterly financial reports are sent to the General Taxation Authority and the Ministry of Finance.
• Oyu Tolgoi provides ErdenesOyu Tolgoi LLC with monthly construction reports with detailed descriptions of all construction progress and total spend.
• Oyu Tolgoi conducts regular, detailed working-level meetings with Erdenes Oyu Tolgoi. For example, the Oyu Tolgoi Finance Department had 14 meetings with Erdenes Oyu Tolgoi to examine the 2013 budget model.
THE SOUTH GOBI, COMMUNITIES AND INFRASTRUCTURE

The future of Khanbogd

Oyu Tolgoi wants to see Khanbogd develop into a thriving community in which employees can live with their families – a community that provides for the economic and social needs of Oyu Tolgoi employees as well as current and future residents of Khanbogd.

Neither the original feasibility study for the mine nor the Investment Agreement include obligations to build a new town or development of Khanbogd. Thus, this is not a budgeted expense under the feasibility study – an especially important issue given all parties’ interests in keeping the costs associated with the mine as low as possible.

Oyu Tolgoi is not permitted to build a town on its own. The laws and customs of Mongolia dictate that Oyu Tolgoi must follow the planning lead of the Government, which has legal responsibility for urban planning, town administration and town maintenance. However, Oyu Tolgoi is working with the Government to develop a long-term master plan for Khanbogd that involves the community, private sector and other stakeholders. When this process is complete and financing is obtained, partners can construct elements of the town.

In the meantime, Oyu Tolgoi has made a number of improvements in the South Gobi region:

- A 35kV power line from the Oyu Tolgoi mine to Khanbogd is scheduled to be operational shortly; Oyu Tolgoi is already supplying the town with 24-hour power. (Investment: 5.9 billion MNT)
- Oyu Tolgoi is studying potential new water sources to provide Khanbogd with access to greater supplies of drinking water. If found,
the water sources will be connected to the soumcentre. (Investment to date: 1.68 billion MNT)

- The company constructed a Vocational Training Center in Khanbogd, which opened in May 2012, which can accommodate 150 students. (Investment: Nearly 2 billion MNT)
- A technical Mining School of Excellence is being built in Dalanzadgad, one of three schools that Oyu Tolgoi is building in Mongolia. (Investment: 7 billion MNT)
- Oyu Tolgoi is building a sports complex in Dalanzadgad, intended to support the development of Mongolian athletes. (Investment: 2.6 billion MNT)
- Oyu Tolgoi is also building a sports hall in Bayan-Ovoosoum. (Investment: 775 million MNT)
- Oyu Tolgoi is funding and managing a world-class Cultural Heritage Programme to preserve the tangible and intangible heritage around Umnugobiimag; programme includes cataloguing and protecting natural and man-made regional cultural heritage sites, including recording and preserving ancient songs with 100 elders. (Investment so far: 1.3 billion MNT)

Water resources

Oyu Tolgoi’s Environment and Social Impact Assessment (ESIA) was approved in 2012 as the result of extensive and thorough discussion with the Government. Today, the ESIA provides the framework within which we work cooperatively to ensure that the use of water in the South Gobi region is carefully managed.

Oyu Tolgoi has been scientifically studying and monitoring the regional surface water supply since 2003. We started hydrogeological assessments of water resources in 2003, and have repeated them again in 2006, 2008 and 2010. These were conducted by professional, independent experts, including the Mongolian Water Authority.
Also in 2003, Oyu Tolgoi initiated a well monitoring programme to track surface water levels in wells around the project area. Today, Oyu Tolgoi monitors water level and quality at 245 boreholes, herders’ wells and springs. Oyu Tolgoi does this in partnership with local herder families, which help identify any changes in water level to gain a clear understanding of natural variations and trends in the area.

Because surface water is scarce, Oyu Tolgoi’s water needs are being supplied by a massive, deep-water aquifer discovered through the company’s extensive hydrological studies. Called GuniiHooloi, it is 40 to 70 km from the project site. GuniiHooloi is a deep-water, brackish, salty aquifer comprised of water that is non-potable, meaning it is unfit for human or animal consumption. Based on these assessments, the Government gave Oyu Tolgoi its approval to source water from the Gunii Hooloi. The company is only allowed to use approximately 20 per cent of the water so the aquifer can never run dry.

Oyu Tolgoi is also working to protect the Undai River (sair), which is an ephemeral waterway, meaning it does not contain water year-round. Because the Undai crosses the open pit mine and waste rock dump, it needs to be diverted for several kilometres around that area and back into its normal channel. This action will ensure the Undai River continues to flow to the south.

**Road construction**

Oyu Tolgoi is building a 109km paved road from the mine site to the Chinese border that is a part of the Mongolian National Highway and meets standards for copper concentrate deliveries. Construction was held up, however, due to delays in the grant of government permits. The road is being constructed in sections; about 50 per cent is expected to be built and paved by mid-2013.
More importantly, Oyu Tolgoi supports development of a comprehensive transportation plan for the South Gobi that involves all mining companies operating there. Oyu Tolgoi believes all roads should be built to the same high international standard as the one Oyu Tolgoi is constructing to protect the Gobi’s environment and minimise dust from operations and transport.

**Economic Development and the South Gobi Development Council**

The Government of Mongolia recently reconstituted the South Gobi Regional Development Council (SGRDC), which includes representatives from all the major mining companies in the South Gobi. Oyu Tolgoi looks forward to the Government’s leadership of the SGRDC, and pledges our own enthusiastic support as a partner alongside the other stakeholders called to participate under the SGRDC’s terms of reference.

The SGRDC was established in 2010 by the Government to provide a broad stakeholder group to guide and facilitate the development of the Southern Gobi region, but the original Council met only a few times, spending most of its time discussing issues around the mining industry in general and to exchange information.
The SGRDC is one of several programmes with which Oyu Tolgoi is involved to meet its goal to improve the livelihoods of the people and areas neighbouring its site.

Foremost among these programmes is a legally binding community Cooperation Agreement, which will formalise the terms of our long-term relationship and regional development activities with the local community, which we are already delivering in good faith. Oyu Tolgoi, the Umnugobi and other nearby soums have been working together since 2011, and are well advanced in their joint development of the Cooperation Agreement. Oyu Tolgoi looks forward to aligning the work being done through the Cooperation Agreement with that to be undertaken by the reconstituted SGRDC.
OPERATIONAL MATTERS

International standard testing of concentrate

The Government recently decided that the state-owned Central Geological Laboratory (CGL) will conduct third-party monitoring and analysis on the products produced by the Oyu Tolgoi concentrator prior to export. Oyu Tolgoi is ready to cooperate fully with the Government, and will comply with all relevant regulations.

Oyu Tolgoi appreciates that it will take some time for the Government to build the lab and establish the required capability for this testing. Oyu Tolgoi customers and the Chinese Inspection and Quarantine agency also need to be consulted to ensure that CGL results will be accepted as third-party assays.

Until then, Oyu Tolgoi proposes to continue using an independent, third party to inspect, test and verify the amount of copper, gold or silver within the concentrate being exported. Oyu Tolgoi has retained Société Générale de Surveillance (SGS), an internationally regarded company headquartered in Switzerland. SGS conducts this testing within a state-of-the-art minerals assay testing laboratory Oyu Tolgoi built at site.

Oyu Tolgoi will be happy to move its testing to CGL as soon as its lab is operational and fully functioning.

Management Costs

It is typical for a mining project on the scale of Oyu Tolgoi to appoint a team to manage the project. Under the shareholders’ agreement, and in return for a Management Services Payment (MSP), the Rio Tinto Group provides world class services and systems which benefit all of Oyu Tolgoi’s shareholders. The expertise that Rio Tinto is providing in order to build and operate Oyu Tolgoi will increase the value of the operation significantly, raising more income for all shareholders including the Government of Mongolia.
It is important to note that the MSP is not designed to create profit for Rio Tinto. Instead, it is intended to compensate Rio Tinto for the services it provides to all shareholders at a fair rate. The level of the fee is consistent with other projects around the world.

The MSP is calculated based as a proportion of the total costs of the project. As Rio Tinto is a significant shareholder in Turquoise Hill Resources, this means that it is not in Rio Tinto’s interest for costs to increase, despite the fact that this would lead to higher MSP payments. The resulting drop in value of Rio Tinto’s share in the project through loss of dividends and increases in financing costs would drastically outweigh any increased revenue under the MSP.

Despite providing its services over the last two years, Rio Tinto has not yet collected the MSP payment.

**Copper smelting**

Consistent with its obligation under the Investment Agreement, Oyu Tolgoi has worked intensely with the Government prior to the parliamentary elections in 2012 to prepare a Memorandum of Understanding (MoU) to analyse the viability of a copper smelter being built in Mongolia. We are ready to work with the Government to finalise this MoU and accelerate how best to conduct studies that examine the economic case for a smelter in Mongolia.

The MoU is in line with the Investment Agreement, which requires that within 3 years of the commencement of production, Oyu Tolgoi will, if requested in writing by the Government, prepare a research report on the economic viability of a party constructing and operating a copper smelter in Mongolia to process mineral concentrate products into metal.
**Power supply**

Oyu Tolgoi is fully committed to its obligations in the Investment Agreement to source its total power requirements from within Mongolia within four years of commercial production. Currently, commercial production is expected to occur by the end of June 2013.

To bring the mine online as quickly as possible – and start to earn project revenues – Oyu Tolgoi worked in close consultation with the Government of Mongolia to secure immediate power through a power purchase agreement with the Inner Mongolian Power Company. A 220 kilovolt (kV) power line between the Oyu Tolgoi mine site and the Chinese border was constructed and commissioned. This allowed the concentrator to be activated.

Currently, there is not enough generation capacity within Mongolia to serve the mine’s needs (estimated to be 450 megawatts). Oyu Tolgoi is considering a number of options to meet its obligations to source its power requirements from within Mongolia in the future. One option which is authorised under the Investment Agreement is an Oyu Tolgoi-owned power plant.

Other options could include purchasing power from any Mongolian provider that can supply adequate quantity and provide security of supply, at competitive pricing. Oyu Tolgoi is also examining the possibility of sourcing supplemental power from renewable energy sources.

Recently, the Government has suggested that a power station could be built at Tavan Tolgoi which would meet OT’s requirements.
MONGOLIAN INVOLVEMENT IN OYU TOLGOI

Building capacity and management experience

Oyu Tolgoi is fully committed that the company be Mongolian-led, and fully supports the appointment of Mongolian nationals to senior management roles based on merit. Under the guidance of Rio Tinto, Oyu Tolgoi has developed comprehensive programmes to train and develop present staff as well as embarking on one of the industry’s most ambitious global programmes to train the future generation of Mongolian mining leaders.

Our staff is provided with a vast number of training and development programmes to help them hone the skills needed to lead a world-class business. A comprehensive management development programme is being rolled out to fast-track the development of high-potential national staff to assume senior roles within the business as soon as they are ready, including graduate training at Rio Tinto projects around the world.

To help build the next generation of Mongolian mining technicians and leaders, Oyu Tolgoi is supporting the vocational training of 3,300 young Mongolian men and women from across every Mongolian province. In addition, Oyu Tolgoi is contributing financial and technical expertise to build three new vocational training facilities and expand four more in seven cities across Mongolia. Oyu Tolgoi and Rio Tinto are also working with leading global educational institutes to provide advice and support in designing university and high school-level curricula to prepare young Mongolians for the 21st century.

For some time, Oyu Tolgoi management has been discussing with Erdenes Oyu Tolgoi the ability to appoint Erdenes Oyu Tolgoi representatives to senior management positions. We have always agreed that the rights of the minority shareholder must be protected, which is why Erdenes Oyu Tolgoi’s 34 per cent ownership carries the right to appoint a...
third of the Oyu Tolgoi Board of Directors, the most senior decision-making body in the Company. The Board in turn has the power and responsibility to direct senior management’s efforts. Oyu Tolgoi will continue to listen to ErdenesOyuTolgoi’s concerns and consider any specific requests in the context of the Company’s existing talent pool and needs. Further, for some time now, Oyu Tolgoi management has informally agreed to have three ErdenesOyu Tolgoi appointees working in the company. One of these appointees already works within the business; while positions in the important governance areas of Company Secretarial and the Internal Audit section remain open to be filled by suitable nominations from Erdenes Oyu Tolgoi.

While listening to ErdenesOyuTolgoi’s concerns and respecting the need to protect the minority shareholder interests, Oyu Tolgoi will continue to advocate an organisational culture that appoints the best person for the job, based on their skills, experience and work ethic. We believe this approach to merit-based promotion will always be in the long-term interests of both the company and the country.

We note that Oyu Tolgoi’s executive management level is currently comprised of 12 accomplished experts across multiple disciplines within the mining industry from multiple countries, including Mongolia, UK, US, Australia, and Japan. These experts collectively have decades of experience in building and running mines across the world. Further, Rio Tinto itself is one of only a few companies around the world with a track record of successfully delivering projects of this size and complexity.

Also, some critics have incorrectly suggested that we pay Mongolians and foreigners differently for doing the same job. We are committed to providing equal pay for equal work and experience in the local market. Oyu Tolgoi organises its employees into pay grades based on the nature of their work. A salary range applies to each pay grade. An individual employee’s position within that range will depend on various factors including skills, experience and performance. Oyu Tolgoi benchmarks its salary ranges to the Mongolian market to ensure they remain competitive.
To read Oyu Tolgoi’s employment policies, visit our website at http://ot.mn/en/people-employment/employment-policies

**Increasing domestic procurement and building a Mongolian supply chain**

Oyu Tolgoi has the clear goal to use more domestic suppliers. Oyu Tolgoi is building and supporting a local, quality-assured supply chain. This is not just about meeting our obligations under the Investment Agreement. It is about good business. Creating jobs and skills in Mongolia will help Oyu Tolgoi to operate more effectively, while ensuring that more of our money is spent in Mongolia.

It is Oyu Tolgoi’s policy and practice to preferentially use Mongolian suppliers – that is, in preference to foreign suppliers – when they are capable of providing goods or services to the technical specification of a world-leading project on competitive terms. Oyu Tolgoi’s procurement policies are available here: http://ot.mn/en/procurement

To meet these objectives, Oyu Tolgoi has developed and is implementing a National Supplier Development Policy and a South Gobi Supplier Development Policy. Collectively, these initiatives underpin Oyu Tolgoi’s efforts to build a national supply chain – and already are yielding results.

The **National Supplier Development Policy** supports Mongolian businesses by providing training to help them successfully bid for tenders and enhance their ability to meet the future needs of OT. It also enables them to take precedent over international companies and allows unsuccessful bids to be resubmitted when they are narrowly beaten by international companies.

The **South Gobi Supplier Development Policy** focuses on increasing the number of South Gobi suppliers. Oyu Tolgoi’s investment in implementing this policy in the South Gobi has increased from $600,000 USD in 2010, to $5 million USD in 2012. Specific programs available to grow South Gobi suppliers include
1. Access to the Dalanzadgad Supplier Development Centre, which provides training, coaching and business support
2. A micro-lending facility to help local businesses develop; annually increased targets for the use of South Gobi suppliers, and favourable payment terms.
3. In addition to the right to resubmit bids established through the National Supplier Development Policy, Oyu Tolgoi will accept slightly higher bids compared to international companies from South Gobi businesses.

These approaches are yielding results:
• Oyu Tolgoi spent $1.1 billion USD in goods and services from Mongolian companies, defined by Mongolian law as those companies with at least 50 percent of more local ownership, from 2010 to 2012.
• 67 per cent (1,131 out of 1,699) of the total number of our suppliers in 2012 were Mongolian.
• 34 per cent of the amount OyuTolgoi spent for supplies in 2012 was with Mongolian suppliers. Our goal is to increase that amount to 45 percent in 2013.
Mongolian banking and financial institutions

Oyu Tolgoi supports the Government’s desire to further grow the nation’s banking infrastructure. Oyu Tolgoi uses domestic financial institutions and Mongolian currency to pay for all goods and services sourced inside Mongolia. All royalties and taxes accruing from the sale of products will be paid in Mongolian currency. This is in compliance with the Investment Agreement and Mongolian legislation.

Given that Oyu Tolgoi conducts international transactions in foreign currencies, it is commercially practical and common practice for a world-class mining company like Oyu Tolgoi to maintain foreign bank accounts in addition to its domestic holdings. Under the Investment Agreement, Oyu Tolgoi is entitled to maintain accounts in commercial banks outside of Mongolia, and may make international transactions.
LEGAL DISCUSSIONS

Entrée Gold

The land area covered by Oyu Tolgoi’s mining license is bordered by two mining licenses held by Entrée Gold LLC. The Oyu Tolgoi group of deposits sits mainly within the boundaries of the Oyu Tolgoi mining lease area. However, a portion of the deposit crosses the lease boundary, so that a percentage of the minerals are set on land registered in the name of Entrée Gold.

As they are part of the same series of deposits, it makes sense for Oyu Tolgoi LLC to mine these areas in a coordinated manner as part of an overall plan. Therefore, Oyu Tolgoi entered an agreement with Entrée Gold which allows Oyu Tolgoi to mine these license areas and contemplates the licenses being held by OT. The economic interest in these deposits is split between Oyu Tolgoi (70-80 per cent value depending on depth) and Entrée Gold (20-30 per cent value).

In accordance with the Investment Agreement the Government owns 34 per cent of the Oyu Tolgoi interest of these two license areas, but has expressed its desire in acquiring a 34 per cent stake in the remaining 20-30% share of the deposits held by Entrée Gold.

Oyu Tolgoi supports the rights of the Government of Mongolia in this regard. That said the rights that are in dispute are not held by Oyu Tolgoi. As Entrée Gold is a separate company, Oyu Tolgoi cannot transfer registered ownership of the Entree licences to the Government, or transfer Entrée’s 20-30% interest share in the licences to the Government. Oyu Tolgoi is encouraging Entrée Gold and the Government to reach a satisfactory conclusion for all parties and will help in any way that it can.
For more information please visit
www.ot.mn