

## MANAGEMENT SERVICES PAYMENTS (MSP)

Context The Oyu Tolgoi Shareholders Agreement states that the Board of Directors shall appoint a team to manage and oversee construction and operations. In return, the manager will receive a Management Services Payment (MSP).

The Board has appointed Rio Tinto to manage the

project, and so will receive the MSP. This means that Oyu Tolgoi will have access to Rio Tinto systems, policies and procedures and intellectual property. Rio Tinto will also provide the required people and appropriate organisation structure to manage full operations. The table below shows the full range of services covered by the MSP:

Mining expertise & technical services	<ul style="list-style-type: none"> <li>• Underground mining standards</li> <li>• Block Cave Underground mine design</li> <li>• Mine planning &amp; design systems</li> <li>• Mining technology and operations standards</li> <li>• Project development &amp; management systems</li> <li>• Asset management systems</li> <li>• Rio Tinto Technology &amp; Innovation</li> <li>• Assay and reconciliation protocols</li> <li>• Rio Tinto global exploration</li> </ul>
Procurement & logistics	<ul style="list-style-type: none"> <li>• Global procurement &amp; contracts management</li> <li>• Contractor management systems</li> <li>• Global vendor database &amp; catalogue</li> <li>• Warehouse management &amp; logistics systems</li> </ul>
Risk and Compliance	<ul style="list-style-type: none"> <li>• Health, safety and environment systems</li> <li>• Sustainable development guidelines</li> <li>• Community relations standards</li> <li>• Corporate governance standards</li> <li>• Business integrity &amp; compliance programs</li> <li>• Fraud &amp; anti-bribery standards</li> <li>• Human rights standards</li> <li>• Risk management systems</li> <li>• Business continuity and disaster recovery standards</li> <li>• Information security standards</li> </ul>
Commercial	<ul style="list-style-type: none"> <li>• Commercial management systems</li> <li>• Global treasury</li> <li>• Cost control systems</li> <li>• IT infrastructure &amp; applications</li> <li>• Benchmarking &amp; business improvement</li> <li>• Document control systems</li> </ul>
Human resources	<ul style="list-style-type: none"> <li>• Human resources policies &amp; systems</li> <li>• Rio Tinto graduate program</li> <li>• E-Learning training modules</li> </ul>

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### Background

Rio Tinto is a leading global mining company. It runs highly efficient operations all over the world. This means that Rio Tinto is an ideal supplier of the broad range of services that are needed to make Oyu Tolgoi highly successful. The benefits of these services, valued across the entire project lifetime, are worth more than ten times the value of fees paid. For example, at full production, Rio Tinto's management services will typically increase cashflows to shareholders by \$1-2bn at a fee of \$60-80m. Rio Tinto is an industry leader in a range of services that are covered by the MSP. These include:

1. Project management – The construction schedule has been compressed as a result of Rio Tinto's effective planning and execution
2. Mining operations – Oyu Tolgoi will benefit from Rio Tinto's 'block caving' mining method. This method is more difficult than conventional mining, but is much cheaper. Few companies in the world can mine in this way. Of those who can, Rio Tinto is the global leader.
3. Marketing – Rio Tinto's expertise and reputation mean Oyu Tolgoi receives full international copper prices, first time in Mongolia.
4. Purchasing – Rio Tinto's buying power, bargaining skills and relationships with international suppliers mean Oyu Tolgoi pays less for its supplies than otherwise.
5. Operating standards – Rio Tinto's management helps Oyu Tolgoi operate to the highest operational, safety and environmental standards. As well as

protecting Oyu Tolgoi employees and the environment, this helps secure funding from important institutions, like international development banks.

Each of these services greatly increases the value of Oyu Tolgoi, to the benefit of all shareholders:

1. Rio Tinto's project management will result in construction being completed 12 months earlier than expected. This will increase near-term cashflows by more than \$1 billion
2. Rio Tinto is implementing 'Block cave' mining which allows Oyu Tolgoi to reach full scale production many years earlier than alternate methods. In addition, the cost of mining each tonne of ore will be reduced approximately two-thirds lower than alternative methods, which greatly increases mining profits
3. Rio Tinto has locked in contracts with customers that generate more revenue than is usually achieved by Mongolian copper miners
4. As examples of Rio Tinto's purchasing power, it is able to purchase mining trucks at 40% lower cost and fuel at 9% lower cost than would otherwise be possible for OT without OT
5. Rio Tinto's ability to meet the highest standards, ensures sufficient funding, at competitive cost, available to develop Oyu Tolgoi

Rio Tinto's services also create benefits beyond the project. As well as providing world class training for 3,000 OT employees, Rio Tinto also supporting the training of thousands more workers and teachers across Mongolia. In

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In addition, Rio Tinto is helping local companies capture opportunities resulting from the OT project. This is consistent with Rio Tinto's overall approach to project development across the world.

### Facts about Rio Tinto

- Rio Tinto is the world's second largest mining company.
- Rio Tinto has operations across a range of products and geographies. It has a focus on developing natural resources into large, long life and efficient mining operations
- Wherever Rio Tinto operates, health and safety is the first priority and sustainable development is at the heart of its operations.

### Facts about the Management Services Payment

- The Shareholders Agreement Specifies that the MSP shall be calculated as:
  - o 3% of all capital and operating costs incurred prior to the commencement of production
  - o 6% of all capital and operating costs incurred after the commencement of production
- When OT reaches full production, payments are expected to be in the range of \$60-80m per year
- In return for the MSP, Rio Tinto provides to Oyu Tolgoi highly valuable skills, systems and processes. It also enables Oyu Tolgoi to benefit from Rio Tinto's reputation, experience and goodwill in the international marketplace. These services increase cashflows to shareholders by \$1-2bn in most years of operations.

- The value of these services is nearly ten times that of the MSP.
- The agreement states that payments should be made quarterly.
- To date, no MSP payments have been made. The parties have agreed that payment will not occur until the project is in commercial production and receiving revenue.

### Q&A

*Q1: Why is Rio Tinto charging a management fee when it already owns the majority of the project?*

A: Rio Tinto ownership interest in Turquoise Hill Resources represents a 33 per cent ownership in Oyu Tolgoi. As such, it is a minority owner. Separately, it also has a role as project manager. The fee recognises that all shareholders, not just Rio Tinto, will benefit from Rio Tinto's management services. These services will increase the volume of copper mined, increase the price at which the copper is sold and reduce mining costs. As a result, there will be more cash available to pay dividends to all shareholders.

Management fees of this type are commonly used at mining joint-ventures around the world to compensate providers of services that enable the mine to operate successfully.

*Q2: Is the size of the management fee fair?*

A: The management fee is designed to compensate Rio Tinto for services it provides, not to deliver a profit through providing the

## MANAGEMENT SERVICES PAYMENTS (MSP)

services. When OT reaches full production, Rio Tinto's management services will increase cashflows to shareholders by \$1-2bn in most years, while management fees incurred will be typically be \$60-80m. Managed across the lifetime of the project, the value of these additional cash flows is more than 10 times that of the fees.

*Q3: How does the MSP compare with joint-venture fees at other mining operations around the globe?*

There is a lot of variation in fee structures at other mining operations. Fees are commonly calculated as 1-3% of revenue, however cost-based fees are also frequently applied. These fees typically cover far fewer services than Rio Tinto will provide to Oyu Tolgoi. For example, revenue-based fees often cover only marketing services, and not the full range of services being provided by Rio Tinto.

If a fee of 2% of revenue were charged to OT, this would result in payments of \$80-140m in most years of operations. This is substantially higher than the fees payable under the MSP. Revenue-based fees can also be highly volatile, varying substantially from predictions in response to market price volatility. These variations would be unrelated to actual costs

incurred by the manager, and introduce considerable uncertainty to all shareholders. It should be noted that negotiations for the MSP were conducted between the Board of Directors and the service provider in a way that is similar to other operations.

*Q4: Will the MSP provide Rio Tinto with incentives to increase costs in order to increase the management fee?*

A: No. The MSP would be higher if capital or operating costs rose. Nonetheless, the value of Rio Tinto's project ownership would reduce by a much larger amount.

Cost increases are always bad for Rio Tinto. For example, if capital expenditure and operating costs were to increase by 20%, the total value to be distributed among shareholders would decline, with the Government of Mongolia's share increasing from roughly 75% to nearly 100%. This increase is largely due to increases in the value of royalties, VAT and other taxes.

While management fees would increase, loss of dividends and increases in financing costs would erode a far greater proportion of the value that Rio Tinto receives from Oyu Tolgoi.