

Supply Chain Management

Considering the current global business environment, supply chain management is becoming significantly important for the operation and reputation of company. In particular, with increased demand from stakeholders for corporate compliance with social responsibility, it is crucial to deal with potential risks in the overall company's value chain in advance. A company should enhance competitiveness by securing stable suppliers and pursue sustainable growth by managing any risks from suppliers.

SK innovation has established a supply chain management system and managed the sustainability of suppliers through continuous evaluation and monitoring.

— Supply Chain Management Policy

SK innovation's supply chain management strategy entails comprehensively considering various aspects for total cost ownership, reliability, on-time delivery and customer service level, SHE (Safety, Health, Environment) management and risk management for financial and non-financial elements (ESG).

In addition, with the aim of creating a fair and transparent trade environment and ensuring sustainability management for suppliers, the company enacted the Supplier Code of Conduct and Purchase Code of Ethics in 2017 and conducted systemic management for the entire purchasing process, including the registration and evaluation of suppliers and the purchase contract management by through e-Procurement System (BiOK).

 Major Contents of the Purchase Code of Ethics	Compliance with fair trade, transparent transaction, laws and international agreements (human rights proclamation, UNGC, etc.)
 Major Contents of the Supplier Code of Conduct	Human rights and labor issues, safety and health, management of environment-friendly business sites, compliance with corporate ethics, prohibition of the use of conflict minerals, establishment of management system, etc.



Screen of e-Procurement System (BiOK)

— Current Status of the Supply Chain

SK innovation classifies and manages its critical suppliers by comprehensively considering various factors such as transaction size, substitute products/service, the core technology possession, and the possibility of risks for non-financial elements (ESG).

Critical suppliers of SK innovation are companies which handle core raw and subsidiary materials (battery raw materials, additives, catalysts, etc.), and which are related to the business or performance of large-scale construction or services at major production plants, such as Ulsan, Incheon, Jeungpyeong, Cheongju and Seosan. As of 2017, 295 companies are classified as critical suppliers, from a total of 3,030 suppliers. Also, we are expanding the scope of the supply chain management to secondary suppliers (Non-Tier 1), in the case of large-scale construction, service and some equipment suppliers at major production plants and suppliers with a high possibility of having issues related to fair transaction.

● Current Status of Suppliers in 2017

(Unit: Number of company, %)

Classification	Number of Suppliers	Percentage of Purchase	
Tier1	Total Suppliers ¹⁾	3,030	100
	Critical Suppliers	295	85
Non-Tier 1	Critical Suppliers ²⁾	57	-

Note 1) Suppliers with recorded transaction performance within the past three years
Note 2) Intermediate contractors with regard to large-scale construction and services at a major production plant, or items of a certain scale (data from SK E&C and Happynarae)

● Amount of Procurement

(Unit: KRW 100 million, %)

Classification	2015	2016	2017
Amount of Procurement	7,436	9,536	11,866
Amount of Local Procurement ¹⁾	3,767	4,833	7,371
Ratio of Local Procurement ¹⁾	51	51	62

Note 1) Limited to Korea

— Sustainable Supply Chain Management

SK innovation conducts economic, social, safety and environmental risk assessment and monitoring both new and existing suppliers. In particular, we monitor economic risk elements on a real-time basis based on the materials of major credit-rating institutions and also manage non-financial risk elements by evaluating human rights/labor and environment issues on a regular basis for any suppliers with a high-risk possibility. For suppliers which acquire excellent outcome

through regular monitoring and audit, we provide them with numerous benefits, such as exemption from deposits and qualification of participating in the maintenance unit. For those suppliers which fail to meet the evaluation criteria, we take various measures such as requesting corrections and ending transaction relations.

● Process of Sustainable Supply Chain Management

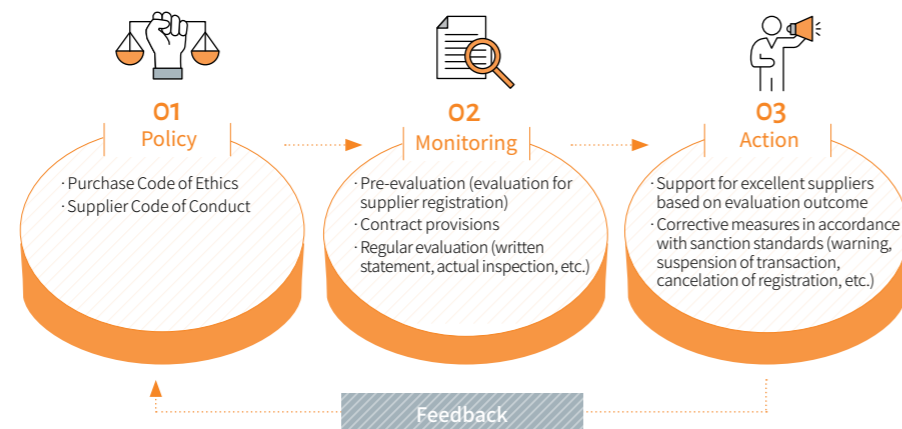
Global Guidelines

- UNGC Principle
- OECD MINE Guidelines
- ⋮

Internal Criteria

- Enhancement of Competitiveness
- Risk Management

Consideration of economic, social, safety and environmental aspects



Preventive Actions for Sustainable Supply Chain

SK innovation conducts a pre-evaluation of suppliers in terms of economic, social, safety, and environmental aspects in pursuit of the goal to carry out sustainable supply chain management. In particular, the company ensures compliance with the Supplier Code of Conduct through the e-Procurement System (BiOK), and registers and evaluates new suppliers. If a supplier fails to meet a certain standard, the supplier is excluded from the list of registered SK innovation suppliers in order to mitigate risks from the stage of supplier registration.

In 2017, the number of newly recruited suppliers was 384, all of which were registered after pre-evaluation was completed.

● Pre-Evaluation for Supply Chain (Unit: Number of company, %)

Classification	2015	2016	2017
Number of Newly Registered Suppliers	304	335	384
Number of Suppliers for Economic, Social, Safety and Environmental Evaluation	304	335	384
Ratio of Pre-Evaluation	100	100	100

Target for 2020

To maintain a ratio of **100%** for pre-evaluation of newly registered suppliers

Evaluation of Risks in the Supply Chain

SK innovation identifies major risk elements, which can occur in the economic, social, safety and environmental aspects and conducts regular evaluations for suppliers which have potential ESG risk factors.

In particular, when it comes to high-risk suppliers, we conduct third-party audit and visit-based investigations to reinforce monitoring and manage ESG risks.

● Supplier Risk Evaluation Results in 2017 (Unit: Number of company, %)

Classification	Major Risk Elements	Target Company	Number of High Risks (Ratio ¹⁾)
Economy	Financial risk such as financial rating and financial information change, etc.	Total suppliers	3,030 (100) 46 (1.5)
	Unfair transactions such as collusion, violation of ethics laws and regulations, etc.		
Society	Human rights, labor, etc.	Business site	832 (27.4) 201 (24)
	Conflict minerals		
Environment	Large-scale safety and environmental accidents (oil leakage in the sea, gas leakage, etc.)	Battery	Raw and subsidiary materials, etc.
	Violation of environmental regulations and laws		
	Level of establishment and management of SHE management system		

Note 1) The high-risk ratio is calculated by % compared to evaluation target companies.

Case of Risk Evaluation in the Supply Chain

SK innovation fundamentally prohibits the use of conflict minerals based on the Supplier Code of Conduct. Under the principle, the company strengthens the management for major raw materials suppliers with a high level of risk for using conflict minerals. In particular, we prevent human rights infringement such as child exploitation in trade of cobalt, raw materials for batteries, by reinforcing monitoring for suppliers.

● Supplier Risk Evaluation Results in the Method (Unit: Number of company, %)

Classification	2017
Tier 1	Total Suppliers 3,030
	ESG Evaluation 3,030
	- Written Inspection 2,886
	- On-Site Inspection ¹⁾ 92
	- Third-Party Audit ²⁾ 52
	Ratio of Evaluation 100
Non-Tier 1	Critical Suppliers 57
	ESG Evaluation 57
	Ratio of Evaluation 100

Note 1) Includes companies for regular annual evaluations, especially those which conduct large-scale construction projects and service at major production plants, such as Ulsan and Incheon
Note 2) Includes target companies for annual evaluation by a government-led mutual growth committee as a company with a high possibility of risk in fair trade.

Target for 2020

To maintain **100%** of suppliers' evaluation rate

Total suppliers (Tier 1) and critical Non-Tier1 suppliers are included.

Corrective Measures

For any suppliers which need improvement based on the diagnosis and evaluation results, SK innovation requests them to establish a plan for corrective measures and improve risk elements (including ESG risks). Through these efforts, approximately 30% of suppliers with a high possibility of risk have improved risk management.

Despite this outcome, in 2017, the total number of suppliers under sanctions based on diagnosis and evaluation results was seven; of them, two suppliers faced permanent suspension of transactions due to severe policy violations when it comes to ethical issues and infringement on fair and transparent trade.

● Corrective Measures for Supplier Risks (Unit: %, case)

Classification	2017
Ratio of the Establishment of an Improvement Plan for High-Risk Suppliers	30
Ratio of ESG Performance Improvement in the 12 Months after an Improvement Plan is Made	100
Measure for the Suspension of Transaction	7 ¹⁾
- Temporary Suspension	5
- Permanent Suspension	2

Note 1) Decisions made by Sanction Review Committee