

BUILDING THE MONGOLIAN INVESTMENT CASE

Geographically located between China and Russia, Mongolia is blessed with a huge resource endowment and a convenient location. Despite undergoing some turbulence, proponents of the country's investment story are confident that it will continue to develop and grow going forward, leveraging off some of the world's largest mines and other strategic resources.

ARTICULATING THE OPPORTUNITIES THAT MONGOLIA REPRESENTS TO INVESTORS

Nick Cousyn: I would characterise Mongolia as medium to long term as an investment opportunity. For example, in the last 20 years, there have been some highs in terms of economic growth but

there have been some lows also – which is where we find ourselves at the moment. For investors to understand Mongolia, they must realise what has taken place over the last few years. For example, in 2011, nobody thought anything would go wrong for Mongolia. In 2014, many people feel nothing can go right. At the same time,



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Mongolia has a great ability to change, and within two years has come full circle. So people must be patient and thoughtful in the way they invest.

Another key take-away in a sustainable downturn, in a democracy people want prosperity but that is simply unsustainable. Investors should pick good assets, and be patient.

Harris Kupperman: There is a lot of pessimism and negativity at the moment. However, as an owner of property in this city and a company that owns approximately 55 income producing properties, we haven't seen that negativity in our numbers.

We track things like days, rent outstanding, bad debts, vacancy; and when we look at our June numbers, our same-store rent increased by 32.3% in Mongolian Togrog terms, which is a mid-teens increase in USD terms, which is quite substantial growth, especially in a market where a lot of people are pessimistic.

When the cycle does turn – and it will – you will see a lot of growth. Things are not that bad, outside of certain industries, like mining. I see a lot of other industries doing well. For example, we have almost no vacancy in our portfolio. But nobody seems to talk about stories other than mining.

GANHUYAG CHULUUN HUTAGT

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Erdembileg.Ts: With regards to the economy, I agree there is potential for change. Right now, I have to say that opportunities are not diminished, but the only thing that has been damaged is investor confidence. That is just a matter of time.

We are working on two construction projects; we sold 30% of properties without even building yet. With the right marketing, we can always build up consumer confidence.

Ganhuyag Chuluun Hutagt: We have learned a lot from our past mistakes. Public opinion towards foreign investors is different today compared with 2 years ago,

now we understand that Mongolia can't sustain itself in the way people thought – which was that everything should be domestic and we should try to push out international investors.

Of course, there will be more measures that need to be taken before things get back on the right track. Everybody agrees we need to move to the second phase of OT. People also realise maybe there were more things on that agenda given on Oyu Tolgoi and foreign companies and maybe there was a self-serving agenda that was against the Oyu Tolgoi development in the first place. The public also wants to move along with the railway projects.

Mongolia needs to prioritise its investments and focus, and a great deal of latitude can be given to investors to help us make things right. Financial literacy, public education about investment, the importance of the government and role of the private companies in the economy. Attitude change needs to happen and people need to change their views towards success and business people. We need to educate the public, which is very important.

We need to have good successful businesses to show they are not here for the short term gains but aim for the long run prosperity for all.

Travis Hamilton: There clearly has been a recognition domestically about the importance of foreign capital – and that Mongolia has to compete against other investment destinations for this capital.

It is not a case of just simply opening up the doors and waiting for money to come in.

There are a lot of places around the world with competing investment opportunities, and Mongolia has to actively promote itself as a viable investment destination to

negative attention from international media over the last couple of years.

What we highlight to investors is that even during challenging times, there are a number of success stories.

Many companies here are achieving their goals and objectives whether they are being awarded mining licenses or reaching other milestones and many operating businesses continue to experience phenomenal growth. Xanadu Mines is a great example of many.

get these in place, we can compete in the global marketplace.

As a small to medium-sized family office, and a Mongolian entity, we look beyond the short and medium term.

We see that growth that comes from the FDI sector is segmented; those sectors will grow on the back of the economic growth.

We highlighted certain areas such as financial groups, insurance and leasing. It is a challenge in the short term, but if we can

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the international investment community. I believe at the moment, Mongolia represents perhaps the best risk-reward opportunities compared with other emerging markets in the world. I have a business which is purely focused on this country.

When compared with other frontier and emerging markets I think the legislation in this country is exceptional, particularly with regards to the new Investment Law, Securities Market Law as well as the recent revisions of the Mining Law.

All of these changes set a solid foundation for future investment in the country.

Of course, Mongolia still has a lot of challenges and it's received a lot of

With regards to what is next, Mongolia can't ignore that the resource sector is going to be the main driver of the economy in the next few years.

We certainly see opportunities beyond the mining sector, but that sector is driving the initial investment flows and the sector requires a massive supply chain that requires further investment. It is the big projects that will get FDI moving and which we believe will generate a significant multiplier effect across the economy that will extend through many sectors. The banking sector of course is one of the first and main recipients of this multiplier effect.

Enkhjargal Natsagdorj: There are two main things that have learnt: one is that policy is key; the second is the rule of law. Once we

stick to the right policies and come back intact, the future should be bright.

Bilguun Ankhbayar: Mongolia highlights a discovery-driven growth which will generate a lot of wealth in the future. A lot of investors are going to do well in the next 1 to 2 years.

The legislation is at an all-time high and we have junior companies that will deliver successful results to investors. Any foreign investors looking at Mongolia should concentrate on the mining industry.

Enkhjargal Natsagdorj: We work with Mongolian companies to help them design and produce good investment reports, and also look for financing methods. I think Mongolia has been spoiled. I had a

chance to work with great companies back in 2010, to try to introduce them to the Mongolia government and various large projects, but I felt there was little interest from Mongolian politicians.

We can talk macro-economics all the time, but everything is down to people, corporations and understanding each other. I was unhappy to see how Mongolia behaves and I think it is a country that needs experience to handle such large amounts of wealth. Politicians now have a lot to think about, especially since

stories – we saw that start of copper mining in the late 1970s in at Erdennt. And more recently we have seen construction of another major copper in the south Gobi region by Tourquise Hill in record time. The discovery and development of the giant Oyu Tolgoi deposit is great success story and it is an important thing to note there are very few places in the world that you can develop a copper mine so quickly.

I have worked in this industry for the last 10 years, there are not many countries in the world that have shown an ability

If we can get some sustainability here, we can get things going. North Asia is a good market to have on your doorstep.

Francis Rozario: I started Asia Capital and Advisors (ACA) 3 years ago after having run Fullerton Financial Holdings for Temasek, which invested in the banking and financial sector. I am here as a potential investor and hope to do something in private equity besides supporting Travis Hamilton's Khan Mongolia Equity Fund which is now managed under ACA.

HARRIS KUPPERMAN

Mongolia Growth Group



Mongolia is not the only country with natural assets. Mongolia is not educated enough to work with foreigners. I hope after this difficult three years, it will be all good. We are a consulting company, helping the government to gain. Now we are suffering because nobody is asking for investment. But after everything goes up, people's attitudes will be better.

Andrew Stewart: We all think the mining sector is a Mongolian problem, but it's actually a global one at the moment. Commodity prices are quite good in terms of historical prices.

The important thing about Mongolia is that we often concentrate on the bad news, but we don't address good stories. Yet Mongolia has a long history of success

to take things from exploration to development in such a short time.

Likewise, we saw an energy sector develop which has been happening in the last 2 to 3 years.

History has proven that you can do things here. Politics are complicated. But there is a track record which goes back to the 1970s. It has a world class deposit and the next stage is important.

Outside of Mongolia, I don't see this happening in the world, so quickly. We don't look at the positives and we need to be patient. Regulations are ready to go in the background. Hopefully we will get some middle ground. Good laws are laws that change and evolve all the time.

Bayanjargal Byambasaikhan: NovaTerra is a small investment shop set up in 2013. I believe in the Mongolian growth story. We are looking at an economy that has grown ten-fold over the last few years.

If there is a continuing growth of 9% to 11%, we will be a US\$50 billion country in less than 15 years.

In terms of investment plans, you will hear numbers from various sources, and everybody gets used to hearing that US\$65 billion will be needed over the next 10 to 15 years to make the economy sustainable. You are talking about energy and mining projects, and other infrastructure sectors. Recently we have been pushing towards an energy export market. If you look at Mongolia, there are

almost 3 billion customers surrounding the country, all are huge users of energy. For me, that's where opportunities are; we are working with the government to ensure policies are in place to help people like us investing into the plans and infrastructure, so we can start exporting energy. In 5 years, Mongolia will be exporting power to surrounding markets. When the Chinese president visits, one of the things we have put on the agenda is to have a framework for trading 20,000 megawatts of electricity between Mongolia and China. That is huge, 20 times of what Mongolia produces today. That is a real project.

NICK COUSYN

BDSec JSC



AVENUES FOR INVESTMENT GOING FORWARD

Travis Hamilton: From everybody's comments, there is a clear need for investment. Beyond the need, there is a serious misconception about Mongolia in the international investment community. The country needs to promote itself to win back interest from investors.

When sentiment turns, which I strongly believe it will, what is Mongolia going to do to facilitate the fund flows coming in?

Ganhuyag Chuluun Hutagt: We all know that we have high level visitors from Russia and China now. We need to analyse what economic advantage it brings to Mongolia.

We recently had our president going to Japan to sign a treaty. We talk to the Americans about free trade. We have approached Canada as well.

Given the situation with Russia and Ukraine, Mongolia could bring benefits to foreign investors who want to enter the Chinese and Russian markets.

Another point I would like to add is we talked about short to medium term, but we need to come up with a long-term vision - what is our competitive edge, what do we offer to the rest of the world. Is it just the land or is it the people? All the money that is accumulated in China and Russia,

they need a safe heaven. Maybe it is not Switzerland, maybe it is us.

It is important for us to come up with comprehensive financial center concept, good bank secrecy laws. That will build up trust, trust can be won through actions. Our government had started rebuilding that trust. We need to do things without slip-ups. We should involve the private sector in the conversation.

Travis Hamilton: The key is how to get capital flows into the country. There are only a few avenues, and only a few opportunities for foreign investors at present.

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Bodi Group



I have met hundreds of investors over the last few months and most of them, rightly or wrongly, say they are not interested in Mongolia until the government resolves their issues with Rio Tinto over Oyu Tolgoi. "If Rio can't do business there, why should I invest there? Show us that the issues are resolved."

It's clearly in everyone's interest to get Phase Two Development of Oyu Tolgoi up and running. If Mongolia can get that done, it will bring not only the massive US\$5.4 billion required for the Phase Two development but also it will likely be the major catalyst to bring back foreign

investor's trust and spur additional capital flows into the market.

Mongolia needs dollars which will come when you have real projects in place. All of the legislative progress is great, but we need projects to start.

Ganhuyag Chuluun Hutagt: The theme is to try to raise the living standard that keeps the government constantly running ahead of itself. The government was printing more money to create money supply which led to a high inflation.

considering the backdrop of the economy. Eight of these companies saw revenue growth in excess of 100%, 5 had earnings growing by 400%. We published research that was focused on the largest 20 non-government controlled stocks on the Mongolian Stock Exchange.

Since 2010, these 20 stocks returned 800% in equity value. In stock exchange terms, you are talking about 450% in dollar terms. If you compare this to the Mongolia Stock Exchange top 20, that index returned about 220% over the same

I was recently appointed to the board of the largest beverage manufacturer of Mongolia, and at the same time, other independent (and international) directors were appointed as well.

This is a great sign in itself.

We are seeing a shift and recognition by local companies to adopt first world principles with regards to governance and transparency and using their boards as a means to tap foreign expertise and experience to help their company's growth.

DR ANDREW STEWART

Xanadu Mines



The government realised it couldn't get the economy going despite the huge resources and aspirations from common people here that need to be met. This is tough.

Enkhjargal Natsagdorj: We need to have a consensus of everything. It is the way forward.

Nick Cousyn: Policies and politics aside, I want to talk about an area that is an unqualified success on an absolute basis. This is Mongolian stocks.

In 2013, the 35 fastest-growing stocks on the Mongolia Stock Exchange grew on average by 24% and earnings were on average about 32%. This was after the GDP had decreased from growing by 17% to around 7%. These are big numbers,

period. Whether you are talking about 1 to 5 year returns, it has outperformed the market margin. On the chart, you can see the owner line has 20 stocks. Those stocks did nothing but went up – what you see here is a secular growth story, with no correlation to negative headlines.

I think the point here is that even today, those Mongolian-listed equities remain fundamentally mispriced, over 2 years, we had seen 47 companies that went private and bought out their minority shareholders.

Travis Hamilton: As investors we look at some key things, not surprisingly governance and transparency. Thankfully I've seen huge improvements in both over recent years.

Bilguun Ankhbayar: While the earnings and corporate transparency continue to increase, a lot of profits are made privately. For foreign investors to access this will be problematic.

Over the next 1 year, there will be a flood into Mongolian products.

We know that government securities will be offered at the domestic stock exchange which will hopefully act as a catalyst to try to utilise the local stock exchange for financing needs for local companies.

Within that respect, we know several companies that look to enter the space as well. To add to previous comments, we like to see new products to enter new markets as well.

HOW HNW INVESTORS CAN ACCESS MONGOLIA - AND HOW IT WILL DEVELOP

ENKHJARGAL NATSAGDORJ
Interconsulting Group



Erdembileg.Ts: Every time we have been approached by investors, they give me the 3Cs of investments. First is cash flow, second is collateral, third is character. Right now, Mongolia is lacking the character part. The right people, right accountability, and with proper governance. In terms of collateral, it has been already a book term that is proven by an avenue of science that Mongolia has minerals underground.

With cash flow, we have eyes on the financial system, we don't have this problem. We need to concentrate on the character part. The 3Cs are the fundamental question people ask. With various events happening in the last 3 years, we have been changing laws without actually compensating investors. We have to work together to find a balance.

Travis Hamilton: My view might be biased, but I believe that for investors looking for a diversified and risk-managed exposure, a Mongolia-focused investment fund with local presence and expertise would offer the best access.

There are bound to be a number of upcoming opportunities via the nascent

stock exchange as state-owned enterprises begin to be privatised and we see more private sector companies look to the market to raise expansion capital or funding to retire expensive debt.

Liquidity is still a challenge, but we expect to see the market develop and evolve rapidly over the next couple of years.

Harris Kupperman: I first visited Mongolia in 2010 as an investor for my hedge fund group. We were looking for businesses that had four key characteristics: liquidity, transparency, strong corporate governance, and a solid business strategy. Unfortunately, we couldn't find any on

the stock exchange. Therefore, we then brought our own company to Mongolia and listed it in Canada, which was 4 years ago.

Since then, a lot of advancement has taken place in this country. Public companies are now filing their financial statements on time, which leads to transparency. Real changes are underway. By 2015, there will be many more suitable businesses on the Mongolian Stock Exchange.

What is still missing is liquidity. One of the great goals of our business is that we always wanted to be listed on the Mongolian Stock Exchange. However, the expenses don't justify it until we get more liquidity on the MSE.

BILGUUN ANKHBAYAR

Mongolian Investment Banking Group



UNDERSTANDING LIQUIDITY ISSUES

Harris Kupperman: People trade, but it is also a lack of enough diversified businesses on the stock exchange.

Ganhuyag Chuluun Hutagt: I still think the stock exchange has a lack of money, and it has a lack of enough companies. These could be actively traded for gains and value, as a saving method. If you look at savings in the banking sector, the problem is that education in the market is low. This gives opportunities to grab majority stocks at cheap prices. When you look at

companies that are doing well, minority interest are not protected well until the beginning of this year.

The guy who owns more than 50% of the company could do whatever he wanted.

Corporate governance-wise, I have a couple of reports here. To what you said about the Mongolian stock exchange, some companies will try to go IPO, when the timing is right, the first mover advantage is huge. New capital raising of funds is unfolding.

privatised because if we go into six rough months, it is very likely they will gain. It is the taxpayers who fund all these losses.

Privatisation has to be done; the stock exchange is a primary vehicle for that. Then at this point, you have to offer liquidity and make the exchange more viable.

Harris Kupperman: As the capital markets continue to develop, in the short term, foreign-listed companies that have exposure to Mongolia will continue to be a key driver of capital into the country. Many foreign companies will have to raise

into a period where there are a lot of opportunities, so we have to enjoy the ride for the next year or so.

Nick Cousyn: If you are not familiar with the market, you need to do proper due diligence. It is difficult for foreigners to operate here.

If you respect Mongolia, we have no issues with the city or national governments. We have great relationships with partners and friends. It is about doing business and respecting people. As you look around

FRANCIS ROZARIO

Asia Capital & Advisors



Harris Kupperman: We have 30 to 35 great companies on the Mongolian Stock Exchange but only a few of them have sufficient liquidity for investors to buy any sort of position. The next generation of listings will grow the capital market. This is the growth phase which you can talk about in a few years.

Also, we will see some families that list subsidiary companies, and this will give the market much greater liquidity.

Nick Cousyn: There are US\$4 billion state-owned companies which, from what I understand, are either breaking even or losing money. That is a horrific return on assets. It is clear these assets need to be in private hands. Some of those shares need to be distributed. They should be

money in order to achieve their goals. Those investors will be offshore which can support the offshore market for these companies. It is going to take more time before we see that capital come to companies listed here. But hopefully that is something we can expect in the years to come.

Bilguun Ankhbayar: Mongolia is a democratic country; the beauty of democracy is it swings. The swings have been there four times since Mongolia has turned democratic and since it has a free market system. Each time it swings from one end to another, the law loses its momentum.

In the future, there will still be swings, but they will be smaller. We are entering

the country, there are a lot of people that continue to say it is tough to be a foreigner. But we are happy to be here.

Enkhjargal Natsagdorj: You should work closely with Mongolian companies because you will not find proper products otherwise. I have experienced that some Malaysian companies came in at the last moment. They need to be patient; we will do due diligence and also educate Mongolian companies. Maybe after one year, they are ready to be a good partner. I think private investment is a major part which will grow in next few years. Some companies that work here are very old fashioned because they only developed in the last 20 years. They try to be control of the management and change the company; it takes time to change. ■