

MONGOLIA GROWTH GROUP LTD.

Management Discussion & Analysis

December 31, 2012

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The management of Mongolia Growth Group Ltd. (“MGG” or “the Company”) presents the Company’s management discussion and analysis for the year ended December 31, 2012 (the “MD&A”), compared with the year ended December 31, 2011. As of January 1, 2011, the Company adopted International Financial Reporting Standards (“IFRS”). This MD&A provides an overall discussion, followed by analyses of the performance of the Company’s major reportable segments. The reporting and presentation currency in the consolidated financial statements and in this discussion and analysis is the Canadian dollar, unless otherwise noted.

This MD&A is dated April 30, 2013 and incorporates all relevant information and considerations to that date.

*The following discussion and analysis should be read in conjunction with the audited consolidated financial statements of the Company for the year ended December 31, 2012 and December 31, 2011 together with all of the notes, risk factors and information contained therein, available on SEDAR at [www.sedar.com](http://www.sedar.com).*

#### **Non-IFRS Financial Measures**

This MD&A makes reference to earnings before interest, taxes, depreciation and amortization (“EBITDA”) and book value per share. MGG uses EBITDA as a measure of the performance of its operating subsidiaries as it excludes depreciation and interest charges, which are a function of the company’s specific capital structure, and also excludes entity specific tax expense. MGG uses book value per share as a measure of the performance of the Company as a whole. Book value per share is measured by dividing shareholders’ equity at the date of the statement of financial position by the number of common shares of the Company (“Common Shares”) outstanding at that date. MGG’s method of determining these amounts may differ from other companies’ methods and, accordingly, these amounts may not be comparable to measures used by other companies. These amounts are not performance measures as defined under IFRS and should not be considered either in isolation of, or as a substitute for, net earnings prepared in accordance with IFRS. The Company refers to “funds used in operations”, “operating losses” and “re-valuation of investment properties” within this analysis. “Funds used in operations” is computed by calculating the cash flow from operations before changes to non-cash working capital from operations.

#### **Forward Looking Statements**

This MD&A contains forward-looking statements relating to future events. In some cases, forward-looking statements can be identified by words such as “anticipate”, “continue”, “estimate”, “expect”, “forecast”, “may”, “will”, “project”, “should”, “believe”, or similar expressions. These statements represent management’s best projections but undue reliance should not be placed upon them as

they are derived from numerous assumptions. These assumptions are subject to known and unknown risks and uncertainties, including the “Risks and Uncertainties” as discussed herein. Actual performance and financial results will differ from any projections of future performance or results expressed or implied by such forward looking statements and the difference may be material.

Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted. From time to time, the Company’s management may make estimates and have opinions that form the basis for the forward-looking statements. The Company assumes no obligation to update such statements if circumstances, management’s estimates or opinions change.

## **Overall Performance**

Mongolia Growth Group Ltd. is a Canadian holding company that invests in both the real estate and financial services industries in Mongolia. MGG is presently engaged in the business of: (i) the ownership of retail, office and residential investment properties; (ii) the management of investment properties; (iii) the repair, construction and development of investment properties; (iv) the underwriting of property and casualty insurance risks; and (v) the sales of property and casualty insurance.

### *Property*

In all its investment property operations, MGG strives to provide the highest quality locations to tenants, which augments their accommodations, business sales or office environment. MGG’s strategy is to acquire the best-located properties in Ulaanbaatar, to repair and redevelop as needed, then to lease the properties to the tenant which benefits most from their location and quality.

The Company’s property portfolio has grown through acquisition and to a lesser extent, through additions of space via construction. As new footage is integrated into the MGG model, the Company’s ability to offer a unique product, multi-unit retail platforms, or large format office space has led to relationships with some of the largest businesses operating in Mongolia. The Company believes that by working with such successful firms, it will add value to the local firms which will benefit from such unique offerings and will lead to excess profitability to the company, vis-à-vis above market rental net yields.

As the Mongolian consumer has benefited from an increase in gross and disposable income, the tenancies of the Company’s investment properties have been able to support increased rents. This market improvement in the rental business has supported company results as most re-let properties have seen double-digit increases in rents and overtime, a commensurate increase in property value.

The general property market continues to be influenced by improvement in the overall Mongolian economy. During 2012, moves by the Mongolian Central Bank to raise interest rates and reserve requirements amongst banks led to a slowdown in terms of overall price appreciation. This has led to increases in capitalization rates as rental rates have continued to increase. Management feels that during the first half of 2012, property prices increased substantially in price. The third quarter of 2012 showed no noticeable increase in property prices, while the fourth quarter showed a significant decline in prices due to liquidity issues in the marketplace. Subsequent to the year-end, the Mongolian Central Bank lowered interest rates which resulted in increases in property prices in early 2013, and as of today, prices in land, land-like assets and downtown soviet apartments are at or above prices seen at the peak in the early summer of 2012. Prices in other markets are still below 2012 peak prices. Management cautions shareholders that property prices have historically been, and continue to be, very volatile. With the June Presidential election looming, as well as other unknown events that may arise, additional volatility is highly probable.

The Company believes that increases in nominal gross domestic product will lead to further increases in both the rental rates and valuations of properties in Mongolia. MGG's property division should benefit from such increases in nominal gross domestic product due to the operational leverage inherent in a property business with relatively fixed operating costs. It is expected that the majority of the organic growth in the revenue of the property division going forward should accrue to the Company's bottom line due to such embedded operating leverage.

### *Insurance*

The Company's insurance subsidiary (Mandal General Insurance or "Mandal") began underwriting in the third quarter of 2011. The underwriting capacity and knowledge of the insurance subsidiary was acquired vis-à-vis the initial overfunding of the company in relation to its risks, and by the hiring of individuals that had previously obtained insurance experience in both Mongolia and abroad. The sales process for the insurance company is longer term in nature. Retail sales continue to substantially lag corporate sales, which are much larger in nature and are infrequent in occurrence.

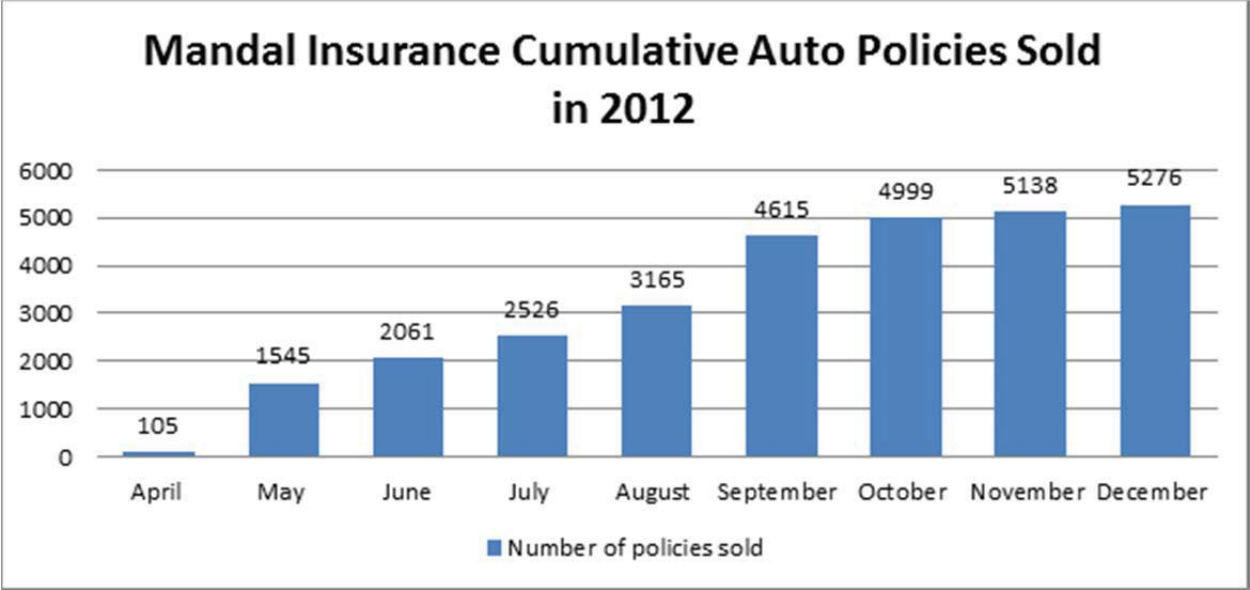
As the Mongolian consumer and business market becomes larger and more understanding of the inherent benefits of insurance, the market is expected to grow substantially. According to the Financial Regulatory Commission ("FRC"), over the past five years, nationwide underwriting has grown at over 20% per annum. Due to the small nature of the insurance market, and the newness of our insurance subsidiary as an entrant in the market, the insurance subsidiary's primary focus has been on business systems development, product development, brand awareness and marketing.

Similar to the foundation of the Company's property business, Mandal has hired staff and incurred expenses that lead to a high level of operational leverage. Many divisions of the insurance operation would not be required to expend further resources even given a substantial increase in premiums written.

Mandal entered new lines of underwriting in 2012, many of which performed to management’s expectations. Underperforming was a financial product line of coverage, primarily comprised of one loss mitigation policy with a large National Mongolian firm. The one line of business incurred a loss ratio of 720% for the 2012 calendar year, mainly due to incurred losses in Q4 2012 being materially more than management expected. The original policy provided for certain recoveries which were not closed by year end, and as such were not accounted for. Since December 31<sup>st</sup> 2012, Mandal has achieved recoveries on the policy, as well as signed a new revised contract with the insured that is behaving more to management’s original expectations, due to claims caps and certain other loss mitigation parameters.

According to statistics produced by FRC, at the end of December 2012, Mandal represents 15.5%, 6.8%, 3.8% and 2.5% of the total equity capital, assets, gross premiums and net premiums of the Mongolian Insurance Market. This is an increase from 14.5%, 8.3%, 0.9% and 0.9% respectively at calendar year end 2011.

Mandal continues to have marketing successes, particularly in mandatory driver’s liability where the total policy count has now grown to 5,276 policies as of the end of December 2012.



**Economic Outlook**

Both markets that the Company operates in, the real estate and insurance industries, have benefited from the significant economic growth achieved in Mongolia over the last few years. The majority of this recent growth is attributable to the mining and construction boom taking place in Mongolia, mainly resulting from the opening of the Oyu Tolgoi and Tavan Tolgoi deposits located in the Gobi desert. The associated infrastructure requirements for these projects have also served to strengthen the local economy. The positive impact of improving consumer and business confidence has further led to a substantive increase in the gross production of the local economy. Uncertainties

due to the recent parliament election, the presidential election taking place this summer, as well as a dynamic legal environment for mining concerns and foreign investment has led to recent stress in both the local mining industry, and the local banking sector. These stresses have created a decrease in the rate at which the Mongolian economy has grown, but in spite of the decrease, the local economy still appears and quite strong. Recent metrics relating to increases in disposable income and unemployment are particularly indicative of a robust and dynamic local economy.

Given the current lack of sufficient real estate space for domestic and international tenants, and the insurance underwriting capacity within the insurance industry in Mongolia, there is room for much further expansion in the amount of business to be done in both industries, and likely increases in the profitability of these industries.

In 2012, the Mongolian government raised \$1.5 billion at interest rates of 4.125% for \$0.5 billion and 5.125% for \$1.0 billion. This money is now filtering into the economy as the government chooses various programs to finance. The Mongolian economy has been starved of capital. \$1.5 billion of low cost capital being injected into what was in 2012 a \$9.96 billion GDP economy, has gone a long way into decreasing the nation's cost of capital, as well as alleviating some of the stress of a decline in mining and FDI.

According to the National Statistics Office, residential property prices in downtown Ulaanbaatar have increased fairly significantly over the past couple of years, depending on the district and year of construction. Management believes that since the inception of the property Companies, its portfolio of assets has likely increased at a more rapid rate due to the attractive positioning of most assets on the primary streets of downtown. Meanwhile, the shortage of high quality development sites has led to an even more rapid increase in the value of well-located sites.

## **Risks and Uncertainties**

The Company, as part of its operations, carries financial instruments consisting of cash and cash equivalents, investments and marketable securities, accounts receivable, and trade payables and accrued liabilities. It is Management's opinion that the Company is not exposed to significant credit, interest or currency risks arising from these financial instruments except as otherwise disclosed in the notes to the consolidated financial statements.

Certain members of parliament have recently asked to re-negotiate the agreement that exists between the government and Turquoise Hill regarding the current tax and stability agreement. There can be no certainty if any changes to the agreement will be reached and how it will impact the investment climate or future GDP growth of Mongolia.

During the last year the Company has purchased apartment units in a knowingly condemned building with the intent that through control of the homeowner's association the Company can procure a lease on the land underlying the building. The process of exerting control over a homeowner's association in order to develop the underlying land-plot is an extensive legal

process, is complicated, lacks precedent and is a generally risky proposition. The total investment at cost in this apartment building at December 31, 2012 was \$4,161,845. The company currently owns 50 of the 51 apartments in the building, has an agreement with the last owner to exchange his unit for space in any future building and has applied to the city for the land use permissions.

Further information related to Mongolia Growth Group Ltd. and the risks and uncertainties of MGG is filed on the System for Electronic Document Analysis and Retrieval ("SEDAR") and can be reviewed at [www.sedar.com](http://www.sedar.com). A comprehensive set of risk disclosures are included in the Company's most recently filed annual MD&A.

### Selected Annual Financial Information

	Year ended December 31 2012	Year ended December 31 2011	Year ended December 31 2010
	\$	\$	\$
Revenue and other income	2,237,694	589,311	1,385
<b>Income</b>			
Income (loss) from continuing operations attributable to equity holders of the Company	(6,073,750)	1,349,153	(247,846)
Net Income (loss) attributable to equity holders of the Company	(6,073,750)	1,349,153	(247,846)
Comprehensive income (loss) attributable to equity holders of the Company	(7,360,920)	107,716	(247,846)
<b>Basic earnings per share ("EPS")</b>			
Earnings (loss) from continuing operations	(0.18)	0.06	(0.10)
Net income (loss)	(0.18)	0.06	(0.10)
<b>Diluted EPS</b>			
Earnings (loss) from continuing operations	(0.18)	0.05	(0.10)
Net Income (loss)	(0.18)	0.05	(0.10)
<b>Balance Sheet</b>			
Total Assets	51,306,531	55,336,889	156,847
Financial liabilities	4,002,971	2,040,129	9,677
Total Equity	47,303,560	53,296,760	147,170
Shares Outstanding at year end	34,143,352	34,143,352	2,964,300
Book Value per share	1.39	1.56	0.05

## **Results of Operations**

As of December 31, 2012, MGG's operations continued to focus on the rapid growth of the Mongolian economy. As part of its corporate strategy of aggressive growth, the Company has continued to purchase rentable property, repair and expand existing properties, lease available properties and sell property and casualty insurance.

Refer to Note 21 of the interim financial statements of the Company for a table of segmented information.

### *Revenues*

MGG's consolidated revenues for the year ended in December 31, 2012 increased to \$2,237,694 from \$589,311 during the year ended December 31, 2011. The majority of the increase in revenue is attributable to having a full year of operations in 2012 whereas 2011 the Company was in a start-up phase of business and did not have the same pool of rentable investment property in the property company for the entire year, and the insurance company only started to write policies in the fourth quarter of 2011 whereas it had a full year in 2012.

The Company's investment property business contributed the majority of the revenue for the year ended December 31, 2012 with rental income of \$1,572,603 compared to \$495,242 during the year ended December 31, 2011. As well, related to investment properties, for the full year, the Company realized a gain of \$12,768 on the disposal of investment properties which were classified as held for sale. There were no properties disposed of for the year ending 2011.

The Company's insurance business contributed \$628,424 of net premiums earned in 2012, compared to \$77,786 of net premiums earned in 2011. The insurance business did not begin selling policies until the fourth quarter of 2011.

The Company also earned \$863,313 (2011 - loss of \$344,246) of net investment income on a consolidated basis in 2012. The Company's property business earned \$282,114 (2011 - \$32,796), while the Company's insurance business earned \$574,454 (2011 - \$247,470) and the Company's corporate division earned \$6,745 (2011- loss of \$624,512).

### *Expenses*

Total expenses for the year 2012 increased to \$6,455,865 from \$3,809,334 during 2011. The increases in expenses for the year is mainly attributed to operating expenses which have increased due to increases in operations and general expenses related to the growth of the business.

In 2012, the insurance business incurred the largest share of these expenses totaling \$2,330,648 (2011 - \$1,668,561). The investment property business incurred expenses of \$2,034,674 (2011 - \$1,066,682) while the corporate division incurred expenses of \$2,090,543 (2011 - \$1,074,091).



Salaries and wages were up significantly across all divisions in 2012 as the Company's total number of employees roughly doubled from the previous years ending employee count. In 2011, the Company was in its infancy and thus had very few employees throughout most of the year. As well, with the growth in the Mongolian economy we expect to see a continual increase in this figure as wages across the country continue to climb and the standard of living improves.

Share based payments decreased from \$1,798,603 in 2011 to \$1,367,720 in 2012. This decrease is mainly attributable to 500,000 consultant options which were issued and expensed fully in 2011.

Professional fees totalled \$1,293,477 in 2012, up from \$492,953 in 2011. This increase is attributable to increases in legal expenses, audit expenses and various other professional fees including property valuation fees. A substantial portion of this increase incurred as a result of the Company's application to list its common shares on the TSX Venture Exchange (TSXV). These listing expenses are not expected to reoccur.

#### *Operating Profit (Loss)*

The property business of MGG generated an Operating or EBITDA loss before the fair value adjustment on investment properties of \$341,746 during the year of 2012 (2011 - loss of \$523,511). Included in these loss calculations are share based payment expenses of \$643,857 in 2012 and \$290,800 in 2011 which significantly impact the EBITDA number. Without these share based payment expenses the property business would show a gain of \$302,111 in 2012 and a loss of only \$232,711 in 2011. The decrease in the EBITDA loss in 2012 is the result of increased rental revenue offset by an increase in expenses associated with building a property management team, along with increased property taxes and insurance expenses associated with a larger portfolio. The Company incurred a small gain of \$12,768 (2011 - nil) on the disposal of investment properties. In addition, this division had added expenses related to due diligence on property assets that were not acquired, certain pre-development expenses that were not capitalized related to future property developments and employee education and training activities that have no offsetting revenue impact. In addition, the property business reported net investment income of \$282,114 in the year of 2012 (2011 - \$32,796).

MGG's insurance business generated an Operating or EBITDA loss of \$1,624,616 during the year of 2012 (2011 - loss of \$1,579,031). Included in these loss calculations are share based payment expenses of \$253,168 in 2012 and \$1,087,493 in 2011 which significantly impact the EBITDA number. Without these share based payment expenses the insurance business would have a loss of \$1,371,448 in 2012 and \$491,538 in 2011. In addition the insurance company reported investment income of \$574,454 for the year of 2012 (2011 - \$247,470). The majority of this is due to an increase in net premiums earned and continuing investment income offset by sizable marketing expenses associated with building the Mandal brand.

The Company's corporate overhead contributed to an Operating or EBITDA loss of \$2,080,919 during 2012 (2011 - loss of \$1,071,184). Included in these loss calculations are share based payment expenses of \$470,695 in 2012 and \$420,310 in 2011 which significantly impact the EBITDA number. Without these share based payment expenses the loss at corporate would be \$1,610,224 in 2012 and \$650,874 in 2011. The majority of this loss was incurred for legal and audit expenses and other corporate expenses associated with the general corporate activity of the Company. In addition, the Company had very substantial expenses related to changing the Company's listing from the Canadian National Stock Exchange to the TSX Venture Exchange Listing. These listing expenses are not expected to reoccur.

In total, the Company's divisions reported an Operating or EBITDA loss, before the fair value adjustment on investment properties, of \$4,047,281 during the 2012 ( 2011 - loss of \$3,173,726). Included in these loss calculations are share based payment expenses of \$1,367,720 in 2012 and \$1,798,603 in 2011 which significantly impact the EBITDA number. Without these share based payment expenses the loss in the consolidated Company would be \$2,679,561 in 2012 and \$1,375,123 in 2011. In addition the Company reported net investment income of \$863,313 (2011 - loss of \$344,246) during the year.

#### *Fair Value Changes in Investment Property and Financial Assets*

As the Company incurred no impairments to its December 31, 2012 investment and marketable securities portfolio fair value changes were only recognized with respect to MGG's investment property portfolio. The Company had 61% of its investment property portfolio valued by an external independent valuation professional who is deemed to be a qualified appraiser holding a recognized, relevant, professional qualification and who has recent experience in the locations and categories of the investment properties valued. The remainder of the investment property portfolio was valued by management.

The properties owned by the Company are classified into three categories in the Company's 2012 consolidated financial statements; property and equipment, other assets and investment properties.

Properties that are used by the Company in the course of business are currently accounted for as property and equipment. These properties did not experience a fair value adjustment and are also subject to depreciation expense. At the end of 2012, the Company had six properties classified as property and equipment with a net book value of \$4,130,719 (2011 - \$4,223,568). Furthermore, four properties were presented as "other assets - prepaid deposits on investment properties" in the 2012 Consolidated Financial Statements - Note 7. Prepaid deposits on investment properties totalled \$1,626,240 in 2012 (2011 - nil). These four properties were fully paid, however the Company has not yet received the new titles for these properties. While these properties were each valued by a qualified appraiser, these properties were presented at the lower of cost or market resulting in an impairment provision of \$1,206,876 reflected in the unrealized gain (loss) on fair

value adjustment on investment properties. The remainder of the properties were classified as investment properties. As of December 31, 2012, investment properties had an aggregate fair value of \$ 30,786,742 (2011 - \$26,166,286). Over the course of 2012, the Company added properties at a cost base of \$8,190,935 and disposed of 20 properties for gross proceeds of \$1,656,768 which resulted in a gain of \$12,768.

Additionally one property package included in investment properties was valued at the lower of cost or market. This property consisted of the 50 apartment units described in the “Risks and Uncertainties” section. The properties were purchased with the intent that through control of the homeowner’s association, the Company can procure a lease on the land underlying the building. Management believes that valuing these properties at cost is the most conservative method of valuation as a piece of land of that size and location is extremely rare but as it is considered a redevelopment property, it is measured at cost until the earlier of the date of construction or the date at which the fair value becomes reliably measured as to be in accordance with IFRS.

Management believes that certain properties that are currently classified as property and equipment and other assets – prepaid investment property could be sold for substantially more than their carrying value if they were sold at year end market values. Management anticipates that these assets along with the investment property portfolio will continue to increase in value in the future.

The majority of the Company’s investment and marketable securities portfolio is held in non-market quoted assets which are held in callable short-term and mid-term paper of investment grade financial institutions in Mongolia. These investments are held within the Company’s insurance subsidiary and are held due to the statutory requirements of the subsidiary’s primary regulator, FRC.

### *Net Income*

For the year ended December 31, 2012, the Company incurred a net loss of \$6,073,750, compared to net income of \$1,349,153 for the year ended December 31, 2011. This year’s unfavourable result is primarily attributed to the unrealized loss on fair value adjustment on investment properties of \$2,697,212 compared to a \$5,740,919 unrealized gain in 2011. In addition, the Company recorded a significant expense for share based payments of \$1,367,720 (2011 - \$1,798,603). Finally, the Company, incurred claims and insurance benefits expenses of \$1,042,387 at Mandal. A large portion of this reserve number relates to a contract related to customer delinquencies which has experienced unusually bad results during the first months of its existence. Management is hopeful that as this product matures, losses will moderate.

Management cautions investors that property portfolio losses and stock option expenses are non-cash accounting entries caused by a decrease in the fair value of the Company’s investment portfolio and accruals for share based payments.

MGG's property division has continued to produce positive operating cash flow; however this is insufficient to cover corporate expenses and insurance expenses. Management anticipates that this cash flow will continue to increase in future quarters as vacant properties become occupied, rents are renewed at higher rates, and expenses remain fairly constant in the property division.

Management cautions investors that the Company is primarily focused on increasing shareholder value on a per share basis. This means that operationally management is more concerned with asset appreciation at the expense of short-term cash flow. Management expects this to be the case for the foreseeable future.

### Summary of Quarterly Results

The following table provides selected financial information for the eight most recently completed quarters.

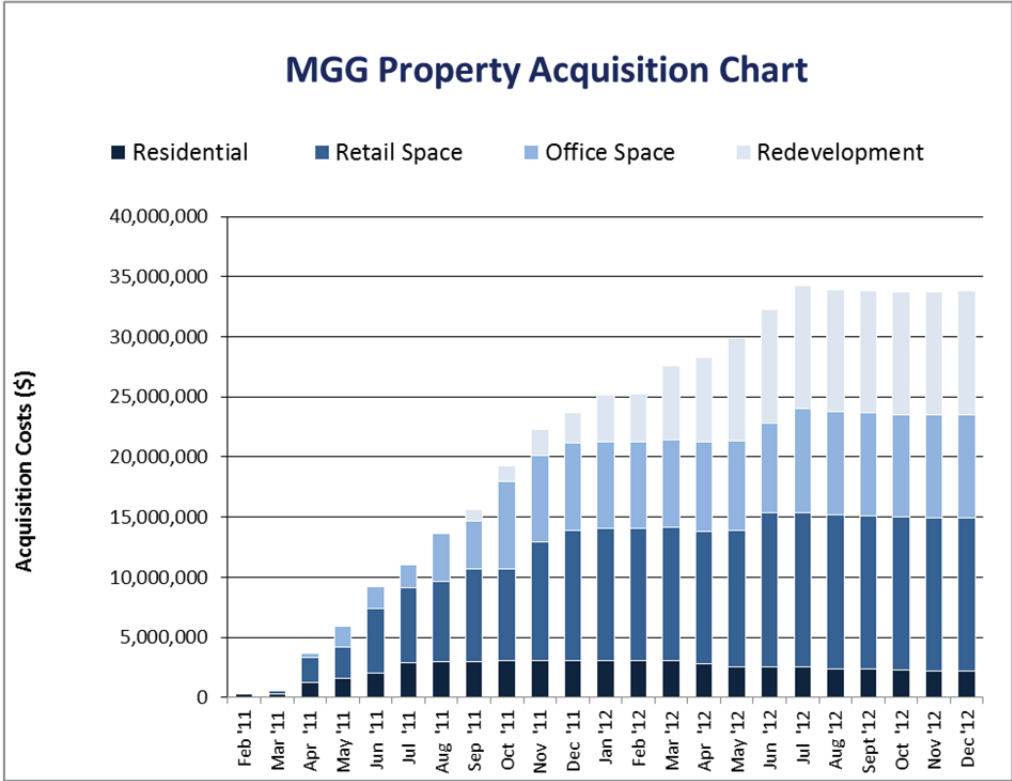
Quarterly Consolidated Financial Information								
(In Dollars)								
	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011
<b>Revenue</b>	618,435	577,905	571,472	469,882	360,914	186,134	42,263	0
<b>Net income (loss)</b>	(4,488,408)	(446,069)	(494,782)	(644,491)	2,794,533	(820,149)	(485,585)	(139,646)
<b>Income (loss) per common share</b>	(0.13)	(0.01)	(0.02)	(0.02)	0.11	(0.03)	(0.02)	0.00
<b>Total Assets</b>	51,306,531	52,048,976	56,058,108	55,783,296	55,336,889	36,439,544	36,250,423	10,353,848
<b>Weighted Average Shares</b>	34,143,352	34,143,352	34,143,352	34,143,352	23,902,851	21,814,422	16,617,951	10,184,185
<b>Ending Shares</b>	34,143,352	34,143,352	34,143,352	34,143,352	34,143,352	30,297,168	30,297,198	14,167,571

MGG's revenue continued to grow during 2012 with consolidated revenue and net investment income increasing to \$618,435 in the fourth quarter of 2012 compared to the fourth quarter of 2011 consolidated revenue and net investment income of \$360,914, an increase of 71%. The increase in revenues has been offset by an increase in expenses and a fair value loss adjustment on investment properties in the fourth quarter of 2012.

### Property

During the fourth quarter of 2012, MGG's property subsidiary earned rental income of \$397,810 compared to rental income of \$266,845 in the fourth quarter of 2011, an increase of 49%. This increase is the result of the addition of properties to the investment portfolio and increases in rental prices offset by an increase in commercial properties being renovated, certain property revenues related to Mandal being eliminated on consolidation and the sale of certain residential units.

During the quarter, the property subsidiary was subject to a \$2,697,212 unrealized loss on fair value adjustment on investment properties compared to a \$5,740,919 unrealized gain during the Q4 2011.



Acquisition Costs were translated from Mongolian Tögrög into Canadian dollars at the December 31, 2012 rate of 1383.57

*Insurance*

The fourth quarter of 2012 represents the Company’s fifth complete quarter of operations since policies were approved by FRC. During the fourth quarter, MGG’s insurance subsidiary earned net premiums of \$330,734, compared to net earned premiums of \$77,786 in the fourth quarter of 2011, an increase of 325%. This increase is attributable to having a full year of operations in 2012 versus only one quarter in 2011.

The insurance subsidiary has spent aggressively to develop the Mandal brand name through marketing and advertising. The Company expects this marketing spending to increase nominally in the future, but decline relative to premiums written. The management team at Mandal continues to explore ways to leverage marketing spend through creative partnerships.

Similar to the foundation of the Company’s property business, Mandal has hired staff and incurred expenses that lead to a high level of operational leverage. Many divisions of the insurance operation would not be required to expend further resources even given a substantial increase in premiums written. As expected, the largest expense within the insurance business is reserving. During 2012,

claims and reserves amounted to \$1,042,387 compared to \$51,591 in 2011.

## **Liquidity**

As at December 31, 2012, MGG had working capital of \$12,554,733 (2011 - \$21,059,481) comprised of cash and cash equivalents, investments and marketable securities, other assets, reinsurance assets, deferred acquisition expenses, net of trade payable and accrued liabilities, income taxes payable and insurance contract liabilities. Management considers the funds on hand to be sufficient to meet its ongoing obligations.

## **Related Party Transactions**

Related party transactions for fiscal 2012 were as follows:

For the year ending December 31, 2012, Mandal General Insurance paid \$122,528 (2011 - nil) to property subsidiaries of MGG, as payment for their office rental and a retail outlet. Also for the year ended December 31, 2012, the Company's various property subsidiaries paid a total of \$25,856 to Mandal General Insurance for insurance coverage on MGG's portfolio of investment properties along with various auto insurances. 90% of the property related risks associated to these coverages were ceded to an A.M. Best A+ rated German re-insurer and 9% were ceded to a well-rated direct lines insurer in China. These related party transactions are not expressed in segmented reporting of either the insurance business or the property business as both the revenue and expenses associated to them are eliminated upon consolidation.

## **Critical Accounting Estimates**

The preparation of financial statements in accordance with IFRS required management to make assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated based on historical experiences and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

The critical estimates made in the preparation of the consolidated financial statements include the following:

- Fair value of investment properties - The estimate of fair value of investment properties is the most critical accounting estimate to the Company. An external appraiser estimates the fair value of investment properties annually. The fair value of investment properties is based on the nature, location and condition of the specific asset. The fair value of investment properties represents an estimate of the price that would be made in an arm's length transaction between knowledgeable, willing parties. The Company operates in the emerging real estate market of Mongolia, which given its current economic and industry conditions, has an increased inherent risk given the lack of reliable and comparable market information. At December 31, 2012, the unrealized fair value adjustment was a loss of \$2,697,212 (2011 - gain of \$5,740,919).

- Valuation of insurance contract liabilities - The estimate of the ultimate liability arising from claims made under insurance contracts is another critical accounting estimate. There are several sources of uncertainty that need to be considered in the estimate of the liability that the Company will ultimately pay for such claims. The ultimate cost of claims liabilities is estimated by using a range of standard actuarial claims projection techniques in accordance with Canadian accepted actuarial practice. At December 31, 2012, the insurance contract liabilities totaled \$2,300,604 (2011 - \$361,820).
- Accuracy of share based compensation expense - The estimate of the ultimate expense arising from share based compensation plans is another critical accounting estimate. There are several sources of uncertainty that need to be considered in the estimate of the share based compensation expense recorded by the Company. The ultimate expense is estimated by using a number of key assumptions such as the expected volatility of the share price, the dividends expected on the shares, the risk-free interest rate for the expected life of the option and future forfeiture rates. For the year ending December 31, 2012, the cost of the share based payments totaled \$1,367,720 (2011 - \$1,798,603).
- Operating environment of the Company - Mongolia displays many characteristics of an emerging market including relatively high inflation and interest rates. The tax and customs legislation in Mongolia is subject to varying interpretations and frequent changes. The future economic performance of Mongolia is tied to the continuing demand from China and continuing high global prices for commodities as well as being dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government of Mongolia together with tax, legal, regulatory and political developments. Management is unable to predict all developments that could have an impact on the Mongolian economy and consequently what effect, if any, they could have on the future financial position of the Company.

### **Capital Risk Management**

The Company's objective when managing capital is to ensure the Company is capitalized in a manner which provides a strong financial position for its shareholders.

The Company's capital structure includes equity and working capital. In managing its capital structure, the Company considers future investment and acquisition opportunities, potential credit available and potential issuances of new equity. The Company's objective is to maintain a flexible capital structure that will allow it to execute its stated business. Upon acquiring investment properties and operating businesses, the Company will strive to balance its proportion of debt and equity within its capital structure in accordance with the needs of the continuing business. The Company may, from time to time, issue shares and adjust its spending to manage current and projected proportions as deemed appropriate.

The method used by the Company to monitor its capital is based on an assessment of the Company's working capital position relative to its projected obligations. At December 31, 2012, the Company's working capital was \$12,554,733 (2011 - \$21,059,481) and the Company had no debt.

### **Off-Balance Sheet Items**

As at December 31, 2012, the Company has no off-balance sheet items.

## **Financial Risk Management**

### *Credit risk*

The Company's exposure to credit risk is managed through risk management policies and procedures with emphasis on the quality of the investment portfolio. For the year, most of the Company's investments consisted of institutional deposits. The majority of the funds invested are held in reputable Barbadian, Canadian or Mongolian banks. The Company is in the early stages of development and is continually improving its policies regarding monitoring its credit risk.

The Company is exposed to credit risk as an owner of real estate in that tenants may become unable to pay the contracted rents. The Company mitigates this risk by carrying out due diligence on significant tenants and limiting the Company's exposure to each tenant. The Company's properties are diversified across residential and commercial classes.

Amounts due from policy holders are short-term in nature and are not subject to material credit risk.

### *Liquidity risk*

As at December 31, 2012, the Company does not believe the current maturity profile of the Company lends itself to any material liquidity risk, taking into account the level of cash and cash equivalents, investments and marketable securities as at December 31, 2012. The Company does not have material liabilities that can be called unexpectedly at the demand of a client.

### *Currency risk*

The Company owns properties located in Mongolia and marketable securities in Mongolia and Barbados, and is therefore subject to foreign currency fluctuations that may impact its financial position and results. Changes in the Mongolian Tögrög and U.S. to Canadian dollar foreign currency exchange rate impact the fair value of securities denominated in Mongolian Tögrög and in U.S. dollars. The Mongolian operations hold their investments in Mongolian Tögrög denominated securities and the Canadian operations hold securities denominated in Canadian and U.S. dollars.

The approximate impact of an increase of 10% in the Mongolian Tögrög against the Canadian dollar would increase the Other Comprehensive Income ("OCI") of the Company by \$4,828,959 (2011 - \$3,581,255). The approximate impact of a decrease of 10% in the Mongolian Tögrög against the Canadian dollar would decrease OCI of the Company by \$4,828,959 (2011 - \$3,581,255).

The approximate impact of an increase of 10% in the U.S. dollar against the Canadian dollar would increase net income of the Company by \$87,994 (2011- \$367,962).



## **Internal Controls over Financial Reporting**

Changes in securities laws no longer require the Chief Executive Officer and Chief Financial Officer of junior reporting issuers to certify that they have designed internal control over financial reporting, or cause it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards.

Instead, an optional form of certification has been made available to junior reporting issuers and has been used by the Company's certifying officers for the December 31, 2011, annual filings. The new certification reflects what the Company considers to be a more appropriate level of CEO and CFO certification given the size and nature of the Company's operations. This certification requires the certifying officers to state that:

- (i) they have reviewed the annual MD&A and consolidated financial statements;
- (ii) they have determined that there is no untrue statement of a material fact, or any omission of material fact required to be stated which would make a statement or its omission misleading in light of the circumstances under which it was made within the annual MD&A and consolidated financial statements;
- (iii) based on their knowledge the annual filings, together with the other financial information included in the annual filings, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of the date and for the periods presented in the filings.

## **Strategy**

MGG separates its operations into three reporting segments for ease of management oversight. These segments are property, insurance and corporate.

At all three reporting segments, the Company's focus has been on hiring key employees, implementing reporting systems and setting the Company up for continued growth in the future. A significant challenge that the Company has encountered is finding skilled employees, given the growth experienced during the past two years. The growth in senior employees has moderated now that the majority of key positions are filled. The Company plans to spend more time and energy on training employees, rather than hiring many new employees, as the Company grows in the near future.

### *Property*

MGG's property division slowed the pace at which it acquired assets in 2012. Management and employees have worked hard to aggressively build up the infrastructure needed to manage this division. The Company was successful in filling several key positions within its property division reducing the need for Management to be involved in the daily operations of the business, allowing them to spend more time on the corporate operations of the Company. Management plans on

continuing to spend time training and guiding employees in Mongolia, but expects this to decrease throughout the year.

Due to the rapid growth of the Mongolian economy and a shortage of high quality rental locations, property rents continue to increase, particularly in office and prime retail locations. When leases have been reviewed, many of them are at rates that are substantially below market rents. These leases should reset over the short-term and should substantially increase revenues if rental rates stay current. The Company has maintained most leases on short durations. The Company also includes rent escalation clauses in most of its leases with tenants that are over one year in duration. MGG's property investment subsidiary plans on further expanding via the investment of additional capital into income producing and redevelopment properties in Ulaanbaatar. The Company's plan is contingent on procuring further funds for investment and on finding suitable investment targets which meet or exceed MGG's stringent investment criteria.

Since inception, MGG has acquired a number of redevelopment properties. To date, the Company has only remodeled, rebuilt and completed additions on properties. It is Management's intent to begin small-scale denovo property development on both company owned brownfield and greenfield sites. MGG's intent is to remain a substantial owner of the properties, post-completion.

During the third quarter, MGG began the substantial renovation of its corporate headquarters and two other office buildings. This renovation resulted in certain tenants leaving the buildings or reconfiguring their office space usage. These renovations were effectively completed during the fourth quarter of 2012. The spaces are substantially improved and should lead to higher rental revenues for the property division upon lease out.

To date, only minimal work has been done in evaluating the potential economics of our development properties, but based on rough estimates, the following numbers would appear to be representations of the potential economics of these projects based on estimates of December 2012 market prices for construction costs, average market rents and sale prices observed in Ulaanbaatar. Management cautions investors that these numbers will change dramatically based on future changes in building costs in Ulaanbaatar and changes in market rents and sale prices. In addition, Management is looking for ways to expand these land packages which will potentially impact the economics of the projects.

	<b>Approx. Meters of Land</b>	<b>Development Type</b>	<b>Approx. Finished Size</b>	<b>Approx. Build Cost</b>	<b>Current Monthly Rent</b>	<b>Expected Payback on Development</b>
Asset 1	2,200	Class A Office	30,000 Meters	\$1,500-\$1,700 Per Meter	\$45-\$65 Per Meter	2.5 To 4 Years
Asset 2	2,600	Class A Office	40,000 Meters	\$1,500-\$1,700 Per Meter	\$45-\$65 Per Meter	2.5 To 4 Years
Asset 3	1,300	Residential	300 Units	\$900-\$1,200 Per Meter	\$2,500-\$3,500 Per Meter Sale Price	Pre-Sales Should Fund It.
Asset 4	8,000	Mixed Use	30,000 Meters	\$1,200-\$1,500 Per Meter	\$20-\$40 Per Meter	3 To 6 Years
Asset 5	900	Mixed Use	10,000 Meters	\$1,200-\$1,500 Per Meter	\$45-\$65 Per Meter	2.5 To 4 Years
Asset 6	1,700	3 Floor Retail	5,000 Meters	\$700-\$900 Per Meter	\$15-\$25 Per Meter	2.5 To 4.5 Years

MGG has labeled some properties as “held for sale.” These properties are primarily small retail or residential properties. MGG has chosen to sell these properties as the revenues derived from them are insufficient to offset the costs of managing them. During the year, twenty of these properties were sold and four of these properties remained as held for sale as of December 31, 2012. Over time, the Company intends to continue the practice of disposing of smaller properties that are no longer core to the Company’s strategy.

### *Insurance*

The Company’s insurance subsidiary received its insurance license on June 2, 2011, and began to aggressively target customers in October 2011. To date, it has focused its operations on both the retail and corporate market. The focus at Mandal is to underwrite conservatively so that all stakeholders are confident that insureds will be compensated on all legitimate claims. Through the use of reinsurance, Mandal attempts to ensure that it can cover losses due to high severity and rare catastrophic events.

The Company’s expectation is that the insurance company will incur operating losses for at least the next year. Anticipated losses will likely be caused by the sizable costs of marketing and growing the business, against insufficient earned premium revenue. Some of these losses will be offset by the insurance company’s investment portfolio. It is expected that the investment portfolio will grow as the Company increases sales and associated reserves, which generate investible float. Due to Mongolia’s high interest rate environment, float is incredibly valuable.

*The following section outlines the significant events that have taken place within the insurance company during the 2012 year;*

On April 5, 2012, Mandal sold a sizable bankers blanket bond to Khan Bank, the largest bank in Mongolia based on branch count. This transaction was 100% reinsured by syndicates of the Society of Lloyd's. Mandal's strategy is to greatly expand its commercial fronting business over the coming year.

On April 18, 2012, Mandal received a special permit to write auto liability coverages and is actively marketing these products to the consumer segment of the market. At the end of December, Mandal had sold a total of 5276 mandatory liability insurance policies. Management expects that after an initial drive to acquire customers, the growth of this business will subside in 2013, followed by annual increases in premiums due to substantial future increases in the total sum insured.

On May 16, 2012, MGG announced that it signed a binding term sheet agreeing to sell shares of Mandal General Insurance LLC to UMC Capital LLC, at a purchase price equivalent to MGG's original funding cost in June 2011. Following the closing of this transaction, MGG and UMC Capital will respectively own approximately 84% and 16% of Mandal's outstanding shares. In addition, UMC Capital will retain the right to purchase an additional 25% of Mandal at the higher of stated book value or funding cost. At the end of Q4 2012, this transaction has not been closed.

On August 20, 2012, Mandal signed an agreement with Khan Bank to distribute insurance products through its network of over 500 branches throughout Mongolia. Management expects that the roll-out of these products will begin in 2012 and grow substantially through 2013.

On November 6, 2012, Mandal was recognized by the Business Council of Mongolia as the "Best Local Company in Mongolia".

## **Outlook**

The Mongolian economy continues to be one of the best performing economies globally based on data from The National Statistics Office of Mongolia ("NSO") – December 2012 edition, with preliminary estimates of annualized 2012 GDP growth of 12.3% at constant prices compared to the previous year. The Mongolian Consumer Price Index increased 14.0% during the year, based on data from the NSO. This growth is being funded by Foreign Direct Investment inflows to a number of sizable mining projects, the re-investment of earnings from existing projects, and general increases in economic activity within the consumer and governmental sectors of the economy.

MGG has been a beneficiary of these trends in both its property and insurance operations.

Continuing increases in market rental rates for commercial properties are expected to eventually lead to increases in property value of the Company's holdings.

As Mongolians see a higher standard of living, they will likely seek protection for their valuables. Additionally, corporations are beginning to understand the necessity of using insurance to avoid business volatility. These two trends have been important in seeing the Company's insurance subsidiary grow since inception in June 2011.

It is anticipated that the Mongolian economy will remain strong through 2013, which should bode well for the Company.

It is anticipated that the Company will continue to seek ways to raise additional equity capital to further the development of its businesses. MGG is also exploring utilizing conservative levels of debt funding for its property investments however, there can be no certainty that capital can be borrowed at rates that are attractive to the company.

### **Reorganization Transaction**

On December 1, 2010, Mongolia Growth Group Ltd. announced the signing of an agreement that Harris Kupperman and Jordan Calonego planned to purchase 320,500 common shares of the Corporation on a post-consolidated basis from the founding board members. The transaction was completed on February 2, 2011. The Corporation also completed the following transactions on February 2, 2011, which were approved by the shareholders at the annual and special meeting of shareholders on January 17, 2011:

- A private placement of the Corporation which raised gross proceeds of \$4,611,253 from the sale of 12,685,452 common shares on a post-consolidated basis;
- The filing of articles of amendment renaming the Corporation "Mongolia Growth Group Ltd." and consolidating the common shares of the Corporation at a ratio of 1:2;
- The filing of an application for the de-listing of the common shares from the NEX board of the TSXV and an application for the listing of the common shares on the CNSX; and
- The appointment of Paulo Bilezikjian, Jordan Calonego, Bill Fleckenstein, Harris Kupperman and Paul Sweeney as the new directors of the Corporation.

### **Liquidity**

As at December 31, 2012, MGG had working capital of \$12,554,733 (2011 - \$21,059,481) comprised of cash and cash equivalents, investments and marketable securities, other assets, reinsurance assets, deferred acquisition expenses, net of trade and accrued liabilities, income taxes payable and insurance contract liabilities. Management considers the funds on hand to be sufficient to meet its ongoing obligations.

## **Economic Volatility and Uncertainty**

The past economic volatility and uncertainty in Canada and around the world has contributed to dramatically restricted access to capital and reduced capital markets activity. The Company's management believes that the Company has sufficient resources to carry on its business and remain a going concern.

MGG holds the majority of its assets, investments and operations in the nation of Mongolia. Mongolia is presently experiencing drastic changes in its fast growing economy. Economic volatility and uncertainty in Mongolia could result in inflation, hyperinflation, economic stagnation, adverse taxation, political extremism, negative policy amendments and other similarly detrimental scenarios which would materially harm the Company.

Substantial risk and uncertainty exists due to the level of economic growth in Mongolia. According to the Bank of Mongolia, money supply (M2) increased 8.3% in the last 12 months ending December 31, 2012. Loans outstanding in the banking industry also increased substantially during the last 12 months, rising 23.9%, though this has slowed in recent months. Such changes in money supply and lending may be warranted due to the growth of the local economy. However, historical economic disequilibrium of such magnitude in other nations has frequently led to hyperinflation, unstable economic conditions, hardship and strife.

Depending on the requirements of MGG's businesses, additional funds may be required to be raised in the capital markets and there is no guarantee that sufficient funds raised will be available to complete a financing.

## **Events Subsequent to Year End**

Subsequent to year end, MGG purchased \$1,594,000 worth of properties.

The Company's shares began trading on the TSX Venture on January 9, 2013, and were simultaneously delisted from the CNSX.

MGG announced the appointment of John Shaw to the board of directors of the Company on January 17, 2013.

350,000 5-year Options and 125,000 3-year Options at a price of \$4.13 were issued to MGG's employees, Directors and Consultants on March 1, 2013.

MGG announced that Paulo Bilezikjian has resigned from the board of directors of the Company on March 4, 2013.

Management granted a three month extension on March 15, 2013, to UMC Capital to both complete and close the Share Purchase Agreement transaction. The deadline for both was extended to June 15, 2013, due to regulatory delays, and delays in UMC Capital funding the acquisition costs.

## **Financial Instruments**

The Company's financial instruments consist of cash and cash equivalents, investments and marketable securities, accounts receivable and trade and accrued payables. The Company is subject to interest risk as it earns interest income from its cash deposits. It is management's opinion that the Company is not exposed to significant credit risks arising from these financial instruments and that the fair value of these financial instruments approximates their carrying values. Management believes that there are material currency risks associated to the majority of the Financial Instruments of the Company as they are held in Mongolian Tögrög. For further discussion of financial instrument risks, see the Insurance and Financial Risk Management note.

## **Changes in Accounting Policies**

The consolidated financial statements of the Company were prepared in accordance with IFRS, as issued by the International Accounting Standards Board (IASB). For all periods up to and including the period ended December 31, 2010, the Company prepared its financial statements in accordance with Part V Pre-Changeover Accounting Standards, of the Canadian Institute of Chartered Accountants Handbook, Canadian generally accepted accounting principles (Canadian GAAP). Explanations of the impact of the transition to IFRS as of December 31, 2010 and January 1, 2010 on the financial position, financial performance and cash flows can be found in note 23 of the financial statements.

In 2010, the Company had no operations. With the simplistic nature of the Company in the previous year, IFRS did not result in any change to the Company's reported financial position at January 1, 2010, or December 31, 2010, results of operations and cash flows for the year ended December 31, 2010, thus no reconciliation information was presented.

## **Outstanding Share Data**

As at December 31, 2012, the Company had 34,143,352 common shares issued and outstanding. As at December 31, 2012, 11,372,500 of the Company's common shares, or approximately 33.4% of the issued and outstanding shares, were directly or indirectly controlled by the Company's directors and officers. As of December 31, 2012, the Company had 600,000 stock options outstanding with an exercise price of \$1.64 per share (500,000 have an expiry date of March 9, 2021, and 100,000 have an expiry date of March 9, 2014). The Company also had 722,000 stock options outstanding with an exercise price of \$4.20 per share, (at issuance, 825,000 had an expiry date of April 25, 2016, and 75,000 had an expiration date of April 25, 2014, of these a total of 128,000 were forfeited during 2011 and 50,000 were forfeited during the quarter). In addition, the Company had 170,000 options outstanding with an expiry date of September 7, 2016, and an exercise price of \$4.77 (175,000 options were issued initially, 5,000 were forfeited during the quarter). Furthermore, the Company had 150,000 options with an expiry date of December 2, 2016, and an exercise price of \$4.25. Lastly, the Company had 190,000 5-year stock options to purchase shares of MGG at a price of \$4.00 per share with an expiry of March 23, 2017.

At period-end, the Company has 358,000 options that are exercisable (2011 - nil).

<b>Outstanding</b>	<b>as at December 31, 2012</b>
Common shares	34,143,352
Options to buy common shares	1,782,000

### **Additional Information**

Additional information relating to Mongolia Growth Group Ltd., including its audited financial statements, is available on SEDAR at [www.sedar.com](http://www.sedar.com).