

MONGOLIA GROWTH GROUP LTD.

# MANAGEMENT DISCUSSION & ANALYSIS

First Quarter 2016

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**To The Shareholders of MGG;**

The first quarter of 2016 has seen us demonstrate continued progress in terms of reducing costs and improving efficiencies.

On the cost side, the first quarter of 2016 showed a \$195,824 (25%) reduction in costs before depreciation and equity compensation when compared with the first quarter of 2015. We believe that there are additional cost cuts that can be realized going forward.

Adjusted Funds From Operations (AFFO) improved significantly year over year from a loss of \$290,744 in Q1 2015 to a loss of \$119,712 in Q1 2016.

Offsetting these improvements in our overall operations, our revenues in Mongolian Tögrög terms have continued to slide throughout 2016. This has been caused by a weak economy, increased tenant turnover and heightened bad debt expense as tenants are unable to sustain their businesses due to the economy. Despite the continued decline in the Mongolian economy, we believe that our shares are undervalued and have initiated an NCIB to repurchase shares as we believe that the accelerating weakness in the economy may give us an opportunity to purchase shares at advantageous prices in the future.

Rest assured, we are doing all that we can to lose less money and preserve the value of our company, but between the rapid decline in market rental rates along with the movement in the Canadian Dollar to Mongolian Tögrög exchange rate, our current quarterly rate of loss may be the best that can be achieved until the economy recovers.

Sincerely,

*Harris Kupperman*

CEO and Chairman

# **MONGOLIA GROWTH GROUP LTD.**

## **Management Discussion & Analysis**

### **March 31, 2016**

The management of Mongolia Growth Group Ltd. (“MGG” or “the Corporation”) presents the Corporation’s management discussion and analysis for the three months ended March 31, 2016 (the “MD&A”), compared with the three months ended March 31, 2015. As of January 1, 2011, the Corporation adopted International Financial Reporting Standards (“IFRS”). This MD&A provides an overall discussion, followed by analyses of the performance of the Corporation’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 May 25, 2016 and incorporates all relevant information and considerations to that date.

*The following discussion and analysis should be read in conjunction with the Consolidated Condensed Financial Statements of the Corporation for the three months ended March 31, 2016 and March 31, 2015 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 adjusted earnings before interest, taxes, unrealized fair value adjustments, share based payments depreciation and amortization (“**Adjusted EBITDA**”). The Corporation uses Adjusted EBITDA as a measure of the performance of its operating subsidiaries as it excludes depreciation and interest charges, which are a function of the Corporation’s specific capital structure, and also excludes entity specific tax expense. 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 Corporation 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. “Operating Profits” is computed by calculating the profit before tax and any fair value adjustments. The Corporation also refers to Funds from Operations (“FFO”) and Adjusted Funds from Operations (“AFFO”). “FFO” is not defined under IFRS. The Corporation calculates FFO in accordance with the Real Property Association of Canada (“REALpac”) White Paper on Funds from Operations issued April 2014. FFO is defined by the Corporation as net income (loss) and comprehensive income (loss) calculated in accordance with IFRS, excluding: (i) Unrealized change in fair value of investment properties (ii) depreciation and amortization of investment properties; (iii) gains (or losses) from sales of investment properties and equipment; (iv) tax on gains or losses of sale on investment properties (v) deferred income tax (expense) recovery net of foreign exchange adjustments (vi) impairment/losses on all real estate assets (vii) Gains or losses on PPE properties (viii) share based payments. “AFFO” is not defined under IFRS and may not be comparable to AFFO used by other issuers. The Corporation has defined AFFO as FFO subject to certain adjustments, including: development expenses not capitalized, large one-time expenses and other adjustments as determined by Management.

## **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 Corporation’s management may make estimates and have opinions that form the basis for the forward-looking statements. The Corporation assumes no obligation to update such statements if circumstances, management’s estimates, or opinions change.

Forward looking statements are included within the Outlook, CEO Message to Shareholders and Executive Strategy sections of this MD&A.

## Section 1 – Overview

### Financial and Operational Overview

During the first quarter of 2016, the Corporation continued to focus on reducing costs in the midst of a weakening Mongolian economy, however cost reductions were partially offset by declines in rental revenues. During the first quarter, FFO and AFFO losses declined \$171,032 when compared to the first quarter of 2015.

The Corporation's rental revenue decreased by 8.9% over the same quarter last year, which was largely as a result of increased vacancies and an increasing amount of rental discounts provided to tenants. Additionally, the Corporation was forced to reduce rental rates on many property assets when leases came up for renewal. The Corporation's office space experienced higher vacancy rates than usual due to the departure of a significant tenant at the Corporation's head office. The Corporation is working to increase the occupancy at this property, but has struggled to fill this space due to oversupply of office space and a weakening economy. Despite the weakness in the economy, the Corporation's occupancy rates continue to outperform the market, with a weighted average occupancy rate of 91.6% at the end of the quarter.

During the quarter, the Corporation did not record an unrealized fair value loss on its investment properties (Q1 2015 -Nil). If market values continue to decline, the Corporation will likely need to record unrealized fair value losses in future quarters.

During the quarter, the Corporation disposed of one non-core asset for a loss of \$10,352 (Q1 2015 - 4 properties – gain of \$14,483). It is anticipated that the Corporation will continue to dispose of properties in future quarters in order to fund working capital needs along with the Corporations Normal Course Issuer Bid program. Proceeds from the sale were used for working capital and its NCIB program. As of March 31, 2016, the Corporation had five investment properties classified as available for sale. (Q4 2015 – 4 classified as available for sale).

Contrary to recent years, the Mongolian Tögrög started the 2016 year on a decline versus the Canadian dollar, depreciating from average of 1,438 MNT/CAD on December 31, 2015 to 1575 MNT/CAD in at the end of March 2016; a 9.5% decline during the quarter. This depreciation led to a \$4,254,751 comprehensive loss during the quarter.

## **Economic Overview**

During recent years, the Mongolian real estate sector has benefitted from significant local economic growth. The majority of this recent growth is attributable to the mining and construction booms 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. In addition, an increase in other industries, particularly tourism and agriculture have helped to grow the economy. The positive impact of improving consumer and business confidence has led to a substantial increase in the gross production of the local economy.

During 2015, the Mongolian economy witnessed a decrease in its growth rate, with this decline accelerating in the second half of the year. This slow-down has been caused by reduced prices for commodities, political uncertainty, the arrest of certain foreign executives, a decrease in bank lending, along with doubt over the timing of the continuation of the Oyu Tolgoi underground development. These factors have led to a substantial decline in foreign direct investment (FDI) which has reduced the rate of growth of the economy. Subsequent to quarter end, Oyu Tolgoi received the formal notice to proceed with underground development. The continuation of this project is a sizable milestone for Mongolia and is anticipated to inject substantial FDI into the economy.

The Mongolian economy was negatively impacted by the global commodity market downturn. The National Statistics Office of Mongolia (“NSO”) estimates first quarter year over year 2016 growth was 3.1% down from 4.4% in Q1 2015. The Corporation closely monitors the World Economics Sales Managers’ Index as an indicator of economic conditions in Mongolia. The Headline Sales Managers’ Index declined below 50 (indicating contraction) in the first quarter of 2014 and has consistently stayed in contraction territory since then. The March 2016 reading of 33.4 was one of the lowest since the data series began and indicates “marked deterioration in business conditions across the country.”

Management believes that the current economic slow-down is the result of policies that have discouraged Foreign Direct Investment (“FDI”). When the government takes the appropriate steps to stimulate FDI, it is expected that the economy can return to prior rates of economic growth. Management remains a believer in the long-term growth potential of Mongolia.

## **Property Overview**

The general property market continues to be influenced by the overall Mongolian economy. With the accelerating decline in the Mongolian economy, there has been a noticeable increase in vacancy, particularly in office and residential space. In the downtown core, this has led to a substantial decline in pricing for both rental rates and sales for those two asset classes. High street retail has seen less of an increase in supply, and demand for space remains adequate although lease rates have continued their decline during the first quarter of 2016. While most data is anecdotal, office rental prices in the downtown core have declined between 30-60%, while retail lease rates have declined by approximately a third in Mongolian Tögrög terms over the past 12-18 months. Recently, a number of prestigious office buildings have offered highly aggressive rates in order to fill vacancy. Based on those indicative rates, the Corporation would experience a substantial decline in rental rates for existing office assets.

Outside of the downtown of Ulaanbaatar, a noticeable increase in building activity has saturated most markets and led to a more substantial decline in prices. In addition, there has been a recent increase in office and residential construction activity that will likely lead to future saturation in those markets. Finally, there has been a noticeable increase in the number distressed property owners, including banks that are experiencing a rapidly increasing number of bad debts and foreclosures. It is likely that these individuals



will be forced to liquidate their property assets, potentially at prices that are substantially below current market prices. Management cautions shareholders that property prices have historically been, and continue to be, volatile.

Management expects a continued high demand for well-located retail space, with a lower demand level for office space. However, MGG continues to have below market rates of vacancy in all asset classes and believes that it is substantially outperforming the overall market in terms of occupancy.

MGG has seen a slight increase in bad debt and late payment of rent over the past year. Additionally, a large number of tenants are asking to have their rents reduced due to the economic crisis. MGG proactively evaluates tenants based on past rental history before changing the terms of rental contracts.

If the economy continues to deteriorate, it is expected that market rental rates will continue to decline. Additionally, overall rental revenue is expected to decline as existing leases are re-signed at current market rates that are often substantially lower than the rates that existed when contracts were previously signed. In many cases, it is expected that upon signing new leases, rents will continue to drop considerably.

## **Section 2 - Executing the Strategy**

### **Core Business**

During the past four years, Management and employees have worked hard to build up the infrastructure needed to manage MGG's institutional property platform. This platform is unique in Mongolia and is one of the only platforms capable of managing assets through the full cycle of ownership from acquisition and development, through disposition and includes dedicated departments that manage maintenance, leasing, marketing and tenant management. Management believes it has a strong team in place to lead the Corporation into its next phase of growth.

Due to MGG's unique platform, the Corporation is adding third party leasing and property management to its focus, in order to leverage its existing resources. Management believes that it has excess capacity to handle these functions and has seen a sizable increase in interest in using its brokerage operation as awareness spreads in the Ulaanbaatar market. The Corporation intends to more actively target this brokerage opportunity once its website is renewed and relaunched.

Since inception, MGG has acquired a number of redevelopment properties. To date the Corporation has also remodeled, rebuilt and completed additions on properties. During 2015, the Corporation spent substantial resources on redeveloping its Tuguldur retail center property; however these redevelopment efforts have been recently put on hold due to a slowing economy and uncertainty regarding the ability to lease added space due to the rapidly increasing vacancy level in the city. The Corporation did complete a 334 meter extension to Tuguldur during early 2016 and a lease was signed with a well-respected Mongolian tenant in early 2016. It is expected that this tenant will begin to pay rent on June 1st of 2016. Due to the project going over budget and the sizable decline in market rents from when the project began, until a lease was signed, this development project did not hit internal return targets, further validating the Corporation's decision to cease all further development spending.

Given the current economic situation, the Corporation is focused on finding additional opportunities to reduce costs and reduce the Corporation's cash burn. In addition, the Corporation is looking to sell additional properties in order to have sufficient liquidity to survive the downturn.

### **Portfolio**

Mongolia Growth Group's properties are located in the Downtown and the Central Business District of Ulaanbaatar.

Within the financial statements, MGG classifies properties in each of the following categories; Investment Properties, Property and Equipment, and Other Assets/Prepaid Deposits. Fluctuations in the values of the Corporation's property portfolio during the quarter can be attributed to changes in valuations, properties purchased and sold, and the change in value of the Functional Currency (Mongolian Tögrög) versus the Canadian dollar.

### **Investment Properties**

Investment Properties include properties held to earn rental revenue, for capital appreciation, and/or for redevelopment. Investment Properties are initially valued at fair value, which is the purchase price plus any directly attributable expenditure eligible for capitalization. Investment Properties are subsequently valued at fair value, which reflects market conditions at the date of the statement of financial position.

The following table represents properties classified as Investment Properties, as of March 31, 2016:

	31-Mar-2016			31-Dec-2015		
	# of Properties	Value at 31-Mar-16 \$CDN	Meters	# of Properties	Value at 31-Dec-15 \$CDN	Meters
Residential	1	260,357	-	1	285,170	-
Office	3	4,245,093	2,650	3	4,649,657	2,650
Retail	25	23,355,435	8,370	26	25,842,765	8,532
Land and Redevelopment	4	14,330,445	7,058	4	15,696,158	7,058
<b>Total</b>	<b>33</b>	<b>42,191,330</b>	<b>18,078</b>	<b>34</b>	<b>46,473,750</b>	<b>18,240</b>

Overall, the investment portfolio performed substantially better than similar properties in Ulaanbaatar, with the exception of Tuguldur, which has continued to struggle with high turnover. The Corporation believes that this is a result of mistakes made during the initial lease-up phase, compounded by the fact that many long-term leases were signed at below-market rents. This asset has now stabilized at average weekly occupancy rates of between 60% and 70% and correcting these mistakes continues to be a focus of management. Additionally, the Corporations' headquarters building has seen an increase in vacancy as a sizable tenant had ended its lease in March 2016. Subsequent to quarter end, a portion of this space has been leased, but at lower rates than the prior tenant was paying.

## Property and Equipment

Properties are classified as Property and Equipment if the Corporation occupies more than 10% of the property. Properties classified as Property and Equipment are measured at cost less accumulated depreciation, less any accumulated impairment losses. All repairs and maintenance costs to these properties are charged to the consolidated statement of operations during the period in which they occur unless eligible for capitalization.

The following table represents properties classified as Property and Equipment, as of March 31, 2016:

	31-Mar-2016			31-Dec-2015		
	# of Properties	Value at 31-Mar-16 \$CDN	Meters	# of Properties	Value at 31-Dec-15 \$CDN	Meters
Residential	1	90,675	-	1	99,316	-
Office	1	2,434,023	1,300	1	2,665,989	1,300
Retail	-	-	-	-	-	-
Land and Redevelopment	-	-	-	-	-	-
<b>Total</b>	<b>2</b>	<b>2,524,698</b>	<b>1,300</b>	<b>2</b>	<b>2,765,305</b>	<b>1,300</b>

## Other Assets/ Prepaid Deposits

Investment property purchases where the Corporation has paid either the full or partial purchase proceeds to the seller, but the Corporation has not yet received the official land or building title from a Mongolian property office, are recorded at the lower of cost or fair market value as Prepaid Deposits on Investment Properties and classified within other assets.

The following table represents properties classified as Prepaid Deposits on Investment Properties, as of March 31, 2016:

	31-Mar-2016			31-Dec-2015		
	# of Properties	Value at 31-Mar-16 \$CDN	Meters	# of Properties	Value at 31-Dec-15 \$CDN	Meters
Residential	-	-	-	-	-	-
Office	-	-	-	-	-	-
Retail	-	-	-	-	-	-
Land and Redevelopment	1*	63,661	28	1*	69,727	28
<b>Total</b>	<b>1</b>	<b>63,661</b>	<b>28</b>	<b>1</b>	<b>69,727</b>	<b>28</b>

\* These land assets are part of the land packages outlined in the Investment Properties section and are not standalone land packages.

## Occupancy Rates

A summary of MGG's property portfolio occupancy rates is set forth in the following table:

	31-Mar-2016	31-Dec-2015	31-March-2015
	Occupancy Rate*	Occupancy Rate*	Occupancy Rate*
Office	80.9%	91.7%	94.1%
Retail	100.0%	84.4%	96.7%
<b>Weighted Average**</b>	<b>91.6%</b>	<b>87.4%</b>	<b>95.6%</b>

\* Occupancy rates are calculated on a per meter basis;

\*\* Weighted Average is calculated based on total meters available for lease

Demand for retail space has remained strong, despite a difficult economy. During 2015, the Corporation received the title to a large retail space, consisting of 379 square meters that was previously tied up in litigation between the former owner and tenant. This space has now been leased with rental revenue expected to begin in the second quarter of 2016. Occupancy levels for the Corporation's Office space, excluding its headquarters building which lost a major tenant at the end of the quarter, have been strong even while vacancy levels throughout the city have increased significantly throughout as additional supply entered the market. Management attributes its success due to increased marketing initiatives and realistic price expectations.

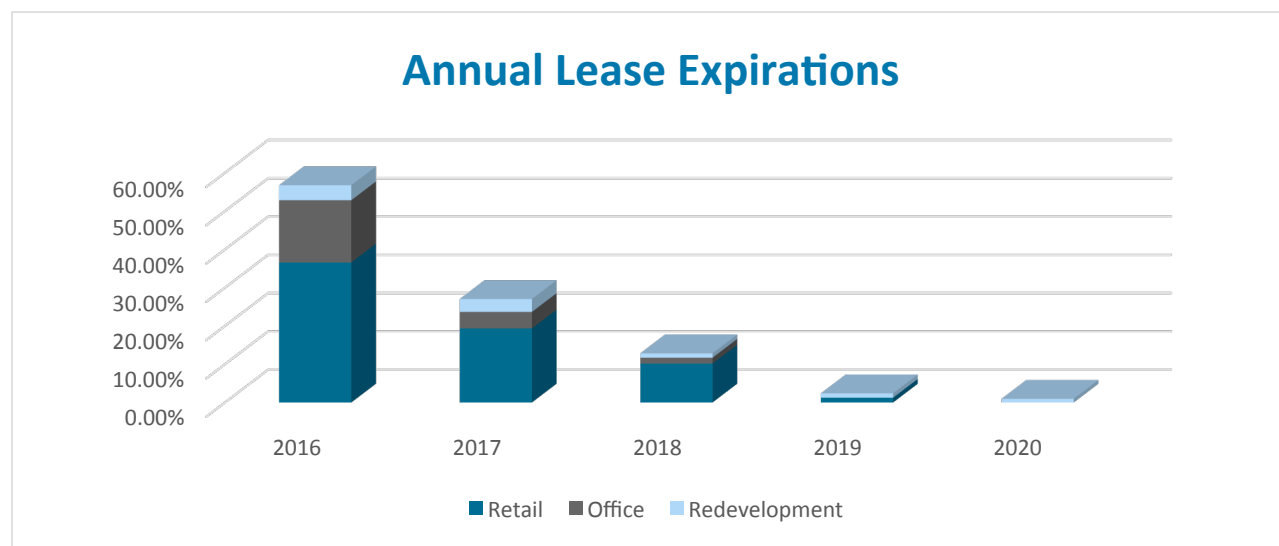
The Corporation would like to caution shareholders that it is experiencing abnormally high levels of tenant turnover and occupancy levels fluctuate dramatically between months as tenants break leases. It is expected that turnover will increase as the economy continues to decline and it is uncertain if the Corporation will be able to continue to find new tenants due to the weak economy.

## Leasing Schedule

In order to reduce the Corporation's exposure to currency fluctuations and inflation, the Corporation targets shorter lease durations with most tenants. Management's experience is that this practice is in line with the local industry standards with the expectation that when MGG leases expire, existing tenants are offered the first right to re-lease the space at then prevailing market rates.

During the first quarter of 2016, there were approximately 1,020 meters of leases, representing about \$11,970 in monthly rental revenue that had expired. The Corporation actively monitors lease renewals and anticipates that many of these leases will be renewed with existing tenants, but at rates that are below current rates.

A summary of the Corporation's lease expirations by asset class is presented in the chart below:



The weighted average remaining lease term decreased significantly to 10.3 months at March 31, 2016, from 17.1 months at March 31, 2015, and 17.3 months at March 31, 2014 calculated as a percentage of monthly revenues. An increasing number of tenants are on month-to-month contracts as they evaluate if they can sustain their businesses, given the continued decline in economic activity. We anticipate that a number of these tenants will cease to be tenants in future months.

It is Management's belief that most existing leases are at rates that are above current prevailing market rates. With the current economic conditions, many companies are suffering which is reflected by lower market rental rates in aggregate. It is expected that the Corporation's rental revenue may decline as leases are renewed at current market rates. Offsetting this fact, many of the Corporation's prior leases were signed at rates that did not reflect peak market rates.

Most Recent Retail Lease Signings					
Lease Type	Lease Renewal Date	SqM	Old Price Per Meter (Mongolian Tögrög)	New Price Per Meter (Mongolian Tögrög)	Percent Increase (decrease)
Office Lease	Jan-16	100	40,000	23,000	-42.50%
Retail Lease	Jan-16	187	35,000	24,064	-31.25%
Office Lease	Feb-16	56	26,785	23,808	-11.11%
Retail Lease	Feb-16	107	32,710	32,710	0.00%
Office Lease	Mar-16	24	29,000	27,000	-6.90%
Office Lease	Mar-16	88	23,000	23,809	3.52%

## Section 3 - Results of Operations

### Selected Quarterly Financial Information (CAD)

	Quarter ended	Quarter ended	Quarter ended
	31-Mar- 2016	31-Mar- 2015	31-Mar- 2014
<b>Revenue and other income</b>	490,160	577,752	634,581
<b>Income</b>			
Income/ (loss) from continuing operations attributable to equity holders of the Corporation	(275,372)	(372,991)	696,160
Net Income/ (loss) attributable to equity holders of the Corporation	(275,372)	(372,991)	696,160
Total Comprehensive income/ (loss) attributable to equity holders of the Corporation	(4,530,123)	1,711,276	(963,492)
<b>Basic earnings per share ("EPS") (in CAD)</b>			
Earnings/ (loss) per share	(0.01)	(0.01)	0.02
<b>Diluted EPS (in CAD)</b>			
Earnings/ (loss) per share	(0.01)	(0.01)	0.02
<b>Balance Sheet</b>			
Total Assets	46,241,247	55,548,676	49,253,675
Total liabilities	1,652,513	2,737,690	3,826,185
Total Equity	44,588,734	52,810,986	45,427,490
Shares Outstanding at quarter end	35,512,829	34,848,745	34,538,352
Book Value per share	1.26	1.52	1.32

## **Rental Revenue from Investment Properties**

Revenue from Investment Properties decreased from \$538,249 in the first quarter of 2015 to \$490,442 in the first quarter of 2016. The decrease during the quarter was primarily attributable to an increase in vacancy and rental discounts provided to tenants due to the economic downturn offset by initiatives that have successfully increased revenues.

## **Revenue from Other Sources**

Revenue from other sources consists of late fees and other income. For the first quarter of 2016, revenues from other sources totaled \$10,070 compared to \$25,020 for the first quarter of 2015. Revenues decreased due to lower late payments and penalty income collected throughout the year. Due to economic hardship and to maintain occupancy, the Corporation has been forced to waive late fees for certain tenants. It is expected that this will continue to be the case for the foreseeable future.

## **Gain/Loss on disposal of Investment Properties**

The Corporation disposed of one property for a net loss of \$10,352 during the quarter. During the first quarter of 2015, the Corporation disposed of four properties for a net gain of \$14,483.

## **Fair Value Adjustment on Investment Properties**

The estimate of fair value of investment properties is a critical accounting estimate to the Corporation. An external appraiser estimates the fair value of the majority of the Investment Properties annually, the remainder are appraised internally by Management. 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 Corporation 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. For the quarter ending March 31, 2016, the fair value adjustment to investment properties was \$nil (2015 Q1 - nil).

## **Currency**

The Mongolian Tögrög has fluctuated significantly over the past five years. The Mongolian Tögrög has depreciated 6.8%, 5.1%, 11.5% and 5.3% in 2011, 2012, 2013 and 2014 respectively versus the Canadian Dollar while appreciating 11.4% in 2015 then depreciating a further 9.5% during the first quarter of 2016. The fluctuation in the currency is reflected in the Corporation's financial statements, most notably in the investment property portfolio, as it is the largest item on the balance sheet. Note 5 in the financial statements disclose the foreign exchange adjustment, which flows through the investment property classification during each period. As at December 31, 2015 the Corporation recognized a significant foreign exchange adjustment gain of \$6,471,774 to its investment property portfolio due to the 11.4% appreciation of the local currency during the year, while it incurred a \$4,254,751 loss during the first quarter due to the 9.5% depreciation of the local currency.

## **Operating Profit/ (Loss)**

The Company generated an Adjusted EBITDA loss of \$105,991 during Q1 2016 compared to a loss of \$211,739 during Q1 2015. This reflects overall cost reduction in the quarter compared to the same quarter last year offset by lower revenue.

The following reconciles net income before income tax to Adjusted EBITDA from operations.

	Q1 2016	Q1 2015
Net Income / (loss) before Income taxes	(279,399)	(417,096)
Add Depreciation and Amortization	17,593	30,951
Subtract Interest and Investment Income	3,903	5,145
<b>EBITDA</b>	<b>(257,903)</b>	<b>(381,000)</b>
Subtract Fair Value Adjustment	-	-
Add Share Based Payments	151,912	169,261
<b>Total Adjusted EBITDA</b>	<b>(105,991)</b>	<b>(211,739)</b>

### Funds From Operations ("FFO")

While FFO does not have a standardized meaning prescribed by IFRS, it is a non-IFRS financial measure of operating performance widely used by the real estate industry. The Real Property Association of Canada (REALpac) recommends that FFO be determined by reconciling FFO from net income.

For the three months ended March 31, 2016, negative FFO improved to a loss of \$119,712 in Q1 2016 from a loss of \$290,744 in Q1 2015. The improvement is primarily due to a reduction in expenses due to cost cutting measures initiated since the beginning of the year offset by a decline in revenue.

### Adjusted Funds From Operations ("AFFO")

Since FFO does not consider capital expenditures and other one-time expenses. AFFO is presented herein as an alternative measure of determining available cash flow. AFFO is not defined by IFRS but the Corporation follows recommendations by REALpac. During Q1 2016, the Company's AFFO numbers improved primarily due to a lower loss and a smaller change in deferred taxes.

During the first quarters of 2015 and 2016, there were no development costs not capitalized nor any significant one-time expenses, therefore AFFO numbers were consistent with FFO numbers. It should be noted that FFO and AFFO may include certain one-time costs related to the Corporation's cost cutting plan that were not sufficiently large enough to be broken out, but their exclusion would have further reduced the Corporation's AFFO loss for the quarter.



## Reconciliation of FFO and AFFO

The analysis below shows a reconciliation of the Corporation's net income to FFO and AFFO for the quarters ended March 31, 2016 and March 31, 2015;

	Quarter ended	Quarter ended
	31-March	31-March
	2016	2015
	(\$)	(\$)
<b>Net Income for the period</b>	<b>(275,372)</b>	<b>(372,991)</b>
<i>Add (deduct) items not affecting cash</i>		
Unrealized Change in fair value of investment properties	-	-
Depreciation and amortization of investment Properties	1,530	18,374
Loss (gain) from sales of investment properties	10,352	(14,483)
Tax on sales on investment property	4,888	20,002
Deferred Taxes	(13,022)	(93,008)
Impairment/losses on all real estate assets	-	-
Impairment of other assets	-	-
Loss (gain) on PP&E properties	-	(17,899)
Share Based Payments	151,912	169,261
<b>Funds From Operations</b>	<b>(119,712)</b>	<b>(290,744)</b>
<i>Add (deduct)</i>		
Development costs not capitalized	-	-
Significant one-time expenses	-	-
<b>Adjusted Funds From Operations</b>	<b>(119,712)</b>	<b>(290,744)</b>
<b>Per Unit – Basic</b>		
Funds From Operations	0.00	-0.01
Adjusted Funds From Operations	0.00	-0.01
<b>Per Unit – Diluted</b>		
Funds From Operations	0.00	-0.01
Adjusted Funds From Operations	0.00	-0.01

**Net Income**

For the quarter ending March 31, 2016, the Corporation incurred a net loss of \$275,372 compared to a net loss of \$372,991 for the quarter ending March 31, 2015. The smaller loss in comparison to last year's is primarily due to a decrease in expenses year over year.

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

## Section 4 - Financial Condition

### Cash Flow

Mongolia Growth Group's primary sources of capital are cash generated from equity issuance, financing and asset sales. Management expects to meet all of the Corporation's obligations through current cash and cash equivalents along with cash flows from asset sales.

The following table provides an overview of the Corporation's cash flows from operating, financing and investing activities for the quarter ended March 31, 2016, and March 31, 2015.

Net change in cash related to:	Q1 2016 (\$)	Q1 2015 (\$)	Q1 2014 (\$)
Operating	(146,386)	(622,535)	(275,317)
Investing	160,732	403,904	(3,004,261)
Financing	(7,400)	-	443,400
Effects of exchange rates on cash	(74,654)	51,358	(54,398)
<b>Net change in cash during the period</b>	<b>(67,708)</b>	<b>(167,273)</b>	<b>(2,890,576)</b>

Overall, net cash outflows during the first quarter of 2016 were lower than the previous year's first quarter, due to decreased outflows from operating activities offset by lower inflows from investing activities and negative exchange rate effects. The changes in components of cash flows for the quarter ended March 31, 2016 compared to the quarter ended March 31, 2015 were the result of the following factors:

- **Operating** – Operating cash outflows for the quarter decreased mainly due net change in non-cash working capital as well as lower operating costs.
- **Investing** – Investing cash inflows for the quarter decreased due to lower disposals of investment properties.
- **Financing** – The Company purchased 18,500 shares at a total cost of \$7,400 during the quarter while there were no financing activities during the first quarter of 2016.

As at March 31, 2016, the Corporation had approximately \$967,564 in cash and cash equivalents.

### Total Assets

As of March 31, 2016, the Corporation had \$1,333,088 in Current Assets of which approximately 73% were held in cash and cash equivalents (Q4 2015 –\$1,363,271 and 76%).

The majority of the Corporation's assets are classified as Non-Current Assets, mainly Investment Properties. Investment Properties are carried at Fair Market Value and decreased throughout the quarter by way of dispositions and the depreciation of the local currency.

In the first quarter of 2016, assets classified as Investment Properties decreased to \$42,204,173 from \$46,473,749 as at December 31, 2015, due to a stronger Canadian dollar. Property and Equipment decreased to \$2,703,986 (December 31, 2015 - \$2,978,150) due to the decline in local currency.

## Total Financial Liabilities

As of March 31, 2016, the Corporation had current liabilities of \$760,868 (December 31, 2015 – \$850,716) consisting primarily of payables and accrued liabilities.

As of March 31, 2016, the Corporation had no long-term debt outstanding; as such the only non-current liability on the balance sheet is deferred income taxes. Deferred tax liabilities decreased during the quarter to \$891,645 in Q1 2016 (Q4 2015 - \$990,109).

The Corporation considers all other current cash commitments to be immaterial and operational in nature.

## Total Equity

The equity of the Corporation consists of one class of common shares.

<b>Outstanding</b>	<b>31-Mar-16</b>	<b>31-Dec-15</b>
Common shares	35,512,829	35,512,829
Options to buy common shares	3,513,000	3,288,000

## Options Outstanding

At period-end, the Corporation had 3,055,500 options that were exercisable (December 31, 2015 – 2,510,500).

The Chart below shows the historical option grants and options outstanding as of March 31, 2016.

Option Price	Granted	Forfeited	Cancelled	Exercised	Total Options Outstanding	Total Exercisable	Non exercisable
1.64	100,000	0	0	100,000	0	0	0
1.75	300,000	0	50,000	250,000	0	0	0
1.90	1,363,000	85,000	0	200,000	1,078,000	1,078,000	0
4.20	900,000	408,000	362,000	0	130,000	130,000	0
4.77	175,000	100,000	55,000	0	20,000	20,000	0
4.25	150,000	50,000	95,000	0	5,000	5,000	0
4.00	190,000	0	190,000	0	0	0	0
4.13	475,000	75,000	400,000	0	0	0	0
1.09	375,000	0	0	0	375,000	375,000	0
0.72	935,000	20,000	0	0	915,000	457,500	457,500
0.74	640,000	0	0	0	640,000	640,000	0
0.38	350,000	0	0	0	350,000	350,000	0
<b>Total</b>	<b>5,953,000</b>	<b>738,000</b>	<b>1,152,000</b>	<b>550,000</b>	<b>3,513,000</b>	<b>3,055,500</b>	<b>457,500</b>

## Acquisitions and Dispositions

During the first quarter of 2016, the Corporation did not purchase any properties and spent \$13,482 on capital expenditures compared to capital expenditures of \$555,872 during the first quarter of 2015 spent to further develop one of its redevelopment assets.

During the quarter, the Corporation disposed of one property for cash considerations of 239,955 (Q1 2015 - four investment properties for consideration of \$1,006,753).

## Off-Balance Sheet Items

As of March 31, 2016 the Corporation had no off-balance sheet items.

## Events Subsequent to Quarter End

Subsequent to quarter end, the Corporation has purchased 16,500 and cancelled 33,500 of its shares.

## Section 5 - Quarterly Information

### Quarterly Results

The following table is a summary of select quarterly information over the previous eight quarters:

	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015	Q4 2014	Q3 2014	Q2 2014
<b>Revenue (\$)</b>	490,160	526,949	340,871	501,936	577,752	316,712	424,787	542,837
<b>Net income (loss) (\$)</b>	(275,372)	(5,503,493)	(2,701,490)	(1,352,996)	(372,991)	117,251	(1,489,119)	5,033,379
<b>Income (loss) per common share (\$)</b>	(0.01)	(0.16)	(0.08)	(0.04)	(0.01)	0.00	(0.04)	0.15
<b>Total Assets (\$)</b>	46,241,247	50,815,170	54,495,461	54,790,433	55,548,676	54,106,591	55,523,885	54,965,199
<b>Weighted Average Shares (No.)</b>	35,512,829	35,315,357	35,248,810	35,114,612	34,848,745	34,652,992	35,800,084	34,495,983
<b>Ending Shares (No.)</b>	35,512,829	35,512,829	35,512,829	35,512,829	34,848,745	34,848,745	34,848,745	34,748,745

## **Section 6 – Critical Estimates**

### **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 judgments 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 Adjustment on Investment Properties**

The estimate of fair value of investment properties is the most critical accounting estimate to the Corporation. An external appraiser estimates the fair value of the majority of the Investment Properties annually, the remainder are appraised internally by Management. 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 Corporation 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. For the three month period ending March 31, 2016, the Corporation did not have a fair value adjustment on its investment properties (Q1 2015 – nil).

### **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 Corporation. 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 options and future forfeiture rates. For the quarter ending March 31, 2016, the cost of the share based payments totaled \$151,912 (Q1 2015 - \$169,261).

### **Operating Environment of the Corporation**

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 continuing demand from China and increasing 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 Corporation.

### **Assets and Liabilities Held for Sale**

The Corporation makes judgments in determining whether certain non-current assets or group of assets and liabilities meet the specified criteria under IFRS for classification as held for sale. At March 31, 2016, the Corporation has identified four investment properties which meet the specified criteria and has accounted for them as assets held for sale.

## **Deferred Tax Assets**

Deferred tax assets are recognized to the extent that it is probable that deductible temporary differences will reverse in the foreseeable future and there will be sufficient future taxable profits against which the deductible temporary differences can be utilized. The Corporation reviews the carrying amount of deferred tax assets at the end of each reporting period which is reduced to the extent that it is no longer probable that deferred tax assets recognized will be recovered, or increased to the extent that sufficient future taxable profit will be available to allow all or part of a previously unrecognized deferred tax asset to be recovered. Estimates of future taxable income are based on forecasted cash flows from operations, available tax planning opportunities and expected timing of reversals of taxable temporary differences.



## **Section 7 – Risk Management**

### **Credit risk**

The Corporation's exposure to credit risk is managed through risk management policies and procedures with emphasis on the quality of the investment portfolio. For the quarter, most of the Corporation's investments consisted of institutional deposits. The majority of the funds invested are held in reputable Canadian or Mongolian banks.

The Corporation is exposed to credit risk as an owner of real estate in which tenants may become unable to pay contracted rents. The Corporation mitigates this risk by carrying out due diligence on significant tenants. The Corporation's properties are diversified primarily across commercial classes. Historically, bad debts have not been a substantial expense for the Corporation.

### **Liquidity risk**

The Corporation does not believe its current maturity profile lends itself to any material liquidity risk, taking into account the level of cash and cash equivalents, investments and marketable securities and long term debt as at March 31, 2016.

As at March 31, 2016, MGG had working capital of \$572,220 (December 31, 2015- \$512,555) comprised of cash and cash equivalents, investments and marketable securities, other assets, net of trade and accrued liabilities, income taxes payable and long term debt (current portion).

### **Currency risk**

The Corporation owns properties located in Mongolia and collects rental revenue in Mongolian Tögrög, and is therefore subject to foreign currency fluctuations that may impact its financial position and results. Changes in the Mongolian Tögrög, U.S. dollar and Canadian dollar foreign currency exchange rates impact the fair value of securities denominated in Mongolian Tögrög and in U.S. dollars.

### **Economic Volatility and Uncertainty**

Over the past few years, economic volatility and uncertainty around the world has contributed to dramatically restricted access to capital and reduced capital markets activity for more speculative businesses. The Corporation's management believes that the Corporation 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, political extremism, and other similarly detrimental scenarios which could materially harm the Corporation.

Coinciding with the slowdown in the economy, Inflation during 2015 dropped significantly from 9.8% in January 2015 to 1.9% in December 2015. During 2016, inflation levels stabilized at 1.7%, 2.0% and 1.7% respectively for the first three months of 2016.

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 required to augment the Corporation's operations.

## **Risks and Uncertainties**

The Corporation, 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 Corporation 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.

Further information related to Mongolia Growth Group Ltd. and the risks and uncertainties of MGG are 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 Corporation's most recently filed annual MD&A.

## **Financial Instruments**

The Corporation's financial instruments consist of cash and cash equivalents, investments and marketable securities, accounts receivable, trade and accrued payables and long term debt. The Corporation is subject to interest risk as it earns interest income from its cash deposits and pays interest on its long term debt. It is Management's opinion that the Corporation 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 certain Financial Instruments of the Corporation as they are held in Mongolian Tögrög. For further discussion of financial instrument risks, see the Insurance and Financial Risk Management note.

## **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 caused 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 Corporation's certifying officers for the March 31, 2016 interim filings. The new certification reflects what the Corporation considers to be a more appropriate level of CEO and CFO certification given the size and nature of the Corporation's operations. This certification requires the certifying officers to state that:

- (i) they have reviewed the interim 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 interim MD&A and consolidated financial statements;
- (iii) based on their knowledge, the interim filings, together with the other financial information included in the interim filings, fairly present in all material respects the financial condition, results of operations and cash flows of the Corporation as of the date and for the periods presented in the filings.

## **Recent Accounting Pronouncements**

IFRS9, *Financial Instruments* ("IFRS9"), On July 24, 2014, the IASB issued IFRS 9, "*Financial Instruments*" ("IFRS 9") to replace International Accounting Standard 39, "*Financial Instruments: Recognition and*

*Measurement*". IFRS 9 is effective for years beginning on or after January 1, 2018. Early adoption is permitted if IFRS 9 is adopted in its entirety at the beginning of a fiscal period. The Corporation is currently evaluating the impact of adopting IFRS 9 on the Consolidated Financial Statements.

The Corporation is currently evaluating the impact of IFRS 9 on its condensed consolidated interim financial statements.

In May 2014, the IASB issued IFRS 15, "Revenue from Contracts with Customers" ("IFRS 15"), a new standard that specifies the steps and timing for entities to recognize revenue as well as requiring them to provide more informative, relevant disclosures. IFRS 15 supersedes IAS 11, Construction Contracts, and IAS 18, Revenue, as well as various IFRIC and SIC interpretations regarding revenue. Adoption of IFRS 15 is mandatory and will be effective for the Corporation's beginning on September 1, 2017, with earlier adoption permitted. The Corporation is assessing the impact of adopting this standard on its financial statements.

### **Additional Information**

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