

MONGOLIA GROWTH GROUP LTD.  
Management Discussion & Analysis  
June 30 2013

## **MONGOLIA GROWTH GROUP LTD.**

### **Management Discussion & Analysis**

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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 three and six month period ended June 30, 2013 (the “MD&A”), compared with the three and six month period ended June 30, 2012. 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 August 28, 2013 and incorporates all relevant information and considerations to that date.

*The following discussion and analysis should be read in conjunction with the condensed unaudited interim consolidated financial statements of the Company for the period ended June 30, 2013 and June 30, 2012 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”). 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. 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 office, retail, and redevelopment 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 Mongolia, 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.

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 increases in rents and 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 led to increases in capitalization rates as rental rates continued to increase. During the second quarter of 2013, the Mongolian Central Bank lowered interest rates which resulted in increases in property prices, 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.

The Mongolian togrog (MNT) has fluctuated significantly over the past two years. In 2011, the average exchange rate between the MNT and the Canadian dollar was approximately 1250 for the year, whereas subsequent to the period ending June 30, 2013 the MNT reached a high of over 1500. The fluctuation in MNT is reflected in the Company'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

line during each period. As at June 30, 2013 the Company recognized a slight increase in the foreign exchange adjustment, but subsequent to the period end the movement in MNT has continued to be unfavourable. The MNT weakness and a continued decline may impact negatively the Company's MNT denominated assets once converted to Canadian dollars.

Recent fears over the uncertainty of the future development plans for the Oyu Tolgoi mine and worries over the decline in the Mongolian Togrog have led to a slowdown in commercial property transactions.

It should also be noted that the recent initiation of 8% mortgages for certain conforming apartments has led to a sizable increase in apartment prices and an even stronger increase in the value of land assets that are suitable for building apartments.

Finally, the city of Ulaanbaatar has recently announced that it will not be releasing heating permits for new commercial development and will be revoking a number of existing commercial permits. This may serve to further reduce the available supply of commercial space, in a market that is already supply constrained. This move was undertaken in order to reserve scarce heating supply for new residential construction until the new Amgalan "thermal only" power plant is built.

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*

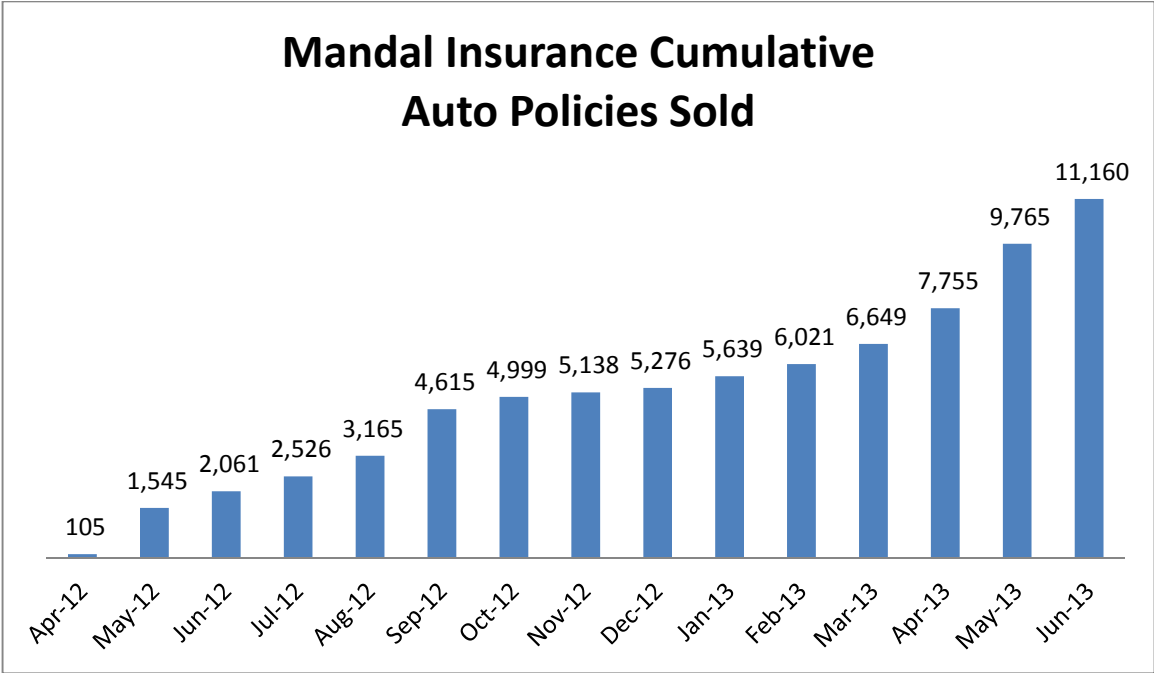
The Company's insurance subsidiary (Mandal General Insurance or "Mandal") began underwriting in the fourth quarter of 2011. The underwriting capacity and knowledge of the insurance subsidiary was acquired vis-à-vis the initial funding of the company, and by the hiring of individuals that had previously 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. 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.

According to statistics produced by FRC, at the end of the Q1 2013, Mandal represented 7.2%, 5.8% and 5.1% of the total assets, gross premiums and net premiums of the Mongolian Insurance Market. This is an increase from 6.8%, 3.8% and 2.5% respectively at calendar year end 2012.

Mandal continues to have marketing successes, particularly in mandatory driver’s liability where the total policy count has now grown to 11,160 policies as of the end of June 2013.



During the quarter Mandal signed a Memorandum of Understanding with XacBank, was chosen to market a national Student Casualty Insurance product in 2013-2014 and signed a cooperation agreement with Golomt Bank Leasing.

**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 presidential election 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 quite strong.

The completion of the presidential elections in June, ending the elections cycle that started mid-2012, has freed politicians to direct their focus back to the economy. During the second quarter, the government announced a program to offer 8% mortgages on certain conforming apartments. As consumers refinance their properties, we have seen a stimulative effect on the economy. Loans outstanding in the banking industry also increased substantially during the last 12 months, rising 42.1%. From June 30, 2012 to June 30, 2013, the national consumer price index increased 8.8%. The growth of money supply (M2) has slowed in the months of July and June to 1.1% and 1.2% compared to an increase of 10.2% in the month of May. One area of concern in the economy remains FDI, which has been on decline since 2012. After controversial discussions regarding the foreign investment and mining laws, the government announced a planned new FDI law that is expected to support foreign investment.

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 Company's property business, its portfolio of assets has likewise increased 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 redevelopment sites.

## Selected Quarterly Financial Information (\$CAD)

	Quarter ended June 30 2013	Quarter ended June 30 2012	Quarter ended June 30 2011
Revenue and other income	771,189	571,472	42,263
<b>Income</b>			
Loss from continuing operations attributable to equity holders of the Company	(1,223,474)	(494,782)	(485,585)
Net loss attributable to equity holders of the Company	(1,223,474)	(494,782)	(485,585)
Comprehensive loss attributable to equity holders of the Company	(935,577)	(1,202,172)	(404,459)
<b>Basic earnings per share ("EPS") (in dollars)</b>			
Loss from continuing operations	(0.04)	(0.01)	(0.02)
Net loss	(0.04)	(0.01)	(0.02)
<b>Diluted EPS (in dollars)</b>			
Loss from continuing operations	(0.04)	(0.01)	(0.02)
Net loss	(0.04)	(0.01)	(0.02)
<b>Balance Sheet</b>			
Total Assets	52,443,237	56,058,108	36,250,423
Financial liabilities	4,514,354	3,394,328	10,661
Total Equity	47,928,883	52,663,780	36,239,762
Shares Outstanding at period end	34,303,352	34,143,352	30,297,198
Book Value per share	1.40	1.54	1.20

## Results of Operations

As of June 30, 2013, 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, sell property and casualty insurance and participate in activities consistent with raising capital.

Refer to Note 11 of the unaudited interim consolidated financial statements of the Company for a table of segmented data.

### Revenues

MGG's consolidated revenues for the three months ended June 30, 2013 increased to \$771,189 from \$571,472 during the quarter ended June 30, 2012. The balance for the consolidated revenues for the six months ended June 30, 2013 increased to \$1,547,665 from \$1,041,354 for the six months ending June 30, 2012. The majority of this increase is attributable to having a larger investment property portfolio generating rental income and an insurance subsidiary that is more established.

The Company's investment property business contributed a large part of the revenue for the second quarter of 2013; \$431,512 of rental income compared to \$383,920 during the second quarter of 2012. The property business contributed \$845,897 for the six months ended June 30, 2013 compared to \$767,024 for the same period ending June 30, 2012. As well, related to investment properties, the Company realized a loss of \$13,794 on disposal of investment properties for the six month period ending June 30, 2013 which were classified as held for sale (June 30, 2012 - gain of \$70,973).

The Company's insurance business contributed \$321,565 of net premium earned, \$159,938 of net investment income and \$28,026 of other revenue during the three month period ending June 30, 2013 compared to \$118,682, \$150,264 and \$9,370 for the three months ending June 30, 2012. For the six months ending June 30, 2013 the Company's insurance business contributed \$663,682 of net premiums earned, \$315,133 of net investment income and \$36,632 of other revenue compared to \$190,665, \$286,808 and \$9,370 for the six months ending June 30, 2012.

### *Expenses*

Total expenses for the second quarter of 2013 increased to \$2,205,539 from \$1,281,267 during the second quarter of 2012. Total expenses for the six months ending June 30, 2013 increased to \$4,283,746, from \$2,539,600 for the same six month period ending June 30, 2012. The increases in expenses for the three and six month period can largely be attributed to an increase in professional fees, salaries and wages, and net claims incurred. As the Company was still in start-up phase in early 2012, increases in expenses in 2013 were a result in the continued growth of the businesses of the Company. As well, during the first quarter of 2013, management spent considerable time and resources on a proposed acquisition of a company that would have substantially increased the size of MGG. In the end, this transaction was not completed. Total expenses for this proposed merger were in excess of \$400,000 for the six month period ending June 30, 2013. It is not anticipated that the Company will attempt any other acquisitions in the near future and that this expense is not expected to be recurring. In addition, the Company undertook an aggressive investor relations initiative which involved meeting with dozens of investors in North America which cost the Company in excess of \$100,000. As well, there was an increase in professional fees related to quarterly financial reviews necessitated by listing on the TSX-Venture exchange and an increase in salaries, wages and bonuses to certain senior management.



### *Operating Profit (Loss)*

The property business of MGG generated an Operating or EBITDA gain before the fair value adjustment on investment properties of \$11,737 during the second quarter of 2013 (Q2 2012 – loss of \$82,054) and \$2,917 for the six months ending June 30, 2013 (loss for the six month ending June 30, 2012 – \$35,174). Included in this calculation for the quarter are share based payment expenses of \$133,374 (Q2 2012 - \$134,290), and \$270,206 for the six month period ending June 30, 2013 (six months ending June 30, 2012 - \$268,580). Without the share based payment expenses, the property business would show a gain of \$145,111 for the three months ending June 30, 2013 (Q2 2012 - \$52,236) and \$273,123 for the six months ending June 30, 2013 (six months ending June 30, 2012 - \$233,406). The increase in the EBITDA number from 2012 to 2013 is the result of increased operating efficiency; increased revenues offset by a slight increase in operating expenses.

MGG's insurance business generated an Operating or EBITDA loss of \$276,235 during the second quarter of 2013 (Q2 2012 – loss of \$60,552) and \$610,940 for the six month period ending June 30, 2013 (six month period ending June 30, 2012 - \$524,495). Included in these loss calculations for the quarter are share based payment expenses of \$39,013 (Q2 2012 - \$135,894) and \$213,560 for the six month period ending June 30, 2013 (six month period ending June 30, 2012 - \$271,788). Without these share based payment expenses the insurance business would have incurred a loss in the quarter of \$237,222 (Q2 2012 – gain of \$75,342) and a loss of \$397,380 for the six months ending June 30, 2013 (six months ending June 30, 2012 loss of \$252,707). The majority of the increase in the loss is due to an increase in the Company's net claims and operating expenses.

The Company's corporate overhead contributed to an Operating or EBITDA loss of \$1,122,719 during the second quarter of 2013 (Q2 2012 - \$543,299) and a loss of \$2,035,055 for the six month period ending June 30, 2013 (six month period ending June 30, 2012 - \$897,344). Included in these loss calculations for the quarter are share based payment expenses of \$133,982 (Q2 2012 - \$120,015) and \$449,477 for the six month period ending June 30, 2013 (six month period ending June 30, 2012 - \$240,030). Without these share based payment expenses corporate would have incurred a loss in the quarter of \$988,737 (Q2 2012 - \$423,284) and \$1,585,578 for the six month period ending June 30, 2013 (six month period ending June 30, 2012 - \$657,314). The large increase in this loss was incurred for legal and consulting expenses relating to work on a possible corporate merger transaction. As well there was an increase in professional fees related to the annual audit, quarterly reviews and tax work, and an increase in salaries and wages.

In total the Company's consolidated divisions reported an Operating or EBITDA loss, before the fair value adjustment on investment properties of \$1,387,217 during the second quarter of 2013 (Q2 2012 – loss of \$685,905) and \$2,643,078 for the six month period ending June 30, 2013 (six month period ending June 30, 2012 - \$1,457,013). Included in these loss calculations for the quarter are share based payment expenses of \$306,369 (Q2 2012 - \$390,199) and \$933,243 for the six month period ending June 30, 2013 (six month period ending June 30, 2012 - \$780,398). Without these share based payment expenses the consolidated Company would have incurred a loss in the quarter of \$1,080,848 (Q2 2012 - \$295,706) and \$1,709,835 for the six month period ending June 30, 2013 (six month period ending June 30, 2012 – \$676,615). In addition the Company reported net investment income of \$232,571 (Q2 2012 - \$215,013) during the quarter and \$485,718 for the six month period ending June 30, 2013 (six month period ending June 30, 2012 - \$353,515).

## Net Income

For the quarter ended June 30, 2013, the Company incurred a net loss of \$1,223,474 compared to a net loss of \$494,782 for the quarter ended June 30, 2012 and a loss of \$1,287,808 for the six month period ending June 30, 2013 versus a loss of \$1,144,731 for the six month period ending June 30, 2012. The increased revenue earned in the three and six months ending June 30, 2013 versus the three and six months ending June 30, 2012 was outweighed by a significant increase in professional fees and employee wages which are a result of growth in the Company's operations. The Company recorded an unrealized gain on fair value adjustment on investment properties during the six month period ending June 30, 2013 which offset a part of the increase in operating expenses (six month period ending June 30, 2012 – nil).

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 long-term 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 (\$CAD)

	Q2 2013	Q1 2013	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011
Revenue	771,189	776,476	618,435	577,905	571,472	469,882	360,914	186,134	42,263
Net income (loss)	(1,223,474)	(64,334)	(4,488,408)	(446,069)	(494,782)	(644,491)	2,794,533	(820,149)	(485,585)
Income (loss) per common share	(0.04)	0.00	(0.13)	(0.01)	(0.02)	(0.02)	0.11	(0.03)	(0.02)
Total Assets	52,443,237	52,859,111	51,306,531	52,048,976	56,058,108	55,783,296	55,336,889	36,439,544	36,250,423
Weighted Average Shares	34,245,230	34,170,019	34,143,352	34,143,352	34,143,352	34,143,352	23,902,851	21,814,422	16,617,951
Ending Shares	34,303,352	34,173,352	34,143,352	34,143,352	34,143,352	34,143,352	34,143,352	30,297,168	30,297,198

MGG's revenue continued to grow, with second quarter consolidated revenue and net investment income increasing to \$771,189 and \$232,571 respectively, compared to second quarter of 2012 consolidated revenue and net investment income of \$571,472 and \$215,013.

## Property

During the second quarter, MGG's property subsidiary earned rental income of \$431,512, compared to rental income of \$383,920 during the same quarter of the previous year; an increase of 12%. For the six month period ending June 30, 2013 the property subsidiary earned rental income of \$845,897 compared to \$767,024 for the same period in 2012; an increase of 10%. This increase is the result of the addition of properties to the investment portfolio, offset by an increase in

commercial properties that were recently renovated being integrated back into the leasing cycle, and certain property revenues related to Mandal being eliminated on consolidation and the sale of certain residential units.

During the second quarter of 2013, this subsidiary has also earned net investment income of \$72,832 (Q2 2012 - \$61,337) on its investment portfolio and \$170,629 for the six months ending June 30, 2013 (six months ending June 30, 2012 - \$61,337).

The property division's overhead expenses rose significantly throughout the past year, but rose less rapidly during this past quarter. Management expects this to continue to be the case throughout the next year.

MGG's investment property portfolio has increased to \$33,543,531 in Q2 from \$30,786,742 at the end of the 2012 fiscal year, taking into consideration the effects of foreign currency translation. This is a \$2,756,789 or 9% increase compared to the end of the year. This increase was due to the purchase of four new properties offset by the sale of two properties as well as an unrealized gain of \$1,136,125 on fair value adjustment on an investment property that was classified as "other assets" at the end of year. The Company anticipates that the investment portfolio will continue to increase in the future.

#### *Insurance*

During the three and six month period ending June 30, 2013, the insurance subsidiary had net earned premiums of \$321,565, and \$663,682 compared to net earned premiums of \$118,682 in the three month period ending June 30, 2012 and \$190,665 in the six month period ending June 30, 2012, an increase of 171% and 248%. The large increase in the insurance company's net earned premium mainly relates to the fact that it was in the early stages of operations in 2012 as it had just begun to write policies in late 2011. This subsidiary has also earned net investment income of \$159,938 and \$315,133 on its investment portfolio for the three and six month period ending June 30, 2013, compared to \$150,264 and \$286,808 for the same periods in 2012, an increase of 6% and 10%.

The insurance subsidiary has spent aggressively to develop the Mandal brand name through 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 spent 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.

#### *Corporate*

Quarterly expenses related to corporate operations totalled \$1,125,434 for the three months ending June 30, 2013, compared to \$539,887 during the same period in 2012, an 108% increase. The expense for the six months ending June 30, 2013 totalled \$2,040,038 compared to \$894,367 for the six months ending June 30, 2012, and increase of 128%. The increase in corporate expenses is mainly attributed to professional fees for the audit and quarterly reviews, legal and consulting expenses relating to work done on a possible corporate merger transaction which was not completed. As well the Corporate office had an increase in salaries and wages.

The Company has continued to incur elevated expenses at the corporate level due to the high cost of being a public company.

Professional fees totalled \$493,324 during Q2 2013, up from \$217,367 in Q2 2012. 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 negotiations to acquire another publicly traded company during the previous quarter. Management expects that professional fees will drop considerably in future quarters as there are no intentions to acquire any other publicly traded companies at the current time.

### **Related Party Transactions**

There were no related party transactions during the quarter.

### **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 loss on fair value adjustment was \$2,697,212 (Gain of \$5,740,919 - 2011) of which \$1,206,876 was an impairment for investment properties classified as prepaid deposits as the Company had not secured the final titles of these properties at year end. The remaining fair value adjustment of \$1,490,336 relates to properties with full titles. During the first quarter of 2013, there was a fair value adjustment gain of \$1,136,125 relating to a property that was not available for use at year end and thus was recorded at the lower of cost and market, but adjusted during the first quarter of 2013 as the property became available for use. During the second quarter of 2013, there were no fair value adjustments done as it was determined by Management that the prices of the Company's property portfolio were relatively stable.
- 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 June 30, 2013, the insurance contract liabilities totalled \$2,617,966 (\$369,742 – Q2 2012).

- 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 options and future forfeiture rates. For the quarter ending June 30, 2013, the cost of the share based payments totalled \$306,369 (\$390,199 – Q2 2012).
- 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 June 30, 2013, the Company's working capital was \$10,479,276 (Q2 2012 - \$9,958,213)

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

As of June 30, 2013, 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 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 appropriate credit checks and related due diligence on the significant tenants. 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*

The Company 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 as at June 30, 2013. The Company's insurance subsidiary does have material liabilities which, in the event of a large claim, could result in short-term liquidity issues at the subsidiary.

### *Currency risk*

The Company owns properties located in Mongolia and marketable securities in Mongolia, 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.

## **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 Company's certifying officers for the June 30, 2013 interim 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 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 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. The most difficult challenge that the Company has encountered is finding skilled employees, given the growth experienced during the past year. The growth in 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 continues to exhibit rapid growth in assets. Management and employees have worked hard to aggressively build up the infrastructure needed to manage this division. There is no anticipation that management expenses will increase materially on a nominal level beyond inflationary increases in salaries. Expenses in the property division are likely to decline as a percentage of revenues in the future.

Due to the rapid growth of the Mongolian economy and a shortage of high quality rental locations, property rents have increased rapidly, 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.

### *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.

### *Corporate*

The corporate operations of MGG are primarily associated with managing its operating divisions, capital allocation, capital raising, investor communication, public company disclosure and compliance, internal audit and generally ensuring the smooth operations of the business of MGG as a public company.

By their nature, corporate operations are a cost center. Following a sizable increase in expenses during the first full year of operations, management expects that these expenses will moderate near current levels. It should be noted that expenses have remained elevated for longer than expected due to certain legal expenses that remain ongoing, but are expected to terminate in the near future.

### **Outlook**

The Mongolian economy continues to grow at a steady rate based on data from The National Statistics Office of Mongolia ("NSO") – July 2013 edition, with estimates of annualized real first half 2013 GDP growth of 11.3%. The Mongolian Consumer Price Index increased 8.3% in July compared to the same period last year based on data from the NSO. This growth is being funded by Foreign Direct Investment inflows to a number of sizable mining projects along with re-investment of earnings from existing projects, and a general increase in the consumer sector of the Mongolian economy.

MGG has been a beneficiary of these trends in both its property and insurance operations. In its property operation, Management believes that market rents will continue to increase, which is expected to drive an increase in the value of the Company's property portfolio.

It is widely 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.

### **Liquidity**

As at June 30, 2013, MGG had working capital of \$10,479,276 (Q2 2012 - \$9,958,213) 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, political extremism, and other similarly detrimental scenarios which would materially harm the Company.

As reported by the National Statistics Office, inflation has been easing continually for the last 4 months. Year over year inflation has been recorded at 8.3% in July, 8.8% in June, 9.7% in May and 10.4% in April. This is a steep decline from 2012, CPI year over year increases never went below 14%. The Bank of Mongolia is working hard to ensure stability although future inflation numbers remain uncertain due to the coal price decline and expanded fiscal policy.

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 Company's operations.

### **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 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 respective 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.

## **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.

## **Events Subsequent to Quarter End**

**On July 19, 2013**, the Company announced that after thorough review, Mandal General Daatgal LLC, MGG's Mongolian insurance subsidiary, has been determined to be a non-core business in respect of the future strategic direction of the Company. The board of directors of MGG has authorized management of the Company to seek value creating alternatives to the ongoing ownership of Mandal.

**On August 12, 2013**, the Company announced a non-brokered private placement offering of up to 3,076,923 units of the Company at a purchase price of \$3.25 per unit on a best efforts basis, for gross proceeds of up to \$10,000,000. Each unit shall consist of one common share in the capital of the Company and one half of one Common Share purchase warrant of the Company. Each full warrant will be exercisable into one common share at a price of \$3.75 per common share. The placement is scheduled to close on September 13, 2013.

Subsequent to the period end the Company sold 2 investment properties with a fair value of approximately \$627,000 for cash proceeds of approximately \$640,000.

## **Outstanding Share Data**

As at June 30, 2013, the Company had 34,303,352 common shares issued and outstanding. As at June 30, 2013, 10,584,000 of the Company's common shares, or approximately 31% of the issued and outstanding shares, were directly or indirectly controlled by the Company's directors and officers. As of June 30, 2013, the Company had 360,000 stock options outstanding with an exercise price of \$1.64 per share (300,000 have an expiry date of March 9, 2021 and 100,000 which were issued initially have an expiry date of March 9, 2014, of which 40,000 were exercised in the quarter). The Company also had 80,000 options outstanding with an exercise price of \$1.90 per share with an expiry date of March 9, 2021 (200,000 options were issued initially, of which 30,000 were exercised in the first quarter of 2013 and 90,000 were exercised in the second quarter of 2013). 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 25th 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 2012). The Company had 150,000 options outstanding with an expiry date of September 7, 2016 and an exercise price of \$4.77 (175,000 options were issued initially, 25,000

were forfeited during 2012). In addition, the Company had 110,000 options outstanding with an expiry date of December 2, 2016 and an exercise price of \$4.25 (150,000 options were issued initially, 30,000 were forfeited during 2012 and 7,500 were forfeited and 2,500 were cancelled in Q1 of 2013). Furthermore, the Company had 190,000 5-year stock options outstanding to purchase shares of MGG at a price of \$4.00 per share with an expiry of March 23, 2017. Lastly, the Company had 350,000 options outstanding to purchase shares of MGG at a price of \$4.13 with an expiry date of March 1, 2018 and 125,000 with an expiry date of March 1, 2016.

At period-end, the Company had 831,000 options that were exercisable (Q2 2012 – 118,000).

<b>Outstanding</b>	<b>as at June 30, 2013</b>
Common shares	34,303,352
Options to buy common shares	2,087,000

#### **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).