Lackluster 2013 for MSE Top 20 Masks Stealth Bull Market in High Quality Stocks

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In April 2013, we made the case to MSE investors that they should take advantage of the uncertainty surrounding Oyu Tolgoi, (which persists to this day) and buy high quality Mongolian stocks. As we looked at the strong financial performance of many local companies and their dirt cheap valuations, we decided to apply a proprietary quantitative methodology to identify the highest quality names. We ran 3 different screens that focused on separate investing disciplines: Growth, Value and a combined Proprietary approach. We then ranked each name based on how they scored on key metrics, which then produced a numeric value which acted as a scorecard. Sentiment at the time we published "A Quantitative Look at Mongolian Equities" was at rock bottom and there was considerable skepticism that a quantitative approach could work in picking local stocks and even more pessimism that it was the right time to start buying. With 2013 in the books, we felt it was time to see how our approach stacked up versus the MSE Top 20 and the results were quite favorable. One caveat we should mention is there are several stocks, particularly on our value list, which haven't traded since we published our original note. In the interest of accuracy, we removed these names from our calculations for the performance of our three screens. The numbers and multiples below are from our original report and based on 2012 financial results, we will do a full revision in April when all MSE listed companies have reported their financials for 2013. From April 8, 2013 our Growth, Value and Proprietary screens produced un-annualized returns of +38.5%, +40.7% & +35.8%, respectively, with several individual stocks up over 100%. The MSE over the same period was +1% and for FY 2013 -8%.

The following are the original screens, where we included individual and overall investment returns for our Growth Value and Proprietary lists.

Table 1. Growth Screen

Tick-er	Company name	Clos-ing price Jan 21, 2014	**YOY closing price change**	Total Growth Score	Revenue (CAGR of last 2 years)	Net profit (CAGR of last 2 years)	Rev-enue Growth YOY	EPS Growth YOY	P/E (2012)	P/B (2012)	P/S (2012)	ROE (2012)	Debt to Equity
BUK	Ulaanbaatar BUK	40,000	**149.8%**	10	159.2%	n/a	200.0%	2256.5%	11.63	1.44	1.62	92.7%	4.12
DHU	Darkhan Khuns	4,300	**132.4%**	14	22.2%	266.2%	9.9%	-881.6%	4.68	0.43	0.33	28.3%	1.72
GTL	Gutal	12,600	**121.1%**	13	484.8%	67.7%	49.8%	251.2%	13.47	1.70	5.27	14.2%	0.07
NEH	Darkhkan Nekhii	12,500	**103.3%**	10	18.5%	14.4%	-7.6%	1.2%	4.12	0.33	0.67	13.3%	0.50
ORD	Orkhon Dalai	3,300	**73.7%**	10	12.7%	31.9%	64.6%	115.5%	17.15	1.00	1.97	12.4%	0.55
SUL	Gazar Suljmel	33,580	**67.7%**	13	32.7%	72.4%	48.7%	88.0%	3.75	1.37	0.75	65.4%	0.57
MIE	Material Impex	13,010	**34.0%**	15	53.2%	193.0%	86.4%	397.0%	5.71	0.73	0.64	73.1%	3.22
BNG	Bayangol Hotel	52,000	**26.8%**	10	18.0%	30.2%	9.7%	13.0%	4.48	0.56	2.00	16.1%	0.19
ADL	Aduunchuluun	1,839	**22.6%**	11	19.0%	24.0%	32.7%	59.5%	0.64	1.22	0.10	23.3%	0.13
GOV	Gobi	5,500	**22.2%**	14	108.5%	181.8%	15.4%	208.1%	6.54	0.52	0.84	15.1%	0.83
TUS	Tushig Uul	2,000	**17.6%**	12	26.8%	109.3%	24.5%	-51.1%	29.10	0.29	1.41	1.6%	0.61
ZOO	Zoos Goyol	1,040	**15.6%**	12	39.1%	30.8%	12.1%	16.8%	20.10	2.13	3.43	11.6%	0.06
APU	APU	3,790	**6.5%**	12	52.5%	9.1%	27.7%	16.8%	11.18	1.56	0.92	30.6%	0.97
JTB	Genco Tour Bureau	85	**1.9%**	12	50.4%	53.8%	21.6%	-5.7%	34.72	0.69	2.98	2.8%	0.04
CHR	Uvs Chatsargana	2,988	**-0.4%**	14	381.1%	291.8%	5.0%	116.6%	201.17	4.54	10.69	12.9%	4.37
ULN	Ulaanbaatar Hotel	93,040	**-2.1%**	12	18.2%	34.9%	10.4%	-0.7%	13.94	2.82	5.21	23.8%	0.06
SHG	Sharyn Gol	7,400	**-8.6%**	11	17.7%	195.1%	30.7%	344.4%	45.89	2.02	6.23	5.2%	0.04
RMC	Remicon	149	**-23.9%**	15	102.2%	154.8%	56.8%	48.1%	5.54	0.92	0.79	27.0%	0.51
BDS	BDSec	2,400	**-29.4%**	13	47.3%	34.4%	17.3%	3.4%	25.28	3.77	6.45	16.1%	0.02
	AVERAGE		**38.5%**										

Table 2. Value Screen (to be continued on the next page)

Tick-er	Company name	Closing price Jan 21, 2014	**YOY clos-ing price change**	Total Value score	Revenue Growth YOY	EPS Growth YOY	P/E (2012)	P/B (2012)	P/S (2012)	ROE (2012)	Debt to Equity
KEK	Mongol Keramik	7,860	**189.5%**	13.0	79.5%	-111.0%	20.87	0.12	0.54	4.7%	7.15
BUK	Ulaanbaatar BUK	40,000	**149.8%**	10.0	200.0%	2256.5%	11.63	1.44	1.62	92.7%	4.12
DHU	Darkhan Khuns	4,300	**132.4%**	15.0	9.9%	-881.6%	4.68	0.43	0.33	28.3%	1.72
GTL	Gutal	12,600	**121.1%**	12.0	49.8%	251.2%	13.47	1.70	5.27	14.2%	0.07
AAR	Autozam	4,665	**112.0%**	16.0	-37.8%	61.2%	4.79	0.29	0.69	7.4%	0.16
NEH	Darkhkan Nekhii	12,500	**103.3%**	15.0	-7.6%	1.2%	4.12	0.33	0.67	13.3%	0.50
UND	Undarga Umnugobi	5,405	**92.7%**	12.0	82.3%	-44.4%	37.87	1.62	1.51	4.4%	0.01
HBO	HBOil	336	**91.8%**	11.0	67.1%	4065.6%	42.86	1.04	5.12	3.3%	0.38
MVO	Mongol Shevro	2,550	**75.9%**	12.0	18.4%	34.6%	89.10	0.38	0.56	1.2%	1.71
ORD	Orkhon Dalai	3,300	**73.7%**	12.0	64.6%	115.5%	17.15	1.00	1.97	12.4%	0.55
SUL	Gazar Suljmel	33,580	**67.7%**	14.0	48.7%	88.0%	3.75	1.37	0.75	65.4%	0.57
UBH	Ulaanbaatar Carpet	14,250	**65.7%**	10.0	0.0%	-136.0%	174.38	0.37	2.21	0.4%	1.06
GHC	Gan Khiits	17,000	**63.6%**	10.0	-26.7%	-94.5%	413.30	0.37	0.93	0.6%	6.01
TAH	Takhi-Co	10,630	**63.5%**	10.0	-5.8%	-1.9%	31.20	4.46	8.52	15.3%	0.01
HSR	Khasu Mandal	3,153	**53.7%**	10.0	-67.0%	45.7%	69.64	0.21	2.66	1.0%	2.24
HRM	Hermes Center	160	**49.5%**	13.0	5.8%	11.5%	18.23	1.00	7.37	5.4%	0.02
MIE	Material Impex	13,010	**34.0%**	12.0	86.4%	397.0%	5.71	0.73	0.64	73.1%	3.22
DES	Dornod Khudaldaa	10,350	**29.4%**	14.0	51.8%	19.8%	15.10	0.79	1.36	1.0%	0.01
MMX	Makh Impex	2,310	**28.3%**	10.0	122.5%	-171.2%	14.50	0.55	0.90	-132.1%	(102.64)
BNG	Bayangol Hotel	52,000	**26.8%**	14.0	9.7%	13.0%	4.48	0.56	2.00	16.1%	0.19
ADL	Aduunchuluun	1,839	**22.6%**	20.0	32.7%	59.5%	0.64	1.22	0.10	23.3%	0.13
GOV	Gobi	5,500	**22.2%**	15.0	15.4%	208.1%	6.54	0.52	0.84	15.1%	0.83
TCK	Talkh Chikher	14,000	**21.5%**	14.0	5.8%	59.3%	8.27	0.35	0.55	12.9%	0.90
ATR	Atar-Urgoo	59,000	**20.4%**	15.0	24.3%	53.2%	10.41	0.99	0.78	12.6%	0.25
TUS	Tushig Uul	2,000	**17.6%**	12.0	24.5%	-51.1%	29.10	0.29	1.41	1.6%	0.61
ZOO	Zoos Goyol	1,040	**15.6%**	13.0	12.1%	16.8%	20.10	2.13	3.43	11.6%	0.06

Table 2-1. Value Screen (continuation of the previous page)

Tick-er	Company name	Closing price Jan 21, 2014	**YOY clos-ing price change**	Total Value score	Revenue Growth YOY	EPS Growth YOY	P/E (2012)	P/B (2012)	P/S (2012)	ROE (2012)	Debt to Equity
SUU	Suu	89,520	**11.9%**	13.0	7.8%	0.2%	10.86	0.95	1.11	23.3%	1.66
APU	APU	3,790	**6.5%**	12.0	27.7%	16.8%	11.18	1.56	0.92	30.6%	0.97
JTB	Genco Tour Bureau	85	**1.9%**	13.0	21.6%	-5.7%	34.72	0.93	2.98	2.8%	0.04
TAV	Tav	44,200	**1.1%**	11.0	-4.3%	-35.7%	27.86	3.56	2.81	19.5%	0.39
JGV	Juulchin Gobi	4,450	**-1.1%**	11.0	-21.6%	-71.5%	73.34	1.01	2.08	2.1%	0.49
ULN	Ulaanbaatar Hotel	93,040	**-2.1%**	11.0	10.4%	-0.7%	13.94	2.82	5.21	23.8%	0.06
TEE	Darkhan Teever	25,000	**-7.1%**	11.0	15.5%	-51.1%	32.52	3.92	2.27	14.0%	0.12
ETR	E-Trans Logistics	117	**-8.6%**	10.0	n/a	n/a	61.65	0.88	1.02	3.3%	0.17
SHG	Sharyn Gol	7,400	**-8.6%**	11.0	30.7%	344.4%	45.89	2.02	6.23	5.2%	0.04
MCH	Telecom Mongolia	1,499	**-14.8%**	11.0	-3.5%	-72.3%	141.88	1.07	1.91	1.0%	0.31
MIB	Moninjbar	220	**-20.0%**	10.0	-21.2%	-59.9%	131.19	1.77	1.46	1.8%	0.41
UYN	Mongol Savkhi	1,100	**-21.4%**	10.0	18.8%	763.5%	244.15	2.08	11.72	0.9%	0.04
RMC	Remicon	149	**-23.9%**	14.0	56.8%	48.1%	5.54	0.92	0.79	27.0%	0.51
BDS	BDSec	2,400	**-29.4%**	11.0	17.3%	3.4%	25.28	3.77	6.45	16.1%	0.02
	AVERAGE		**40.7%**								

Table 3. Proprietary Screen

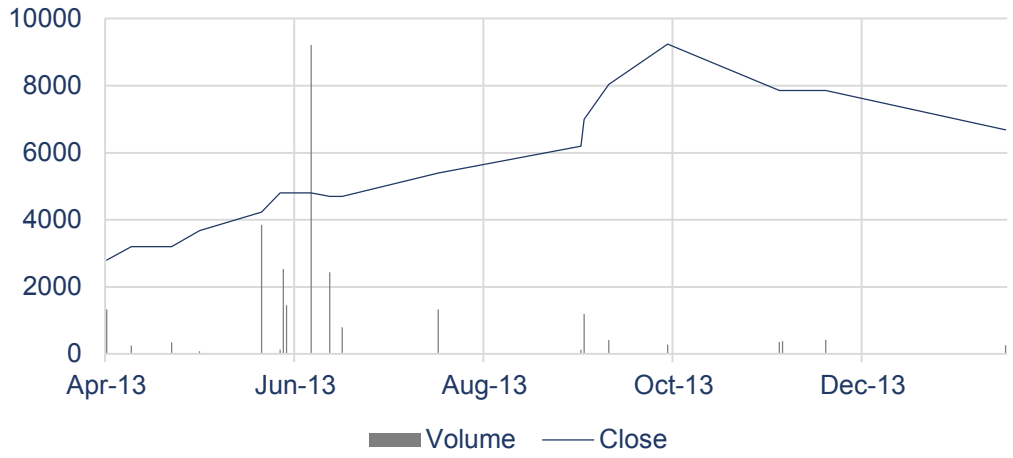
Tick-er	Company name	Closing price Jan 21, 2014	**YOY clos-ing price change**	Propri-etary total points	Revenue Growth YOY	EPS Growth YOY	P/E (2012)	P/B (2012)	P/S (2012)	ROE (2012)	Debt to Equity
BUK	Ulaanbaatar BUK	40,000	**149.8%**	10	200.0%	2256.5%	11.63	1.44	1.62	92.7%	4.1
GTL	Gutal	12,600	**121.1%**	14	49.8%	251.2%	13.47	1.70	5.27	14.2%	0.1
AAR	Autozam	4,665	**112.0%**	9	-37.8%	61.2%	4.79	0.29	0.69	7.4%	0.2
HBO	HBOil	336	**91.8%**	10	67.1%	4065.6%	42.86	1.04	5.12	3.3%	0.4
ORD	Orkhon Dalai	3,300	**73.7%**	9	64.6%	115.5%	17.15	1.00	1.97	12.4%	0.6
SUL	Gazar Suljmel	33,580	**67.7%**	13	48.7%	88.0%	3.75	1.37	0.75	65.4%	0.6
MIE	Material Impex	13,010	**34.0%**	15	86.4%	397.0%	5.71	0.73	0.64	73.1%	3.2
BNG	Bayangol Hotel	52,000	**26.8%**	9	9.7%	13.0%	4.48	0.56	2.00	16.1%	0.2
ADL	Aduunchuluun	1,839	**22.6%**	11	32.7%	59.5%	0.64	1.22	0.10	23.3%	0.1
GOV	Gobi	5,500	**22.2%**	14	15.4%	208.1%	6.54	0.52	0.84	15.1%	0.8
TUS	Tushig Uul	2,000	**17.6%**	9	24.5%	-51.1%	29.10	0.29	1.41	1.6%	0.6
ZOO	Zoos Goyol	1,040	**15.6%**	10	12.1%	16.8%	20.10	2.13	3.43	11.6%	0.1
APU	APU	3,790	**6.5%**	10	27.7%	16.8%	11.18	1.56	0.92	30.6%	1.0
JTB	Genco Tour Bureau	85	**1.9%**	9	21.6%	-5.7%	34.72	0.93	2.98	2.8%	0.0
CHR	Uvs Chatsargana	2,988	**-0.4%**	12	5.0%	116.6%	201.17	4.54	10.69	12.9%	4.4
SHG	Sharyn Gol	7,400	**-8.6%**	11	30.7%	344.4%	45.89	2.02	6.23	5.2%	0.0
UYN	Mongol Savkhi	1,100	**-21.4%**	10	18.8%	763.5%	244.15	2.08	11.72	0.9%	0.0
RMC	Remicon	149	**-23.9%**	14	56.8%	48.1%	5.54	0.92	0.79	27.0%	0.5
BDS	BDSec	2,400	**-29.4%**	10	17.3%	3.4%	25.28	3.77	6.45	16.1%	0.0
	AVERAGE		**35.8%**								

SOME NOTABLE PERFORMERS

Mongol Ceramic JSC

Ceramic company KEK topped our list of best performers with a 10 month return of 236%, but the company is quite small and illiquid even by MSE standards, with a market cap of only $1.2M USD. Since KEK p/b was a modest 0.12x at the time we published our first note, it's still quite cheap and probably worth buying if you can get your hands on it.

Mongol Ceramic JSC (MSE: KEK)



Source: Mongolian Stock Exchange

Ulaanbaatar BUK JSC

Construction materials company BUK came in second with a 10 month return of 150%. Only 3% of the company's shares are outstanding with the remaining 97% residing with UB Management, a Russian company. The financial performance of this company has been nothing short of outstanding and its assets are equally impressive. They own 18 hectare of downtown real estate which

Ulaanbaatar BUK JSC (MSE: BUK)

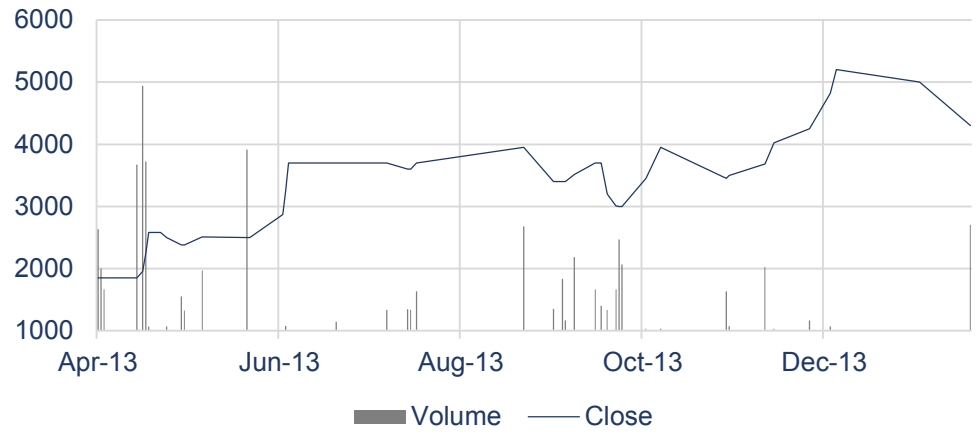
Source: Mongolian Stock Exchange

borders the railroad, with 3 rail spurs and 37 cranes. Recreating/replacing this asset would be impossible today as available land in downtown UB is virtually non-existent, let alone 18 continuous Hectare worth. The company has said in the past it intends to remain a public company, which means they will have to sell equity at some point soon, since the New Securities Law mandates a 25% free float, or 15% under exceptional circumstances. With a market cap of ~$24M USD, it's one of the larger companies on the MSE. We would remain buyers of BUK.

Darkhan Khuns JSC

Food company DHU came in third, with a 10 month return of 132%. DHU is the dominant food company in the city of Darkhan, Mongolia's fourth largest city with a population of 94,000. Out of Mongolia's top 5 cities, Darkhan is by far the closest to UB and is the most connected, in terms of rail and road. Darkhan is primarily an industrial city and ranks third overall in economic output. Bread is the largest category for DHU and the 220 KM distance from UB insulates the Darkhan market from meaningful competition from the likes of its larger peers TCK and ATR.

Darkhan Khuns JSC (MSE: DHU)



Source: Mongolian Stock Exchange

SOME NOTABLE UNDERPERFORMERS

BDSec JSC

The employer of yours truly, BDSec tops the list of underperformers with a 10 month return of -29%. 2013 was a very lackluster year for volume traded on the MSE, with the headline decrease being -36% vs. 2012. If you dig deeper however, there was one very large trade that was done on the MSE to only effect the change of beneficial ownership within the same organization that skewed these numbers considerably. If you remove this one trade, volume traded on the MSE was down a staggering 67% vs. 2012. Our stock was also negatively affected by year end selling, not uncommon in a down year. With a progressive

BDSec JSC (MSE: BDS)

Source: Mongolian Stock Exchange

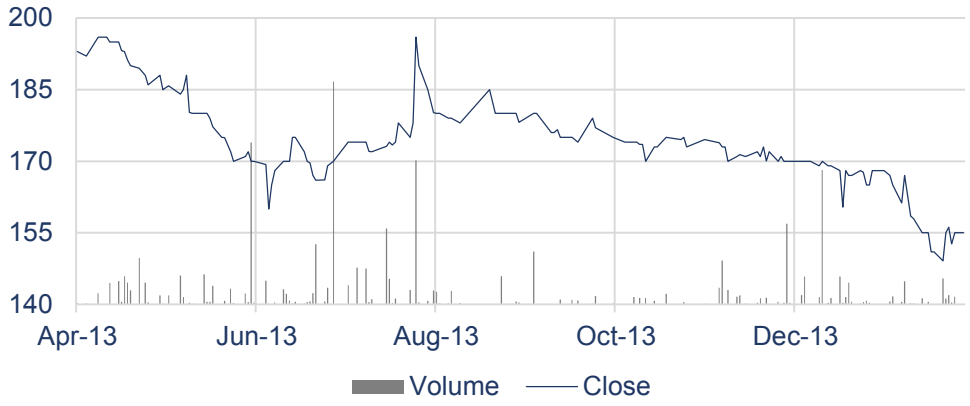
new Securities Law in place, which allows international custodians to operate in Mongolia, the door will soon be open to Mutual Fund money, a significant catalyst for increasing MSE volumes. Given our dominant position in the market place, we anticipate getting a significant portion of the mutual fund related business once it arrives. While BDSec's financial performance is correlated to MSE volumes, we aggressively pursued other opportunities to generate revenue in banking, advisory and proprietary trading, which should allow us to post a modest profit for 2013. MSE volumes also correlate with FDI flows which were down nearly 60% last year, but likely to rebound strongly in 2014.

Remicon JSC

RMC was the next notable underperformer from our screens. For most of 2012, this name was quite popular with investors. RMC's biggest customers are construction companies, which have been negatively affected by the slowdown in the economy and a drop in FDI. Office space was overbuilt in the last few years, decreasing rents and occupancy and pressuring new construction. While we remain positive on the overall market in UB, real estate cycles are not always linear and have their own boom/bust cycles as supply is absorbed into the market. That

said, well placed retail and quality shopping malls are in short supply which is a segment of the market that is still quite attractive. As FDI returns to the country so should investment and credit. RMC has considerable leverage to large infrastructure projects that will soon be underway.

Remicon JSC (MSE: RMC)



Source: Mongolian Stock Exchange

Sharyn Gol JSC

SHG was another name which underperformed, inexplicably, though not to the same magnitude as BDS and RMC, being down only 8.6%. SHG has effectively doubled production from 2012 to 2013 and should nearly double production each year till 2016. Their mine, based on its current resource, has a 50+ year life and is likely much larger as their license area contains significant reserves which will be proved up and exploited in the coming years.

Sharyn Gol JSC (MSE: SHG)

Source: Mongolian Stock Exchange

The EBRD has agreed to lend the company $10M USD that will be used, in part, to improve their existing washing plant, which will produce high quality coal for international export. The other part of the loan is being used to modernize NKT's smokeless briquette plant (SHG owns 93% of NKT). Smokeless briquettes will play a critical role in reducing the horrific pollution levels in UB, which is a priority of the government. The GOM has already funded an environmental agency to help subsidize the purchase of smokeless briquettes. With an EV/Resource of 0.11, SHG trades at a 50% discount to government controlled BAN, which has reported a profit only once in the last 7 years. We think SHG is being priced at giveaway prices, let alone at a multiple which should be applied for its rapid future growth, strong corporate governance and experienced western management team.

SUMMARY

In summary, local stocks identified through our quantitative methodology were by far Mongolia's best performing asset class in 2013. And while we think 2014 will be a positive tide that lifts all boats, MSE equities remain dirt cheap and we would expect another year of meaningful outperformance. Importantly, none of the names we have highlighted need to be recapitalized and all have strong balance sheets, which is not the case with the vast majority of their foreign listed peers. With the MSE boasting a market cap of only $930M, we recently analyzed government and insider ownership of local stocks. The GOM's stake in various equities they still control (BAN, MCH, SHV, etc.) is just under $200M or 20% of the total market cap of the MSE. Insiders own a whopping $510M, or 55% of the total market cap of the MSE, which combined with the government's stake, leaves only $232M, or 25% as a practical "free float" for investors to buy. The insider ownership of the names from our screens was much higher and averaged ~75%. Our client base was particularly aggressive in acquiring available supply in 2013 (though not much was available) and it is our opinion that pockets of liquidity for investors to purchase have dwindled significantly. Investors who want exposure to local stocks within the current framework of the market need to be buying now, else they may be doing so from much higher levels.

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