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MONGOLIAN PRIVATE EQUITY FUND FEASIBILITY STUDY

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ABBREVIATIONS

ADB	Asian Development Bank
BOM	Bank of Mongolia
CEO	Chief Executive Officer
EBRD	European Bank for Reconstruction and Development
EPRC	Economic Policy Reform & Competitiveness Project
GDNT	General Department of National Taxation
GDP	Gross Domestic Product
GP	General Partner
GTZ	German Development Agency
IAFRS	International Accounting and Financial Reporting Standards
IFC	International Finance Corporation
IFI	International Financial Institution
IPO	Initial Public Offering
IRR	Internal Rate of Return
JICA	Japanese International Cooperation Agency
JSC	Joint Stock Company
KFW	KFW Development Bank
LLC	Limited Liability Company
LP	Limited Partner
MNCCI	Mongolian National Chamber of Commerce and Industry
MNT	Mongolian National Tugrug
MoFE	Ministry of Finance and Economy
MSE	Mongolian Stock Exchange
MSEC	Mongolian Securities and Exchange Commission
MT	Mongolian Telecom
NBER	National Bureau of Economic Research
NBFI	Non-Bank Financial Institution
NGO	Non-Government Organization
NSO	National Statistics Office
OSF	Open Society Forum
SME	Small and Medium Enterprises
USAID	United States Agency for International Development
USD	United States Dollar
VAT	Value added tax
WTO	World Trade Organization

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EXECUTIVE SUMMARY

The purpose of the study was to conduct an initial feasibility analysis for the potential establishment of a local private equity venture capital fund to assist high potential enterprises in Mongolia. The results were achieved as a result of on-site interviews with fifty one (51) private sector companies, IFIs, NGOs and interested private sector parties during the period September 13-October 16, 2004. The feasibility analysis was designed to address four broad areas of concern:

1. *Deal flow*. Gather initial data on potential deal flow of transactions that a local private equity fund may engage in; in particular, is there a sufficient number of companies and ventures with high-growth potential that could yield competitive returns to the fund and benefit from equity and quasi-equity investments

2. *Fund capitalization*. Canvass potential investors—individuals and institutional—for interest in capitalizing the fund, assessing their expectations for rates of return, risk perceptions and risk mitigation measures, preferences for sectors, size of investment, term, and exit strategies

3. *Grant-funded technical assistance fund (TAF).* Assess donors and international financial institutions' (IFIs) perceptions and interest in contributing to the establishment of a companion, grant-funded TAF to prepare companies for fund equity investments, provide assistance in transaction structuring, supervise fund investments, assist invested companies with execution, and exit strategies

4. *Preliminary analysis of the legal and regulatory environment and fund design requirements.* If, and only if the first three objectives yield reasonably satisfactory results, provide an initial assessment of the legal and regulatory environment and fund design requirements.

Based on the interviews and analyses conducted, the team draws the following conclusions:

1. There is a high degree of interest from private local investors, IFIs, donors, the financial community, and local entrepreneurs in a private equity venture capital fund
2. Forty-three percent of the 47 companies interviewed manifested interest in private equity financing
3. A contingent commitment of USD 2m to capitalize the fund was obtained from a respected local investor and the Asian Development Bank initiated its interval review process to become an anchor investor in the fund; ADB typically commits no more than 25% of the capital of a fund but can possibly consider higher commitments
4. Results from the preliminary assessment of deal flow are encouragingly positive but further due diligence will be required in the next stage to determine the size and quality of a potential pipeline of transactions capable of returning commercially competitive returns to local investors
5. Similarly, further canvassing of local investors' concrete commitments, terms and rates of return expectations will need to be conducted in the next stage

6. The lack of reliable and readily available data on sector and company performance and ratings, not unusual in developing economies, required a methodology to approach the building of a database of companies; this unavailability of company data will represent a challenge for the future analysis of the pipeline and deal flow
7. Exit strategy for the fund investments remains a high risk, considering a non-functional stock exchange; the fund will have to consider use of a broader array of well-known investment vehicles to manage this risk: quasi-equity investments, royalty schemes, etc.
8. Legal and regulatory constraints of the Company Law, Securities Law, MSE functions and structure of ownership, use and enforcement of International Accounting and Financial Reporting Standards (IAFRS) and reporting requirements will need to be addressed to improve corporate governance and minimize risks to investors and shareholders
9. Given the initial and preliminary size of the fund, estimated at USD 10-12m, and the conditions of the business environment, a grant-financed technical assistance component will be required to prepare companies for investment, help them execute their business expansion plans funded by the equity infusion and deliver commercial returns to investors
10. There was general consensus on the requirements of success for the equity fund: it must operate as closely to commercial private equity funds as possible, be managed by professional portfolio managers, have IFIs as anchor investors, and become eventually self-sustainable from fees realized upon successful exits from investments under management.

The main recommendations are summarized as follows:

Recommendation # 1: Results of this first assessment warrant proceeding with a second stage in the feasibility analysis for the establishment of a local private equity venture capital fund in Mongolia.

Recommendation # 2: Terms of reference for the next stage of the feasibility analysis should be prepared to focus, *inter alia*, on the following:

- Develop more detailed analysis of sectors, company profiles, pipeline (size and returns) of potential transactions for potential consideration by the fund
- Carry out due diligence of potential companies, sectors, and transactions: financial analyses, valuations, financial projections, expected IRRs, and risk assessment
- If findings from this stage warrant it, specify and quantify initial fund design requirements such as expected size, investment strategy, and investment vehicles
- Similarly, if findings are favorable, develop recommendations for the structure and management of a grant-funded technical assistance component that would build upon current capabilities and structures of existing business development projects such as, among others, the Enterprise Restructuring Project and EPRC
- Develop concrete proposals to address corporate governance issues, tax considerations, capital markets functioning, accounting standards, and financial disclosures.

Recommendation # 3: Conduct the second stage of analysis during the first quarter of 2005 with continued funding as approved by the Open Society Forum Board of Directors, potential commitments of USAID through the EPRC Project, and potential continued involvement of Mongolia Links Co. Ltd. Given the interest manifested by the Asian Development Bank, this broad initial partnership can be expanded to include other relevant entities interested in participating in the fund.

SECTION I: INTRODUCTION, PURPOSE, AND OBJECTIVES

A. Introduction

Among transition economies, and more broadly among lower GDP per capita countries, Mongolia has achieved remarkable progress in setting the foundations for a democratic and open-market economy. In an otherwise bleak Central Asian landscape, and sandwiched between two powerful neighbors, the country stands out for the rapidity in implementing reforms that set the basis for a pluralistic and democratic society.

With the most difficult tasks of transition now largely completed, Mongolia needs to build on the foundations for sustainable, broad-based, equitable, private-sector-led economic growth and solidify the social and political achievements of the past to avoid setbacks and reversals. Competitive Mongolian businesses will be the core building blocks of such foundation.

As Mongolia transforms into a market-oriented economy, privatizes state-owned enterprises, and integrates more closely to world economy, a nascent private sector is beginning to take advantage of business opportunities. Emerging private companies are beginning to weave the foundations of a market-oriented economy that must provide jobs to sustain the achievements of a peaceful political transition.

Two factors limiting growth of these emerging companies are market-oriented business know-how coupled with access to medium-term capital at competitive rates. An emerging consensus exists among seasoned observers of and protagonists in this transformation that the environment might be ready for a modest local equity and quasi equity privately managed fund. Such fund would seek competitive returns for its investors but be coupled with a grant-financed technical assistance fund to help disseminate and execute best business practices among pre-investment and invested companies.

This feasibility analysis has its origins in discussions and conclusions reached with seasoned local observers and practitioners by the Open Society Forum (OSF) and the USAID-funded Economic Policy Reform and Competitiveness Project (EPRC). The study was conducted during 13 September and 16 October 2004 with financing from EPRC, OSF, and Mongolia Links Co. Ltd. Mr Dennis Grubb, Managing Director, Invest Asia Ltd. acted as team leader with assistance from Ms Ashidmaa Dashnyam, Finance and Business Specialist, EPRC, Ms Munkhsoyol Baatarjav, Project Manager, OSF, and Mr. Enkhbayar Bayartogtokh on secondment from Mongolia Links Co. Ltd. and Ms Ileana Teodorescu, Financial Analyst in Bucharest, Romania.

B. Purpose and objectives

The purpose of the study was to conduct an initial feasibility analysis for the potential establishment of a local private equity venture capital fund to assist high potential enterprises in Mongolia. The feasibility analysis was designed to address four broad areas of concern:

1. **Deal flow.** Gather initial data on potential deal flow of transactions that a local private equity fund may engage in; in particular, is there a sufficient number of companies and ventures with high-growth potential that could yield competitive returns to the fund and benefit from equity and quasi-equity investments

2. **Fund capitalization.** Canvass potential investors—individuals and institutional—for interest in capitalizing the fund, assessing their expectations for rates of return, risk perceptions and risk mitigation measures, preferences for sectors, size of investment, term, and exit strategies

3. **Grant-funded technical assistance fund (TAF).** Assess donors and international finance institutions' (IFIs) perceptions and interest in contributing to the establishment of a companion, grant-funded TAF to prepare companies for fund equity investments, provide assistance in transaction structuring, supervise fund investments, assist invested companies with execution, and exit strategies

4. **Preliminary analysis of the legal and regulatory environment and fund design requirements.** If, and only if the first three objectives yield reasonably satisfactory results, provide an initial assessment of the legal and regulatory environment and fund design requirements.

SECTION II: STAGES FOR THE ESTABLISHMENT OF A PRIVATE EQUITY FUND IN MONGOLIA: A ROAD MAP

Three broad favorable conditions must exist for the successful establishment and operations of a private equity venture capital fund:

- Strong deal flow, i.e., a reasonable number of high-growth companies that can benefit from private equity or quasi-equity investments to capitalize on available growth opportunities
- Favorable investors perceptions and commitment to capitalize the fund based on a favorable country risk environment and growth opportunities for business firms
- A reasonable enabling and predictable legal and regulatory environment.

The design of a potential private equity venture capital fund (its size, investment strategy, portfolio structure, fund management and administration, exit strategy, and risk mitigation measures) must be responsive to the specific country environment (companies, investors, and legal/regulatory issues).

Exhibit II-1 provides a staged approach or road map for the establishment of a private equity venture capital fund in Mongolia. The approach provides four broad stages or steps leading to the establishment of the fund:

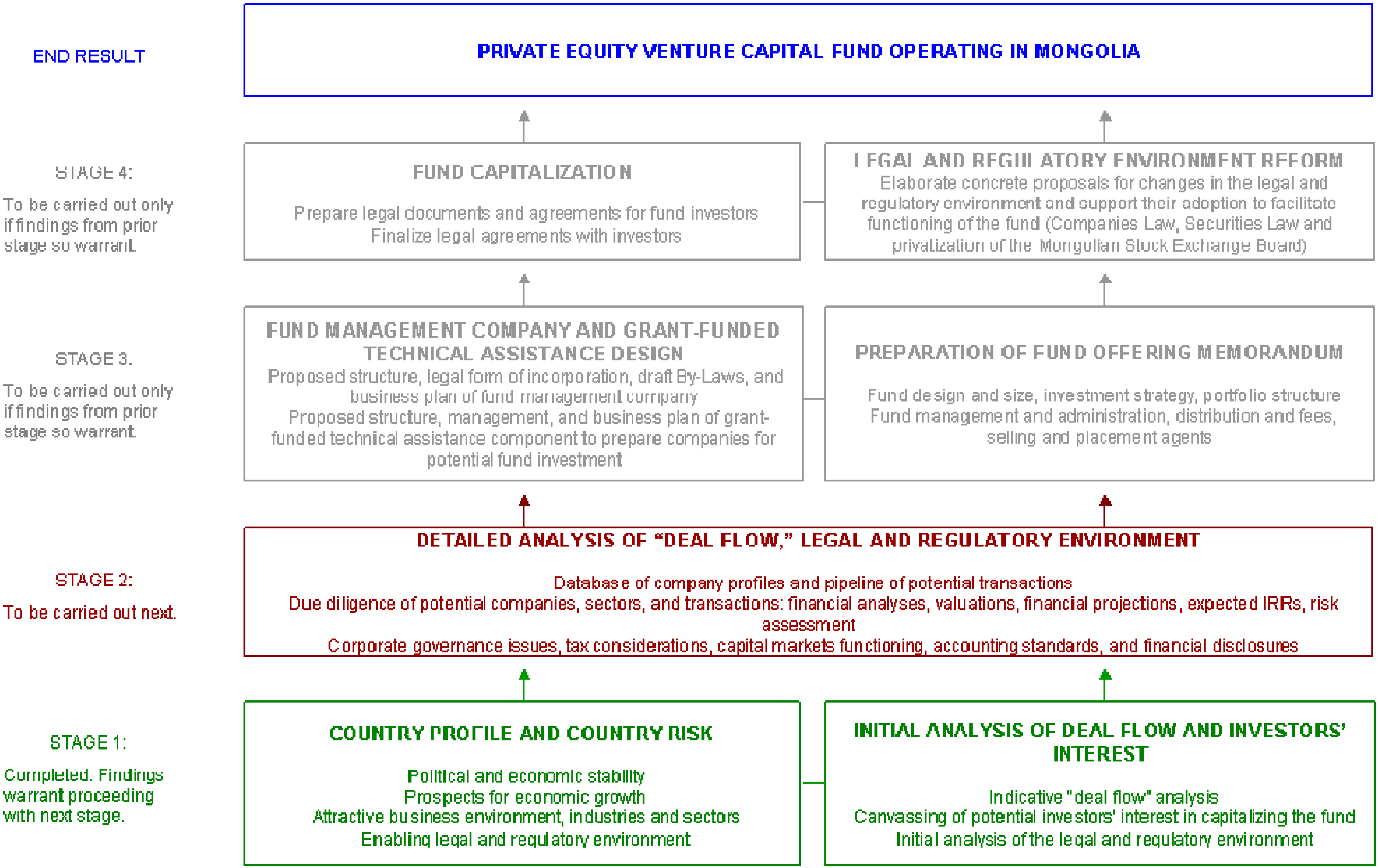
1. Country profile and country risk and initial analysis of deal flow and investors' interest
2. Detailed analysis of deal flow, legal and regulatory environment
3. Fund management company and grant-funded technical assistance design and preparation of Fund Offering Memorandum
4. Fund capitalization and legal and regulatory environment reform.

As indicated in Exhibit II-1, this study has completed the first stage (shown in green in the exhibit). Findings of this stage warrant proceeding with the second stage. Had the results of the study shown weak deal flow and/or lack of investors' interest due to high risk perceptions or/and unpredictable legal and regulatory environment, no further steps or stages would need to be undertaken.

Findings from the next stage, the detailed analysis of deal flow and legal and regulatory environment will also be crucial in the decision on whether or not to proceed with the effort. If findings from the due diligence of potential companies, sectors, and transactions, interest of companies and disclosures are not satisfactory, or the detailed analysis of the legal and regulatory environment yields insurmountable obstacles, no further work should be undertaken. Stages 3 and 4 (shown in gray color) will be undertaken only if findings from stage 2 (shown in magenta color) so warrant.

Thus, the proposed staged approach to the establishment of a private equity venture capital fund has built-in checkpoints for decision making. If findings at any point are not favorable the decision is made not to proceed. On the other hand, subsequent stages build upon findings from prior ones in a cumulative fashion.

Exhibit II-1: Staged approach for the establishment of a private equity venture capital fund in Mongolia



SECTION III: CONCEPT OF PRIVATE EQUITY IN DEVELOPING COUNTRIES

In many respects, private equity investment in developing countries like Mongolia and developed countries is similar. In both settings, professional investors, say the Mongolian Private Equity Venture Capital Fund Company (to be formed), may provide equity or equity-linked capital to privately held firms. A key element for success is a commitment for ongoing involvement of the private equity investor in monitoring and technical assistance to the investee company. A second pre-condition for success is a strong legal system and functioning equity markets that allow for easy exit.

Where private equity in developing countries differs is in its implementation. There are several key differences.

A. Fund structure

The fund structure standard in developed countries is the limited partnership. The general partners are the individual venture capitalists (or an investment management firm controlled by these individuals). The partners are in charge of raising, making, monitoring, and exiting the investments. In return they are paid a management fee plus a share of the profits. But in many parts of the developing world, particularly in Asia, there has been a general lack of legal structures that allow the establishment of limited partnerships. In Mongolia, as in the Asia region, the private equity fund will have to be structured as a corporation under the Mongolian Company Law of 1999, which regulates the establishment, registration and reorganization of a company, its management and organizational structure, its shareholders' rights and obligations, and its liquidation.

B. Funding sources

In addition to local investor and international subscription to capital, many of the sources of capital for private equity funds in developed countries are similar. Several additional parties, however, have played an important role in the raising of private equity funds in developing nations, and this method will certainly be needed to establish a fund in Mongolia. These parties have included foreign aid organizations like the Asian Development Bank, U.S. Agency for International Development, quasi-governmental corporations like the Overseas Private Investment Corporation, and multilateral financial institutions like the International Finance Corporation, the German KFW, and the EBRD.

C. Types of investments

Private equity funds in developing nations undertake transactions familiar in the United States, including leveraged buyouts, consolidations of fragmented industries, and venture capital investments. In Mongolia, as in other developing countries, the need for medium-term capital is required to finance equipment, goods and services, which will assist businesses in developing long-term production capacity. Banks in emerging markets are almost totally asset-based lenders for the short-term, typically less than two years, thus making growth and expansion of production limited. In addition to the basic common and preferred shares, funds in emerging market make more quasi-equity investments, such as: straight term debt, convertible debt, warrants, contingent equity, and several types of transactions less common in the U.S. setting.

A recent analysis of 210 private equity transactions in developing countries found that, compared to the U.S. where convertible preferred securities are ubiquitous, a much broader array of securities are employed and private equity investors often have fewer contractual protections. The choice of the investment security appears to be driven by the legal and economic circumstances of the nation and not by the private equity group. Investments employ common stock or straight debt where capital markets are robust, but in countries where capital markets are less developed, such as Mongolia and the former state-dominated economic systems of the Soviet Union, they are more likely to use preferred stock with a variety of covenants. In nations where the rule of law is less established, or undergoing reform as in Mongolia, private equity groups are unlikely to use common stock. In cases where investors own the majority of the firm's equity, the investment risk is higher, but the higher ownership stake is also an insurance against the investment risk if the company encounters difficulties[1].

D. Exiting

Perhaps the most vexing aspect of private equity investing in developing nations has been the difficulty of ‘exit.’ Proper ‘exit’ allows the realization of the capital gains, providing returns to investors and funds for operating expenses of the management company so that it can continue making additional worthy investments and be sustainable. The fortunes of private equity investors in the developed world have been largely linked to those of the market for initial public offerings (IPOs) distributed in the equity markets. Private equity investors in developing countries cannot rely on these offerings. Even in “hot markets”, where large foreign capital inflows occur, institutional funds are usually concentrated in a few of the largest corporations. Smaller and new firms typically do not attract significant institutional holdings and have much less liquidity. Consequently, private equity investors in developing countries have tended to rely on sales to portfolio firms or strategic investors. This can be problematic, however, when the number of potential buyers is small; the purchaser can exploit the private equity investor's need to exit the investment and acquire company stakes at below fair value. Restructuring the equity market in Mongolia is a high priority to enhance options for exiting.

[1] Josh Lerner and Antoinette Schoar, “Transaction Structures in the Developing World,” NBER, March 2004

SECTION IV: COUNTRY RISK AND COUNTRY PROFILE

A. Mongolian opportunity

The team believes that the country is likely to experience continued macroeconomic, political, financial and industrial development due to a number of factors including: existing legal infrastructure for a functioning market economy, strong international donor support, significant mineral resources such as gold, copper, oil, replenished livestock herds, the world's highest quality cashmere, high tourism potential, access to the large markets of China and Russia, growing young literate workforce, and a large underemployed work force.

As a result of the demand for longer term equity investment and loans, say three to five years, the development of Mongolian private enterprise would benefit from funds provided by a private equity venture capital fund vehicle using equity and quasi-equity instruments.

Mongolia is completing the transition process to a market-based economy and the private sector accounts for 75-80% of GDP and 90% of enterprises are privately owned. GDP has potential to grow at higher rates than the current 5% annual rate, according to estimates of the Ministry of Finance and Economy (MoFE) and international financial institutions (IFIs)[2].

Mongolians have an entrepreneurial spirit and a culture of trade. Lucrative investment exists as a result of the current planned reforms of the coalition government that took office on October 1, 2004. We believe the assets values of companies operating in the country are undervalued, although proper accounting methods and use of IAFRS are incipient.

The expansion of the capital markets and development of a limited liability equity culture may start to untangle in the country. We believe private equity could increasingly use the equity markets—potentially through the existing Mongolian Stock Exchange—to raise new capital for existing and new companies, if coupled with improvements in company disclosure and the premium valuations placed on strong corporate governance.

The new Parliament sworn in on October 1, 2004 avows intensive development of economic policy that aims to improve the legal framework to protect shareholders and foster a business environment seeking to involve business people, banks, financial institutions and citizens freely in stock market activities[3]. Currently, the Asian Development Bank (ADB) Third Financial Markets Reform Mission is constructing the policy matrix and recommendations for capital market sector reforms, including the recommendation for a single regulatory agency for securities, insurance and non-bank financial institutions (NBFIs), which has become the benchmark and international best practice applied to both emerging and developed capital markets.

B. Mongolia's challenges

Although domestic market consumer demand appears strong it is hampered by few gains in productivity and disposable income. Consumer spending is fueled by an underground economy of imported goods and inward cash remittances that supplement low incomes in a high underemployment economy.

In addition, The Multi Fiber Agreement ends January 5, 2005 and the WTO has indicated this deadline will not be altered. Thus, Mongolia will lose up to 30,000 garment worker jobs subcontracted by Korean and Chinese garment companies on subcontracting arrangements.

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[2] National Statistics Office Bulletin
[3] The Mongolian People's Revolutionary Party Platform, May 2004

The often-severe climate conditions affect agricultural production, which accounts for 20% of GDP and the estimated 28 million animal husbandry herd accounts for 79.5% of total agricultural production. The extreme climate conditions can cause significant damages to the economy, as it happened during the winters of 1999-2001, when the country experienced a moment of crisis for its livestock due to unusual cold weather conditions[4].

The country is landlocked and dependent on the Trans-Siberian railroad for trade with two neighbors, Russia and China. An inadequate road system connects Mongolia with China, a country with which it shares its longest borderline. The need for infrastructure upgrading in energy and public services is essential.

The scarcity of accounting skills and qualified corporate lawyers, incipient use of IAFRS, and low levels of corporate governance contribute to low levels of business transparency.

A poorly developed capital market, especially the Mongolian Stock Exchange, requires a greater enforcement of laws and the establishment of a single regulatory authority for securities, insurance, and NBFIs.

C. Economic growth

Mongolia is achieving overall macroeconomic stability, registering a 4% GDP growth rate in 2002, and a 5% GDP growth rate in 2003. After initially declining by 20% in the first transition years (1990-1993), GDP grew by 39% between 1994 and 1999. The estimated GDP growth for 2004 is 5.2%.

GDP may in fact be higher than recorded due to the size of the informal sector of the economy. Official estimates of the size of the informal economy calculate it at 13 percent of GDP; other estimates assume that its actual size is around 35% of GDP.

Mongolia's currency is freely convertible and the USD exchange rate has been fairly stable since 1999, at around MNT 1,100-1,200 (the October 13, 2004 USD/MNT spot rate was 1,208) to the U.S. dollar[5]. Regional data analysis of other comparable transition countries (Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan) that underwent similar political and economic conditions indicate that Mongolia has performed well, registering the second highest GDP per capita, after Kazakhstan, at $448, the highest savings rate of 23.7%, and the lowest inflation rate—1.6% in 2002.

D. Business environment

We believe the business and investment opportunities in Mongolia are quite good, with business registration a seemingly straightforward and inexpensive procedure. In 2003 there were over thirty (30) thousand registered enterprises[6], and 401 listed securities on the Mongolian Stock Exchange[7]. A peculiarity of the business environment is the informal sector, which is estimated to constitute 35% of GDP—composed mostly of individual traders and enterprises.

[4] National Statistics Office Bulletin
[5] National Statistics Office Bulletin
[6] MNCCI Bulletin
[7] Mongolian Securities and Exchange Commission

The business culture is entrepreneurial in spirit and ideas. There is a rapidly growing consumer market, fast developing banking sector, and inexpensive labor market. However, a bureaucratic approach to management remains a legacy of the socialist regime, which lasted 70 years, with emphasis on a production-oriented culture rather than a customer-oriented culture.

Government influence in the economy is still manifested through state-owned enterprises although the government is committed to continuing the privatization of these companies. It is estimated that one third of companies evade some form of tax payment and two thirds of companies purportedly pay a 10% surcharge to General Department of National Taxation (GDNT) officials[8].

The major industries, mining, cashmere, and tourism, as well as meat processing have trade groups that represent their interests. The composition of the Mongolian National Chamber of Commerce and Industry (MNCCI) membership serves as a proxy for the structure of the business sector in general, as follows: 10.3% shareholding companies and state enterprises; 84% limited liability companies; 1.8% banks and non-bank financial institutions; 2.4% associations, agencies and private enterprises; and 1.5% individuals and cooperatives.

E. Conclusion

Mongolia is a growing market economy with political stability since the end of the Socialist era in 1989. The Mongolian private sector now generates 75-80% of GDP and more than 90% of enterprises are privately owned. The market economy is growing and actually the GDP has potential to grow at higher rates than the current 5% annual rate. Mongolia is rich in natural resources that could be used to fuel a transformation of the economy if the right policies are implemented.

Shortcomings in the business environment and legal system still need to be overcome, but prospects are good as the country benefits from significant levels of international technical assistance aid. Mongolia enjoys comparable economic and natural conditions with similar countries that have benefited from private equity investments, such as the Central Asian Republics, Bhutan, and the Pacific Basin Republics such as Fiji, Papua New Guinea (Appendix C).

We believe Mongolia's reform process is overcoming an opaque legal and regulatory system. In addition, conditions by the ADB and other IFIs will help reform a stagnant but operationally functional stock exchange. The establishment of a private equity venture capital fund with partial institutional sponsorship by the IFIs can become a catalyst for developing equity markets, promoting venture capital, accelerating policy reform, and strengthening the legal system.

[8] ADB Private Sector Assessment for Mongolia, December 2003

SECTION V: INVESTMENT OPPORTUNITIES: PRELIMINARY ANALYSIS OF SECTORS, POTENTIAL TRANSACTIONS AND DEAL FLOW

A. Sector Analysis

Based on field interviews with fifty-one companies during the period of September 13-October 16, 2004, we conclude that there is a sufficient number of companies and ventures with high-growth potential—*deal flow*—that could yield competitive returns to fund and benefit from equity and quasi-equity investments. The private equity opportunities of investment can focus on individual companies within a sector and group companies organized across several sectors in order to build a balanced and diversified portfolio with substantial growth potential. A few of the companies possess inherent ability to be market leaders and drive consolidation both nationally and regionally.

We initiated the feasibility study seeking insight on the potential deal flow and asked several commercial bank-lending officers to rank sectors with growth potential and requiring long-term capital—greater than two years[9]. The response differed little between institutions. Meat processing, telecommunications, financial services, tourism, mining service providers, health care and education (not higher education), trade and food industries were mentioned. These sectors should be analyzed more thoroughly during the next stage of the feasibility analysis for the potential establishment of a private equity venture capital fund in Mongolia.

The estimated annual sales growth rates ranked by bankers in priority sectors are in the 15-25% range for meat processing, mining, tourism, and consumer finance sectors, which are also influenced by non-financial factors such as domestic and foreign political and economic conditions, trade quotes from Russia and China, and world commodity prices. The food industry has been attracting significant investment, and current growth is accelerating at 20-30% annual rate. There are no reliable data on the health and education sectors; however, these essential services are being reorganized to attract private investment as a result of increased government spending in the sectors[10].

Interviews with companies' representatives provided an understanding of sector conditions, growth opportunities, and local needs concerning the functioning of equity investments. It was clear from the interviews that few companies understand the equity investment concept. We also found a sufficient number of companies and ventures with reported high growth potential—*deal flow*—that could yield competitive returns to the fund. This observation will need further validation through the conduct of a detailed analysis of deal flow that should be carried out during the next stage of the feasibility analysis.

A1. Mining services

Suppliers and service providers of mining machinery and equipment can represent this sector. In the next few years, exploration and development of production in mining will remain the largest investment sector in the Mongolian economy. Investment opportunities for the fund will include drilling, chemical laboratories, training mining workers, technology upgrading, consulting mining companies, exploration information analysis, production planning, healthcare and workforce social issues, and restoration of used lands.

A2. Cashmere

This sector is one of the sectors in which Mongolians take pride. There are around ten cashmere companies in Mongolia. The planned privatization of Gobi, owned 75% by the

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[9] Interviews with bank officers at Anod Bank, XAC Bank, TDB Bank, Khan Bank, Chinggis Khaan Bank
[10] Based on interviews with Anod Bank and TDB Bank

Government and the largest company in the sector, will open up opportunities for investment in the sector. Currently, most Mongolian raw cashmere is being exported into China where Chinese companies spin and manufacture the yarn and enjoy the value-added margins from the marketing and promotion of the finished product. China and Mongolia hold approximately 60% and 30%, respectively, of the world cashmere market.

A3. Meat processing

The largest three slaughtering houses are located in Ulaanbaatar. Russia is by far the largest importer of Mongolian meat and meat products; however, 98% of the products are for domestic consumption. We interviewed three meat-processing factories in Mongolia and all have financed automated equipment through short-term bank loans. These companies' production standards comply with international meat processing standards, operate with equipment imported from Japan, Korea, and Germany and intend to diversify their export markets.

A4. Financial sector

Subsequent to the banking crisis in 1999-2000, the Mongolian banking sector has made progress and has become healthier. Four banks have increased equity through new investment by IFIs and private investors. The banks and NBFIs have improved their management and service quality; however, there is a need to check the expansion of the NBFI growth and improve regulations. Based on our interviews, we estimate that the seven largest commercial banks have excess liquidity of approximately USD 100-120 million. The insurance industry and related financial services such as leasing are now poised to experience growth and offer attractive investment opportunities.

A5. Food processing and beverage

With the doubling of the Mongolian population to 5 million within the next twenty years, food processing and beverages will experience above average growth. As a result of private sector equity investment, there has been a consolidation within sub-sectors of the agro-processing industry, such as flour, milk, processing fruits and vegetables; however, inexpensive imports from China limit domestic expansion. Recently, a major USD 20 million investment in new imported equipment from Germany and Austria expanded the capacity of the previously state-owned beer company, and the major baked goods company has received a USD 475,000 loan from an IFI for new equipment.

A6. Healthcare

The health care industry is operating well below the demand for adequate health care services. This underdevelopment represents a huge potential in this industry, as there is a growing need for health care services to the growing population of Mongolia, especially in Ulaanbaatar.

A7. Manufacturing

Mongolia is landlocked between two large neighbors, China and Russia, who both have a huge manufacturing base and a low cost labor force. Mongolian companies can compete with neighboring countries' manufacturing industries by concentrating on niche, quality products with unique Mongolian characteristics.

A8. Tourism

Phenomenal nature alone cannot bring sufficient number of tourists into Mongolia. The country requires international standard hotels, airports, road infrastructure, tourist camps, and attractions need to be established in order for the tourism industry to expand and flourish. The industry is fragmented with many small operators of hotels, guesthouses, restaurants, and touring companies. Growth opportunities exist in the sector for savvy and capitalized operators.

A9. Media, publishing and television

Media is one of the sectors with potential for growth. Liberated from the socialist ideology, Mongolians have become more concerned with developing sources of information. There are some very promising media companies, such as cable television providers, broadcast television and publishing.

A10. Telecommunications and Internet

The sector leader in mobile communications holds 85% of market share; however, the sector has further growth potential, as there are still many Mongolians who need access to world standard telecommunication, broadband and internet services. As a result, the market leader has competition from niche providers for all services.

A11. Information technology

Due to Mongolia’s geographic and demographic features, sectors like IT, or more specifically the software industry, could have some potential. There are some promising companies in the software industry, but there is also space for new entrants. Standard Mongolian applications for vertical markets and functions such as accounting systems offer opportunities. In addition to unfulfilled market demand, this industry could benefit from prospective attention and support from Government.

A12. Education

Like new apartment construction, education is expanding rapidly. With a high level of literacy, Mongolians understand the importance of education. Many private schools of diverse quality for all levels of education have been established during the last fourteen years. Presently, there may be a niche for higher quality education providers adhering to international standards.

A13. Trade, distribution and retail

This has been the most dynamic sector of the Mongolian economy over the last fourteen years. For instance, in 2003 and in 2004, the number of taxpayers in these sectors increased five fold and the amount of tax paid more than doubled.

B. Companies and deal flow

To assess demand for the prospective equity fund and *deal flow*—existence of a critical mass of high-growth potential firms—we took the following steps:

1. In order to understand the business environment and sectors, we created a list of Mongolian holding and group companies to be analyzed within each sector; the companies with perceived high-growth potential in a particular sector were marked against the performance of the market leaders in their particular sectors.

2. A larger pool of companies was selected for 'deal flow' potential from among the top 100 companies in the 2002 MNCCI Top 100 list. In addition, more MNCCI member companies were added to the list on a random basis. The MNCCI information matrix included total turnover, total (reported) tax paid, number of employees, and number of new employees, and company contact information, such as CEO, telephone and fax numbers.

3. During the period from September 13 to October 16, the study team collectively, and in rare cases separately, interviewed over 51 companies. The study called for a pre-interview questionnaire process, whereby each interview was preceded with the request to complete a questionnaire (see Appendix E), which was designed to solicit general company requirements for investment capital. The questionnaire was also accompanied by a pro forma balance sheet and income statement. This method for gathering information in the Mongolian context produced no replies, with the exception of one completed questionnaire by a leading hotel, hospitality and brewery company.

4. Finally, the recorded notes taken by the study team were collated into a matrix that contained information about: (a) sector or industry; (b) financing requirements; (c) indication of a company need for long-term capital; (d) for investing companies, an assessment of interest and liquidity to invest in the fund; (e) assessment of company needs in product development, engineering, marketing, accounting, financial engineering and other technical assistance services; and (e) form of incorporation of the company to indicate its organization as a joint-stock company (JSC), limited liability company (LLC) or publicly listed company.

There are currently no published data on company financials, performance or ratings in Mongolia that would offer a suitable starting point for an analysis of deal flow. Our method of selecting companies to be interviewed was the only alternative and was supplemented by requests for referrals to similar companies in the same sector. Our methodology enabled the study team to complete at least one company interview in each sector. In most cases, we were able to have a wide selection of companies, by sector, size, and ownership structures. For instance, we analyzed MobiCom and Micom, which are both in general telecom and IT sectors, but MobiCom is private, while Micom is state-owned as a daughter company of Mongolian Telecom.

Of the fifty-one companies interviewed for the study, only one completed the company questionnaire (Appendix E) requesting information of company's growth plans, basic balance sheet and income statement information. Although preliminary indications of deal flow are favorable, a more detailed due diligence process is required during a second stage of analysis to determine the size of a pipeline of potential transactions and what type of investments are worthwhile. These data will be required to determine the size of the fund and develop an investment strategy for a balanced portfolio.

C. Due diligence process required for next stage

The terms of reference for this initial assessment of potential deal flow did not allow for proper due diligence. A rigorous process of review of company management and operations, market position, cost structures, audited accounts, financial projections, risks, and growth opportunities—due diligence—will need to be undertaken during the next stage.

The list of required documents for the due diligence includes, but is not limited to, the following: corporate records, business descriptions, government agencies filings and correspondence, financing documents and loan agreements, debt instruments and financing agreements, list of mortgages, liens, pledges, or other encumbrances, financial reports and strategic plans, list of all properties, agreements, contracts, and commitments, confidentiality agreements, collective bargaining agreements, licensing agreements, list of all material litigations and claims, judgments, orders, decrees, tax returns over the last three years, the marketing plan, financial reports and the strategic plan and budget, market size and share, etc.

If and when established the management company of the fund and its investment advisor, as part of the due diligence process research, investigate, evaluate and present the potential investment opportunities, participate in the negotiations for the structuring, and monitor the company's investments during the life of the company[11]. The applicants for investment funds will be subject to a business and legal due diligence checklist prepared by the fund management company. Although numerous facsimiles of checklists are available, for example the Central Asia – Small Enterprise Assistance Fund's Investment Guidelines Manual, the task of the management company will apply standards for due diligence based on the information available in Mongolia.

Although the due diligence to be carried out during the next stage is no substitute for the process that the management company of the fund and its investment advisor must conduct, it should be as rigorous as it can possibly be. The concept of due diligence and its demands are fairly new in the Mongolian context and will represent a challenge for the successful completion of the next stage.

D. Financial analysis requirements

The assessment process for a private equity fund investment strategy by a Mongolian fund management company will include the standard financial analysis, including calculation of financial ratios performed on financial statements for at least two historical years. In practice, four categories of financial ratios will be calculated, including: profitability ratios such as Gross Margin, Operation Margin, Profit Before Tax Margin, Net Margin, Return On Assets, Return On Equity; liquidity ratios such as Quick Ratio (Receivables, Cash/Current Liabilities), Current Ratio (Current Assets/Current Liabilities); efficiency ratios such as Sales/Total Assets, Sales/Net Fixed Assets, Sales/Inventory, Sales/Net Receivables; and company's leverage ratio that equals Total Liabilities/Net Worth.

In addition, company and industry sector performance indicators including sales volume, capacity utilization, gross profit margins, operational performance, fixed and variable costs analysis, market share changes (if a listed MSE company) are essential.

In developing the investment guidelines evaluation, a financial forecast for at least 5 years will be created based on a set of assumptions regarding sales growth rates, cost of sales and gross margin, operating and non-operating expenses, cash growth rates, inventory levels and growth rates, receivables and accounts payables, current liabilities, long term debt, fixed

[11] Central Asian American Enterprise Fund, "Investment Guidelines Manual", February 2000

assets growth rates, etc. The financial model will yield a forecast income statement, balance sheet, and cash flow statement.

The IRR (Internal Rate of Return) of the investment is the benchmark financial indicator for ranking the *deal flow*, which is important to the private equity venture capital fund company formulation of strategy and objectives and for the investors placing equity in the fund.

The forecast financial statements will be used for the valuation of the company by applying the DCF (Discounted Cash Flow) method, or the income approach. This method involves the discounting of future cash flows and of company's terminal value at the end of the forecast period to the present time, using the discount rate, which is a rate adjusted to the risk of the particular investment.

In addition to the income approach for evaluating a company, one could concurrently use the cost approach and the market approach to valuation. The cost approach involves the calculation of the value of the company's Net Assets (Total Assets-Total Liabilities), after revaluating and adjusting certain assets and liabilities to market values. The market approach to company valuation consists of three methods: the comparable transaction analysis, where one looks at transaction prices of past deals involving similar companies operating in the same industry and markets; price-to-earnings multiple method, which is employed for listed companies and consists of using the median price-to-earnings multiple of similar companies; and price-to-book multiple method, which is also employed only for listed companies.

These valuation methods will be used to estimate the company's current equity, as well as to determine the value of the company's equity at the time of exit from the investment.

E. Investment risks

Investing in private equity could pose significant risks to investors. Probably the most significant risk is associated with the 'exit' from the investment, which could be a serious risk in Mongolia, as in other countries with a similar low level of legal reform and marginal capital market activities. In order to mitigate some of the perceived exit risks, certain exit provisions can be included in the investment agreement between the private equity venture companies. The most frequent of these provisions are the following[12]:

1. Contract specifies trade sale to a strategic buyer as exit goal, not an initial public offering
2. If exit is not reached within stated time, the firm has to pay dividends in excess of 50% of profits
3. The private equity fund has a put option that can be triggered at any time if there are disagreements with the management
4. The private equity fund is investing alongside with a strategic buyer who might ultimately buy the firm
5. If exit is not reached within stated time, the private equity fund can put back money to parent company of the firm
6. Contract pre-specifies an "arbitrator", for example an investment bank, in case of discrepancies between shareholders to avoid delays in courts
7. If exit is not reached within stated time, the private equity fund can put back shares at price agreed upon by at least three reputable investment banks.

[12] Josh Lerner and Antoinette Schoar. "Transaction Structures in the Developing World." NBER, March 2004

In addition to exit risk, there are other types of risks associated with investing in private equity such as: country risk, market risk, business risk, exchange rate risk, and financial risk. The structuring of the deal can include some financial provisions that could mitigate some of these risks, as follows[13]:

1. Debt converts to equity if the firm defaults
2. Private equity fund issues debt that is backed by guarantees of the parent company of the firm
3. "Forgivable" debt: if the firm reaches certain earnings targets, loan is converted into 0% equity
4. Majority shareholder of company issues the bond, not company, to avoid political constraints
5. Government debt becomes subordinate to equity if the firm defaults.

F. Conclusions

Based on a preliminary assessment of 51 companies, we conclude that there is adequate *deal flow* for the establishment of a private equity venture capital fund in Mongolia.

The lack of published financial information for companies operating in Mongolia requires continued efforts to develop a proprietary database of potential investments. This can only be accomplished by original investigation similar to the methodology employed in this study. We are confident that lending banks and institutions will cooperate in the identification of growth companies. Further, several IFIs and country assistance programs have been working over the last decade to develop technical assistance programs to the private sector, particularly for SME lending. For instance, the Dutch Government and the German GTZ finance the Enterprise Restructuring Project, which currently assists 53 business clients. The client list developed since 1999 began with a prospect identification process similar to the one we used. As the process unfolds, identification of additional prospect companies occurs by referrals.

The next stage to examine the feasibility for the establishment of a private equity venture capital fund in Mongolia should focus on a rigorous process of due diligence to scope the size and quality of a potential pipeline of transactions for the prospective fund.

Proven methodologies exist and have been used successfully to manage typical fund risks in environments similar to Mongolia. If successfully applied, these methodologies can act as a catalyst to improve company performance, corporate governance, and needed changes in the legal and regulatory environment.

[13] Josh Lerner and Antoinette Schoar. "Transaction Structures in the Developing World," NBER, March 2004

SECTION VI: POTENTIAL FUND INVESTORS: PRELIMINARY ANALYSIS OF THEIR REQUIREMENTS AND INTEREST

A. Investment objectives

First, Mongolian private sector interests interviewed for the feasibility study were consistent in the view that a private equity fund should operate in a for-profit manner. The fund should invest in businesses that have good prospects of being commercially viable and profitable. Moreover, the Fund should invest in businesses that are capable of meeting international competition, while creating jobs, exports, and developing the comparative advantages of Mongolia.

Second, private sector investors also agreed that, given current conditions in the Mongolian business environment, additional technical assistance would be required to assist potential investee companies in preparing for a prospective fund investment and in executing business plans post investment. Private sector investors concurred that this technical assistance would be needed to maximize the value of their investments. Access to markets, product development, marketing, improved business practices, and accounting and management systems figured prominently. Private investors also accepted that the costs associated with this technical assistance would need to be grant-financed, at least in its initial stages. Without the concurrence of donors and IFIs to support the technical assistance component, the fund would not be capable of achieving competitive commercial returns to its investors.

Third, this grant-financed technical assistance component would also act as a catalyst to develop and advocate needed changes in the legal and regulatory environment: improved corporate governance and transparency, use of IAFRS, changes in the structure and operations of the stock exchange, etc.

Fourth, it is expected that the private equity fund's investment strategy and track record would be sufficiently strong to attract private and semi-public funds to enlarge the capital base of the fund so that it can eventually become self-sustainable.

B. Interest to invest in private equity

Since 1991, Mongolia has had a two-tier banking system serviced by commercial banks and other financial institutions. The Non-Bank Financial Institution tier continues to grow from seven operating companies in 1999 to over one hundred today. NBFIs can engage in ten different financial activities, with the majority of them involved in lending. In addition to loan activity, other activities include foreign exchange, loan guarantee insurance, leasing, and factoring and payment settlement[14].

In Mongolia, private sector access to capital is quite limited because a diversified financial sector does not exist. Private enterprises depend on the banking system for sources of capital. However, banks have underdeveloped credit assessment systems and depend on extensive use of collateral. Banks also prefer to lend on a short-term basis and limits (20% of share capital) are imposed on the amount that can be lent to each borrower. The interviews confirmed that the demand, particularly the medium-term demand, say 2-5 years is not currently being met by the financial system. Therefore, access to longer term funds, through a private equity fund, is regarded by the market place as necessary.

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[14] Bank of Mongolia, "Research on Main Indicators of Banks and Non-Bank Financial Institutions"

Financial intermediation is not directing capital flows to sectors and companies requiring the medium-term equity and quasi-equity to purchase equipment, goods and services to fuel their growth potential. A private equity venture fund would fill a gap in the financial intermediation process.

C. Capital availability for private equity investments

The feasibility study attempted to measure private sector "indications of interest" among the companies interviewed, which included commercial banks, NBFIs, service and manufacturing companies. This initial assessment of private investors' interest yielded a commitment of USD 2m to capitalize the fund, contingent *inter alia* on IFIs' participation as anchor investors in the fund and professional, international caliber, portfolio management of the fund.

The team also assessed indications of interest from IFIs and donors in capitalizing the fund and/or supporting a grant-financed technical assistance component. We received positive indications from major IFIs (ADB, KFW, EBRD, IFC). The Asian Development Bank expressed interest in capitalizing the fund and has initiated its internal review process for a potential commitment to the fund. ADB typically provides up to 25% of the fund capital, although it may go as high as 30%. Other IFIs expressed high interest in the fund and await publication of these findings and those of the next stage to make further decisions.

Based on these findings, the Board of Directors of OSF has agreed to commit funds to carry out the next stage, the EPRC Project will seek USAID concurrence to do the same, and ADB has tentatively agreed to participate in the due diligence process of potential investee firms to be carried out during the second stage of the feasibility analysis.

D. Systemic risks (the Mongolian Stock Exchange)

The capital market, represented by the Mongolian Stock Exchange (MSE), should normally represent a venue for private equity investment exit through an initial public offering (IPO). MSE has still to reach its potential and become a mechanism for raising equity financing. The study was not intended to assess the condition of the MSE. However, by default several areas of concern were discussed with the Chairman and staff of the MSE. The following is a review based on the discussions[15].

1. *Shareholders' concentration*. As a few shareholders control a company, dividends are not paid to minority shareholders, but this is not due to financial difficulties of the company. The dividend is not paid with the intention to have discouraged minority shareholders 'dump' the stock and allow the large shareholders to buy shares at the discount price, and thus take control of the company.
2. *Dividend distribution system*. Shareholders are difficult to reach as they are geographically dispersed all over the country; this makes it difficult to disburse the dividend payments.
3. *Corporate governance.* Poor corporate governance of the companies leads to a lack of transparency in the market. For instance, in 2003, only 13% of all listed companies held a shareholders meeting. In 2002, only 32.7% of all listed companies submitted their financial statements to the MSE.

[15] Discussions with Mr. Dorligsuren, Chairman of the Mongolian Stock Exchange, and Mr. Gundelbal, Chairman of the Securities and Exchange Commission

4. *Insider information trading*. On Jan 22, 1998, the Securities Exchange Commission amended the Securities regulation allowing securities to be traded outside of MSE. This amendment allowed insider information trading, used by executives of companies to buy company shares 4-5 times cheaper than the stock exchange price.
5. *Lack of coordination of the securities law and regulations with the market environment*. As a result, minority shareholders are not protected, and company management does not listen to their voice. For instance, MSE lost USD 1 million in settlement funds as a result of failure and bankruptcy of commercial banks holding the funds. Although shareholders have recovered USD 300,000, a USD 700,000 remains outstanding.
6. *Privatization of state property through the stock exchange is separate from the primary function of the exchange*. The function of the MSE should be to maintain an orderly market for the buying and selling of shares to facilitate issuers, investors and intermediaries in the capital formation process. MSE is a 100% state-owned state enterprise.
7. *Government role* exercised by the appointment of the Board of Directors is not international best practice for a stock exchange. In effect, the Government member is the owner of the exchange.

Consequently, the MSE suffers from a lack of national and international public trust. As a result, investors and issuers are not utilizing the services of the exchange, and exchange professionals are leaving for other positions. In order to address the MSE's issues, a few immediate steps should be undertaken:

1. Permit 'delisting' companies, which do not meet the Exchange requirements for annual financial statements and annual shareholder's meeting.
2. Require payment of dividends to shareholders maintaining a bank account through the brokerage firms.
3. Amend the Securities Law of 2000 and exchange regulations, in particular the provision on off-exchange trading of listed securities, and strengthen rights of minority shareholders.
4. Change the appointment of the Board of Directors from Government appointees to private sector (including brokers/dealers and other intermediaries) interests, and 'de-mutualize' permitting brokers and dealers, and third party parties, such as the settlement banks to purchase interests.
5. Engage technical assistance experts to improve the operations of the exchange and intermediaries.

E. IRR and expected returns

The level of Mongolian based investors' dilemma is twofold. As companies require investment funds to meet capital requirement, the investors require above average (benchmark) rates of return to compensate for investment risk in such companies. The investor's opportunity to achieve rates of return greater than other instruments available in the market, say 18-19%, through an investment in a private equity fund, say 37% is attractive. This, however, not well understood in the Mongolian market. The high, say 37% IRR, is only achievable on the 'exit' (sale or IPO) of the company.

In addition to providing the companies with long-term funds, the private equity fund must provide a reasonable rate of return to investors.

We prepared a table of financial instruments available in the Mongolian financial marketplace, and imputed a rate of return, 37% for a hypothetical case investment through a private equity fund. The expected IRR is for a hypothetical high growth company and the composite data and subsequent assumptions (Appendix G) were obtained from the study interviews.

Financial Instruments	Monthly IRR	Annual IRR
Deposits		
Demand deposit	0.83%	10.00%
Time deposit	1.83%	22.00%
Government bonds		
180-day bond	1.34%	16.08%
210-day bond	1.36%	16.34%
240-day bond	1.29%	15.53%
Corporate bonds		
Shine Zuun	1.63%	19.56%
Ih Barilga	1.69%	20.30%
Puma bond	1.80%	21.60%
MCS Electronics bond	1.58%	18.96%
Equity		
Tulga	1.70%	20.36%
Spirit bal buram	4.67%	55.98%
Zoos goyol	5.73%	68.75%
Bayangol hotel	4.02%	48.19%
Software company XYZ		
(Hypothetical example)	**3.08%**	**37%**

F. Conclusions

The initial assessment of interest of Mongolian private sector investors and IFIs in capitalizing the fund has been favorable. A contingent commitment of USD 2m has been made by a private local investors and the ADB has initiated its due diligence process for potential anchor investment in the fund. However, specific data have not been recorded on expectations for rates of return, risk perceptions, preferences for sectors, size of investment, term, and exit strategies.

Financial intermediation is not directing capital flows to sectors with a shortage and sectors and companies requiring the medium-term equity and quasi-equity to purchase equipment, goods and services to fuel the growth potential. The interviews confirmed that demand and potential investors believe a private equity venture fund would fill a gap in the financial intermediation process.

The structure and operations of the MSE need urgent and immediate changes to remove constraints for the effective and efficient functioning of a local capital market.

SECTION VII: MONGOLIA'S REGULATORY ENVIRONMENT: INITIAL CONSIDERATIONS

Mongolia has made significant strides in developing a conducive, enabling legal and regulatory environment. Further improvements will be required and there appears to be a commitment on the part of the new Government to enact and implement these changes. These changes should be oriented towards diminishing real and perceived investor's risk to attract private investment and foster private sector-led economic growth.

The potential establishment of a private equity venture capital fund can act as a catalyst to expedite needed legal and regulatory reforms to improve the business environment. We provide an initial overview of potential reforms that need to be addressed in more detail during the second stage of the feasibility analysis.

A. Company Law of 1999

The Company Law needs to be examined regarding potential amendments to the admissible forms of incorporation, especially as it may pertain to the registration and regulation of a private equity venture capital fund company. Currently, the organization of such a company may take one of the two forms permitted: a joint stock company or a closed limited liability company. The closed or LLC form would be suitable as the number of founders of a closed or limited liability shall not be more than 50. Regardless, Article 23 which permits transformation from one form to the other is permitted by resolution of the shareholders.

B. Securities Law of 2002

The next stage of the feasibility analysis should also consider examining the Securities Law for potential amendments to facilitate the operation of an equity fund company. A lack of clarity is evident in Provision 26, Securities Trust Fund, and Investment Fund. First, there is no Trust Fund Law in existence that defines a Trust in Article 26. Regardless, the *Trust Fund* referred to in Provision 26.1 is a company that deals with the purchase and sale of securities, using certain amount of resources collected by the insurance and pension funds for the special purposes of the securities market. The proposed fund initially will not use funds from insurance or pension fund sources, certainly not from state-sponsored programs.

In addition, Provision 26.4 stipulates "The Fund will be an open form that regularly offers the sale of the securities for others". A private equity fund is not an open form as it has a specified life in its charter.

We believe a fund management company can be organized under the existing law. However, we agree with the recommendation being offered by the ADB Third Financial Market Reform Mission that suggests rewriting the entire securities law to remove such ambiguities as in Provision 26. Further, the Mongolian Parliament approved a Resolution in April 2004 to create a new financial regulatory authority for NBFIs, and the Ministry of Justice approved a rewrite of the securities law to eliminate current ambiguities, as the new single regulatory authority will supervise, securities, insurance and NBFIs.

C. Accounting and Reporting

The Accounting Law (1993, amended 2002) requires all companies to adopt IAFRS and submit audited financial statements to MoFE; however, compliance is quite weak. The implementation of IAFRS is a long-term process and the introduction of a private equity fund could be a driver in the process especially with the investment analysis for the fund investments.

Due to the scarcity of qualified accountants and auditors and inadequate accounting and auditing skills, accounts provide insufficient detail, making it difficult for investors to evaluate businesses. In addition, poorly prepared financial statements make DCF valuation difficult, if not impossible. Due to the lack of trustworthy financial statements, commercial lending has to be based on collateral rather than cash flows, and this practice hampers growth and tenure of bank lending.

D. Legal matters and the rule of law

Mongolia needs to improve the transparency and implementation of laws and regulations as they hamper private investment. In part, the weak enforcement of current rules and regulations is due to the shortage of qualified lawyers (many lawyers were educated in the former Soviet Union and are not familiar with market driven legal concepts and requirements).

There is no public participation in drafting of rules and regulations, or a hearing or public consultation process on proposed changes to a law. In addition, foreign direct or portfolio investors require greater interpretation of legal protection affordable under the Mongolian regime.

E. Capital markets

The capital market, consisting of the seven-year-old Mongolian Stock Exchange, does not yet play a meaningful role in the Mongolian economy. The exchange is authorized to trade securities, Government obligations, and corporate bonds. However, the MSE is not recognized as a venue for raising equity and is rather viewed as an instrument of the voucher privatization process. There is a high concentration of share ownership in the 401 listed securities on the Mongolian Stock Exchange. Ownership of securities and bonds placed on the MSE is concentrated in 2,400 shareholder current accounts controlling 83% of MSE listed companies. MSE estimates that three to eight shareholders own the majority of companies[16].

MSE is characterized by low to nonexistent market liquidity. Government has access to the market and banks in need of meeting reserve requirements take up all issues. Companies have limited access to equity capital, and SMEs (as well as large companies) need to rely on short-term bank borrowings for working capital at average monthly interest rates of 1.5% or 18% per annum. Thus, bank lending is the main source of company financing for short and medium-term operating capital. Furthermore, bank lending is asset-based, limiting growth. Mongolia lacks institutions and mechanisms for providing risk capital, such as venture capital and a liquid stock market to access equity financing with IPOs.

F. Corporate governance

The lack of transparency in the capital market and availability of company reporting documents (not required for non-listed LLCs) obstructs the emergence of healthy corporate governance standards and practices. Corporate governance suffers from a lack of necessary pre-conditions for good corporate governance, such as proper accounting statements prepared by qualified accountants, independent auditing firms, modern management and organization principles. The concentration of share ownership in MSE-listed companies supports proliferation of poor corporate governance practices and prevents the stock exchange from expanding its role in the economy.

[16] Conversation with Mr. Dorligsuren, Chairman of Mongolian Stock Exchange

G. Tax considerations

Taxation was ranked as the principal business constraint in 2001 in the USAID-financed Manual for Action in the Private Sector Survey (MAPS Survey). The issue is the effective rate of corporate tax and the application of the tax regulations. For instance, with the capital gains tax at the ordinary rate of 30%, investors want dividends to be tax-free. The tax system for corporations is an advanced payment system coupled with a high tax rate and complex tax regime. The dual corporate tax rate consists of two separate tax rates: 15% for profits up to MNT 100 million; and 30% for profits above MNT 100 million. The high dual corporate tax encourages the creation of subsidiary entities, which complicates management structures resulting in inefficiency and undermined transparency. In fact, the effective tax rate may actually be closer to 60% rather than 30%, for several reasons: there is no loss carry forward provision; advertising and training expenses are limited to 10% of taxable income; expenses in excess of budgeted levels are not allowable against tax; and tax depreciation schedule allows only straight-line depreciation over 5, 10 or 40 years.

Exemptions and tax holidays apply in certain sectors where more than 50% of production is for exporting. The VAT is 15% on company's sales turnover above MNT 10 million ($9,000) per year. There are a few exemptions to VAT: financial services, tourism, education and medical services. A VAT of 5% is charged at the border crossings for all imports.

H. Conclusions

The Mongolian legal and regulatory environment needs improved transparency and enforcement to attract private investment. The weakness of proper accounting standards and enforcement reinforce this opacity.

Despite being operational, the Mongolian Stock Exchange requires upgrading to international best practices, first on the corporate governance side, and thereafter on the trading, settlement and clearing technical issues. Currently, there is no capital market liquidity, access to capital is limited to short-term bank lending, and there is no risk-based financing such as venture capital. There are weak incentives for good corporate governance and there is an ineffective and unduly complex corporate tax system, with a high effective tax rate that impedes corporate and capital market development.

The Mongolian conditions are not dissimilar from other developing nations, especially those of countries emerging from command economies. We recommend that the second stage of the feasibility study for the establishment of the equity fund focus on developing specific change proposals in the Company Law, Securities Law, Mongolian Stock Exchange structure and operations, simplification of and realignment of corporate income tax provisions to international best practices, clear specification of requirements and enforcement of IAFRS and reporting requirements to improve corporate governance.

SECTION VIII: CONCLUSIONS AND RECOMMENDATIONS

This first stage of the feasibility analysis for the establishment of a private equity venture capital fund in Mongolia was primarily designed to provide:

- An indicative "deal flow" analysis comprised of high-growth-potential firms expressing interest in private equity financing
- An initial canvassing of potential local investors' interest and IFIs in capitalizing the fund
- An initial assessment of design requirements of the fund to include a grant-financed technical assistance component and donors and IFIs' interest in supporting such services
- A preliminary analysis of the legal and regulatory environment applicable to the successful launching and operations of the fund.

Based on the interviews and analyses conducted, the team draws the following conclusions:

1. There is a high degree of interest from private local investors, IFIs, donors, the financial community, and local entrepreneurs in a private equity venture capital fund
2. Forty-three percent of the 47 companies interviewed manifested interest in private equity financing
3. A contingent commitment of USD 2m to capitalize the fund was obtained from a respected local investor and the Asian Development Bank initiated its interval review process to become an anchor investor in the fund; ADB typically commits no more than 25% of the capital of a fund but can possibly consider higher commitments
4. Results from the preliminary assessment of deal flow are encouragingly positive but further due diligence will be required in the next stage to determine the size and quality of a potential pipeline of transactions capable of returning commercially competitive returns to local investors
5. Similarly, further canvassing of local investors' concrete commitments, terms and rates of return expectations will need to be conducted in the next stage
6. The lack of reliable and readily available data on sector and company performance and ratings, not unusual in developing economies, required a methodology to approach the building of a database of companies; this unavailability of company data will represent a challenge for the future analysis of the pipeline and deal flow
7. Exit strategy for the fund investments remains a high risk, considering a non-functional stock exchange; the fund will have to consider use of a broader array of well-known investment vehicles to manage this risk: quasi-equity investments, royalty schemes, etc.
8. Legal and regulatory constraints of the Company Law, Securities Law, MSE functions and structure of ownership, use and enforcement of IAFRS and reporting requirements will need to be addressed to improve corporate governance and minimize risks to investors and shareholders

9. Given the initial and preliminary size of the fund, estimated at USD 10-12m, and the conditions of the business environment, a grant-financed technical assistance component will be required to prepare companies for investment, help them execute their business expansion plans funded by the equity infusion and deliver commercial returns to investors
10. There was general consensus on the requirements of success for the equity fund: it must operate as closely to commercial private equity funds as possible, be managed by professional portfolio managers, have IFIs as anchor investors, and become eventually self-sustainable from fees realized upon successful exits from investments under management.

The main recommendations are summarized as follows:

Recommendation # 1: Results of this first assessment warrant proceeding with a second stage in the feasibility analysis for the establishment of a local private equity venture capital fund in Mongolia.

Recommendation # 2: Terms of reference for the next stage of the feasibility analysis should be prepared to focus, *inter alia*, on the following:

- Develop more detailed analysis of sectors, company profiles, pipeline (size and returns) of potential transactions for potential consideration by the fund
- Carry out due diligence of potential companies, sectors, and transactions: financial analyses, valuations, financial projections, expected IRRs, and risk assessment
- If findings from this stage warrant it, specify and quantify initial fund design requirements such as expected size, investment strategy, and investment vehicles
- Similarly, if findings are favorable, develop recommendations for the structure and management of a grant-funded technical assistance component that would build upon current capabilities and structures of existing business development projects such as, among others, the Enterprise Restructuring Project and EPRC
- Develop concrete proposals to address corporate governance issues, tax considerations, capital markets functioning, accounting standards, and financial disclosures.

Recommendation # 3: Conduct the second stage of analysis during the first quarter of 2005 with continued funding as approved by the OSF Board of Directors, potential commitments of USAID through the EPRC Project, and potential continued involvement of Mongolia Links Co. Ltd. Given the interest manifested by the Asian Development Bank, this broad initial partnership can be expanded to include other relevant entities interested in participating in the fund.

ANNEX A: CONCEPT- PRIVATE EQUITY IN DEVELOPING COUNTRIES

ANNEX A: CONCEPT-PRIVATE EQUITY IN DEVELOPING COUNTRIES

Table 1 - Construction of sample. This table summarizes the key features associated with the construction of the sample of 210 private equity transactions.

Private Equity Group		Year of Deal		Industry of Firm		Deal Type		Country of Firm	
Group 1	8	1987	2	Distribution/Retail	14	Buyout	28	Argentina	18
Group 2	6	1988	2	Finance	16	Corp. Acquisition	10	Bolivia	2
Group 3	6	1992	3	Food	29	Distress	4	Brazil	18
Group 4	5	1993	4	Health Care	9	Expansion	97	Bulgaria	8
Group 5	3	1994	2	Information Tech	24	IPO	12	Chile	7
Group 6	3	1995	5	Internet	9	Privatization	10	China	13
Group 7	10	1996	10	Manufacturing	32	Venture Capital	49	Estonia	8
Group 8	8	1997	17	Media	8			Ghana	3
Group 9	6	1998	35	Natural Resources	11			Hong Kong	13
Group 10	6	1999	31	Real Estate	4			India	28
Group 11	11	2000	34	Services	17			Korea	10
Group 12	3	2001	40	Software	10			Indonesia	2
Group 13	2	2002	22	Telecom	14			Latvia	4
Group 14	4	2003	3	Other	13			Malaysia	2
Group 15	10							Mexico	14
Group 16	8							Peru	2
Group 17	6							Poland	13
Group 18	5							Romania	18
Group 19	10							Singapore	6
Group 20	13							South Africa	2
Group 21	14							Taiwan	4
Group 22	8							Tanzania	2
Group 23	5							Thailand	3
Group 24	7							Uruguay	2
Group 25	21							Yugoslavia	6
Group 26	13							Other	5
Group 27	7								
Group 28	2								

Source: Josh Lerner, and Antoinette Scholar. NBER Working Paper No., March 2004

ANNEX B: IN-COUNTRY MEETINGS AND PRESENTATIONS

ANNEX B: IN-COUNTRY MEETINGS AND PRESENTATIONS

Legend

1. Sector
2. Financing Requirements (Yes/No)
3. Investor Interest (Yes/No)
4. Technical Assistance (Yes/No)
5. Corporate Organization

Time	Name	Title	Organization	Phone/Fax	E-mail/Website	Address	Legend
September 9, 2004							
10:00-11:00	N. Zorigt	General director	Tuushin	325907	zorigt@tuushin.mn www.tuushin.mn	Tuushin Bldg. Prime Minister Amar's str. 2, 210620a UB, Mongolia	1.Group company, core bus. International freight forwarding. 2. No, 3. Yes, 4. Yes, 5. LLC
12:00-13:00	P. Baatarsuren	President	Aero Mongolia /airline industry/	99112902 983029	baatarsuren@aeromongolia.mn	P.O. Box-105 Buyant-Ukhaa airport, UB-34, Mongolia	1. Airline, 2. Yes, 3. No, 4. Yes, 5. LLC
14:00-15:00	N. Bazarragchaa	Executive director	TV 5	95151150 680327	info@tv5.mn www.tv5.mn	P.O. Box-143 210523 UB city, Mongolia Songinohairhan district, 2nd fl. Sapporo center	1. Media, core bus. TV broadcasting, 2. No, 3. No, 4. Yes, 5. LLC
16:00-17:00	S. Monhor	Director of finance & economics	Zuunii Nar /textile industry/	345142 326551	mooeo2002@yahoo.com	P.O.Box 46/472 UB, Mongolia	1. Textile, 2. Yes, 3. No, 4. Yes, 5. LLC
September 10, 2004							
10:30-11:30	L. Davaajargal	President	Bridge Group	99111397 450520	davaajargal@bridgegroup.mn	UB-51, Mongolia Bayanzurh district 14th khoroo Enkhtaivan Avenue, Bridge Plaza	1. Group company, core bus. Construction, 2. Yes, 3. No, 4. Yes, 5. JSC
12:00-13:00	M. Nergui	General director	Buteelch Uils Co., Ltd. /textile industry/	99113247 9909		P.O. 350 Nalaikh district, UB, Mongolia	1. Textile, 2. Yes, 3. No, 4. Yes, 5. LLC

Time	Name	Title	Organization	Phone/Fax	E-mail/Website	Address	Legend
14:00-15:00	D. Lhagvasuren	Operational manager	Huvsgul Travel /tourism industry/	460368	info@huvsgultravel.com www.huvsgultravel.com	P.O.Box 2003 Bayanzurkh District, Ikh toiruu, Mongolia 210351	1. Tourism, 2. Yes, 3. No, 4. Yes, 5. LLC
15:30-16:30	B. Gantuya	Manager of financial department	Ulaanbaatar Hotel	99151037 324485	ub-hotel@magicnet.mn	Sukhbaatar Sq. 14 UB-210645, Mongolia	1. Hotel, 2. No, 3. No, 4. No, 5. Listed company
17:00-18:00	Sh. Nurmaa	General manager	Nomin Holding	99092042 313232	nurmaa@nomin.net	State department store #7, P.O.Box-688, Peace Avenue-44, UB-210644, Mongolia	1. Holding company, core bus. Trading, 2. No, 3. No, 4. Yes, 5. LLC
September 11, 2004							
12:00-13:00	S. Batchuluun	Director	Sobbi /renewable energy/	99116433 368030	sobbi@mongolnet.mn	P.O.Box 115, UB- 38, Mongolia	1. Energy, 2. Yes, 3. No, 4. Yes, 5. LLC
September 15, 2004							
10:00-11:00	Mr. Daniel Mahoney	Attorney-At-Law	Lynch & Mahoney	Tel: 325344 Fax: 325358 Cell: 99115542	mahoney@mongolialaw.com	International Trade Center Suite 500, Baga Toiruu 37B Mail: P.O.Box 279 Ulaanbaatar 210646 A Mongolia	
11:15-12:15	Ms. Sazfina Razak	Country Manager, Assurance and Advisory Business Services (AABS)	Ernst & Young, Certified Public Accountants	Tel: 319269, 319270 Fax: 319249 Cell: 99111255	sazfina-moha.razak@my.ey.com; www.ey.com	Chinggis avenue 11/1 Crystal House Business Center Ulaanbaatar Mongolia	
12:15-13:00	Mr. Ganhuyag	Executive Director	XAC Bank	Tel: 318185 Fax: 328701 Cell: 99114537	ganhuyag.ch@xacbank.org; www.xacbank.org; www.xacbank.mn	Prime Minister Amar Street Sukhbaatar District P.O.Box 46/721 Ulaanbaatar 210646 Mongolia	1. Banking, 2. No, 3. No, 4. No, 5. JSC

Time	Name	Title	Organization	Phone/Fax	E-mail/Website	Address	Legend
15:45-16:45	Mr. Boldbaatar	Chairman	Newcom Group	Tel: 311967 Fax: 311969 Cell: 99116699	boldbtr@gol.com; www.newcom.mn	Newcom (Group), LLC Peave Avenue 3/1 Mobicom Building 5th Floor Ulaanbaatar 210620 Mongolia	1. Group company, 2. No, 3. Yes, 4. No, 5. LLC
	Mr. Byambatsogt	Assistant to President		Tel: 313183 311967 Fax: 311969 Cell: 99091662	byambatsogt@newcom.mn		
	Mr. Oyunbat	CEO		Tel: 313183 Fax: 311969 Cell: 99113300	oyunbat@newcom.mn; www.newcom.mn		
September 16, 2004							
9:00-9:50	Mr. Enkhbaatar		MineInfo LLC	Cell: 99116509			
10:00-11:00	Mr. Saha Meyanathan	Resident Representative	World Bank (WB)	Tel: 312654, 312647 Fax: 312654			
11:00-12:00	Mr. Dorligsuren	Chairman & CEO	Mongolian Stock Exchange (MSE)	Tel: 310506, 323068 Fax: 325170 Cell: 99190472	d_dorlig@yahoo.com; www.mse.mn	Sukhbaatar Square – 2 Ulaanbaatar Mongolia	
12:15-13:00	Mr. Bataa	Director, Asset Management Department	Trade and Development Bank (TDB)	Tel: 328229 Fax: 321142	j.bataa@tdbm.mn	Khudaldaany Street 7 Ulaanbaatar 11 Mongolia	1. Banking, 2. No, 3. No, 4. No, 5. JSC
14:00-14:45	Mr. Akira Shimizu	Assistant Resident Representative	Japan International Cooperation Agency (JICA) Mongolia Office	Tel: 325939, 311329 Fax: 310845	Shimizu.Akira@jica.go.jp; www.jica.go.jp	Bodi Tower 7th Floor Sukhbaatar Square 3 Ulaanbaatar Mongolia C.P.O.Box 682 Ulaanbaatar 211213 Mongolia	
15:00-16:00	Mr. Tsenguun	CEO, Deputy Chairman of BOD	Altan Taria	Tel: 631480 Fax: 632097 Cell: 99112127	ptsenguun@altantaria.mn; www.altantaria.mn	Songinokhairkhan District 4th Khoroo Ulaanbaatar-211137 Mongolia	1. Wheat manufacturing, 2. No, 3. No, 4. Yes, 5. LLC
17:30-18:30	Mr. Enkhbat	President & CEO	Mongol Daatgal, National Insurance & Reinsurance Company (MDIC)	Tel: 313697 Fax: 310347 Cell: 99117281	enkhbat@mongoldaatgal.mn; enkhbat_b@mobemail.mn; www.mongoldaatgal.mn	Mongol Daatgal Building Seoul Street Ulaanbaatar-210644 Mongolia	1. Insurance, 2. No, 3. No, 4. No, 5. JSC

Time	Name	Title	Organization	Phone/Fax	E-mail/Website	Address	Legend
September 17, 2004							
10:30-11:30	Mr. Terry Chuppe Ms. Nergui	Team Leader, Financial Service Policy and Regulatory Expert Economics Offcer	Asian Development Bank TA Project for Preparing the Third Financial Sector Program Asian Development Bank (ADB)	Tel: 329836 Fax: 311795 Cell: 99778573 Tel: 329836, 323507 Fax: 311795	emergingmk@aol.com dnergui@adb.org; http://www.adb.org/mnrm	Asian Development Bank Mongolia Resident Mission MCS Plaza, 2nd Floor 4 Natsagdorj Street P.O.Box 1083 Central Post Office Ulaanbaatar-13 Mongolia	
11:45-12:45	Ms. Gereltuya	Office Manager	European Bank for Reconstruction and Development (EBRD), Mongolia Cooperation Fund	Tel: 315443 Fax: 311103 Cell: 99117987	ebrd_mcf@mongol.net; www.ebrd.com	2nd Floor Zorig Foundation Building Peace Avenue 9A	
14:00-15:00	Mr. Gundelbal	Chairman	Mongolian Securities and Exchange Commission (MSEC)	Tel: 329084, 262811 (secretary) Fax: 329084	gundenbal_msec@mongol.net	Government House IV Baga Toiruu 6 Ulaanbaatar-46 Mongolia	
September 20, 2004							
9:00-9:45	Mr. Dorjnamjim	Country Officer	International Finance Corporation (IFC)	Tel: 312694 Fax: 312696 Cell: 99114828	dlhaajav@ifc.org; www.ifc.org	IFC Ulaanbaatar Office 11-A Peace Avenue Ulaanbaatar 210648 Mongolia	
10:00-11:00	Mr. Peter Morrow	Chief Executive Officer	Khan Bank, Agricultural Bank of Mongolia	Tel: 455474, 460617 Cell: 99113749	pete@magicnet.mn; www.agbank.mn	Agricultural Bank of Mongolia Building	1. Banking, 2. No, 3. No, 4. No, 5. JSC
11:15-12:00	Mr. Ganbold	Technical Director	MiCom	Tel: 323224, ext. 11 Fax: 322473 Cell: 99115630	ganbold@micom.mng.net; www.micom.mn	Sukhbaatar Square-1 P.O.Box 1124 Ulaanbaatar 210611 Mongolia	1. IT, 2. Yes, 3. No, 4. Yes, 5. State owned
12:15-13:00	Mr. Enkhtuvshin	Vice President, Finance	MCS Holding Co. Ltd.	Tel: 312625 Fax: 312175 Cell: 91116918	tuvshin@mcs.mn	MCS Plaza Seoul Street-4 Ulaanbaatar-210644	1. Group company, 2. No, 3. No, 4. No, 5. JSC

Time	Name	Title	Organization	Phone/Fax	E-mail/Website	Address	Legend
	Mr. Batsaihan	Vice President, Business Development Strategy	MCS Group	Tel: 312625, 311079 Fax: 312175 Cell: 99096696	batsaihanb@mcs.mn; www.mcs.mn	Mongolia	
September 21, 2004							
9:30-10:30	Mr. Saikhansambuu		Naran Tuul Trade				1. Trade, 2. No, 3. No, 4. No, 5. LLC
10:30-11:30	Mr. Baatarsaikhan	President & CEO	Juulchin, Tourism Corporation of Mongolia	Tel: 320163 Fax: 320246 Cell: 99117880	juulchin@mongol.net; www.mongoljuulchin.mn; www.mongoliahunts.mn	Juulchin Tourism Corporation Chinggis Khaan Avenue 5B Ulaanbaatar 210543 Mongolia	1. Tourism, 2. No, 3. No, 4. Yes, 5. JSC
11:30-12:30	Mr. Sergelen	Chairman	Monkhangai Group	Tel: 91914767 Fax: 689742 Cell: 91912790	www.minii-suljee.mn	P.O.Box-153 Ulaanbaatar-21 Mongolia	1. Group company, core bus. Trade, 2. Yes, 3. No, 4. Yes, 5. JSC
13:00-14:30	Mr. Erdenejargal Mr. Enkhbat	Executive Director TV Program, Director and Host	Open Society Forum	Tel: 313207 Fax: 324857 Tel: 313207 Fax: 324857	jargal@soros.org.mn; www.forum.mn enkhbat@forum.mn; www.forum.mn	Jamiyan Gun Street 5/1 Sukhbaatar District Ulaanbaatar-48 Mongolia	
14:30-15:20	Mr. Bold	Chairman, BD, Golomt Bank	Golomt Bank	Tel: 311530, 311971 Fax: 325873, 312307	lubold@mongolnet.mn; www.golomtbank.com	Sukhbaatar Square P.O.Box-22 Ulaanbaatar 210620A Mongolia	1. Banking, but Mr. Bold is chairman of Bodi International Group which owns Golomt, 2. No, 3. No, 4. No, 5. JSC
15:30-16:30	Mr. Enkhbat	General Director	Sansar CATV Co. Ltd.	Fax: 313770 Cell: 99115712	sansar tv@magicnet.mn	P.O.Box-757 Ulaanbaatar-44 Chingeltei District Ulaanbaatar Mongolia	1. CaTV, 2. Yes, 3. No, 4. Yes, 5. LLC
September 22, 2004							
9:30-10:30	Mr. Ganbold	Deputy Director	Delta San	Tel: 312635 Cell: 91917962	si_ganbold@magicnet.mn		1. NBFI, 2. No 3. No, 4. No, 5. JSC
11:00-12:00	Mr. Paul Chare Mr. Munkhbat	Executive Vice President – Operations Senior Vice President, Advisor to	Ivanhoe Mines	Tel: 310785-(825) Fax: 311469 Cell: 99110467 Tel: 310775 Fax: 311469 Cell: 99112385	paulchare@ivanhoemines.mn munkhbata@ivanhoemines.mn	Ivanhoe Mines Mongolia Inc. Olympic Street 6 Sukhbaatar District Ulaanbaatar-210648 Mongolia	1. Mining, 2. No, 3. No, 4. No, 5. listed in Toronto and Australian SE

Time	Name	Title	Organization	Phone/Fax	E-mail/Website	Address	Legend
	Ms. Allison Croft	Chairman Community Development Office		Tel: 310785 Fax: 312337 Cell: 99099903	allisonc@ivanhoemines.mn		
12:10-13:00	Mr. Klaus Bader	General Director	Khaan Holding. Khan Brau Hotel Mongolia, Mongolian-German Joint Venture	Tel: 315513 Fax: 325861 Cell: 99186332	khanbrau@magicnet.mn; www.khanbrau.net	Brauhaus Sukhbaatar District Ulaanbaatar Mongolia	1. Group company, core bus. Beverage, 2. Yes, 3. No, 4. No, 5. JSC
16:00-17:00	Mr. Enkhtur Mr. Ariunzul Ms. Undrakh	President & CEO Senior Economist, Investment Banking Division Specialist, Investment Banking Division	Anod Bank	Tel: 327566, 315200 (direct) Fax: 313070 Cell: 99112226 Tel: 327556 Fax: 315431 Cell: 99098826 Tel: 327556 Fax: 315431 Cell: 99171612	enkhtur@anod.mn; www.anodbank.com ariunzul_id@anod.mn undrakh_id@anod.mn	P.O.Box – 361 Juulchny Street – 18 Ulaanbaatar-13 Mongolia	1. Banking, 2. No, 3. No, 4. No, 5. LLC
September 23, 2004							
9:30-10:30	Mr. Igor Kovarsky	Vice President, Government Affairs & Corporate Development	Boroo Gold Co. Ltd. Centerra Gold Inc.	Tel: 317798, 99823365 (Gereltuya, secretary) Fax: 316100 Cell: 99110654	igor.kovarsky@centerragold.com; gereltuya.b@centerragold.mn	Bodi Tower 11th Floor Sukhbaatar Square P.O.Box 223 Ulaanbaatar-210648 Mongolia	1. Mining, 2. No, 3. No, 4. No, LLC
12:30-14:00	Mr. Sainbileg	Corporate Banking Director	Trade and Development Bank	Tel: 329048 Fax: 329048 Cell: 99114081	sainbileg@tdbm.mn	Khudaldaany Street-7 Ulaanbaatar-11 Mongolia	1. Banking, 2. No, 3. No, 4. No, 5. JSC
15:00-16:00	Ms. Chimgee	Director, Supervision Department	The Bank of Mongolia	Tel: 328482 Fax: 322846 Cell: 99114541	Lchimgee@hotmail.com; www.mongolbank.mn	Baga Toiruu 9 Ulaanbaatar – 46 Mongolia	
16:15-17:00	Mr. Mishigdorj	Director of the Human Resources Department	Capital Bank	Tel: 319247 Fax: 310833	center@capitalbank.mn; www.capitalbank.mn	Capital Bank Head Office Sambuu Street-48 Ulaanbaatar-211238 Mongolia	1. Banking, 2. Yes, 3. No, 4. Yes, 5. LLC

Time	Name	Title	Organization	Phone/Fax	E-mail/Website	Address	Legend
September 24, 2004							
9:30-10:30	Mr. Saintsogt	Executive Director	Chinggis Khaan Bank	Tel: 633105 Fax: 633185 Cell: 99113137	chkhbank@mongol.net	Chinggis Khaan Bank Building 20th Khoroo Bayangol District Ulaanbaatar Mongolia P/Box-322	1. Banking, 2. No, 3. No, 4. No, 5. JSC
September 27, 2004							
11:00-11:45	Mr. Jonathan Simon	Project Director	Enterprise Restructuring Project	Tel: 310537 Fax: 310537	jonsimon@magicnet.mn; www.enterprise-restructuring.com	Tavan Bogd Plaza 1st Floor	
12:00-13:00	Ms. Dariimaa	Director	Boorj Tour Co. Ltd.	Tel: 315412 Cell: 99116362	darima_ch@yahoo.com	Chingeltei District 4 Khoroo, Bldg. 6 Tsetsee Gun College # 310	1. Toursim, 2. Yes, 3. No, 4. Yes, 5. LLC
15:00-15:45	Mr. Sunjidmaa	Founder & CEO	bizMongolia, Mongolian Business and Economic Information Services and Consultancy	Tel: 95154939 Fax: 315344 Cell: 99177912	sunjidmaa@bizmongolia.mn; www.bizmongolia.mn	P.O.Box-421 Ulaanbaatar-210646 Mongolia	
16:00-17:00	Mr. Batsaikhan	Managing Director	APU Joint-Stock Company	Tel: 342434 Fax: 343063 Cell: 99112222	bagi@apu.mn; www.apu.mn	APU Building Chinggis Khaan Avenue Ulaanbaatar-36 Mongolia	1. Beverage, 2. No, 3. No, 4. No, 5. JSC
September 28, 2004							
10:00-11:00	Mr. Enkhbat	President & CEO	Admon Printing & Publishing	Tel: 321153, 329253 Fax: 327251 Cell: 99114450	admon@magicnet.mn; www.admon.mn	Amar's Street-2 Admon Building P.O.Box-92 Ulaanbaatar-13 Mongolia	1. Publishing, 2. No, 3. No, 4. Yes, 5. LLC
11:30-12:30	Mr. Demberel	Chairman & CEO	Mongolian National Chamber of Commerce & Industry	Tel: 324620 Fax: 324620 Cell: 99112509	chamber@mongolchamber.mn; www.mongolchamber.mn; www.mongoliamarket.mn	Sambuu Street-11 Ulaanbaatar-38 Mongolia	
15:30-16:30	Mr. Ronnie Lamb	CEO	Mongol Amical, Mongol Cashmere & Camel Wool	Tel: 344150 Fax: 344015 Cell: 99118210	mccwc@magicnet.mn	Khan Uul District Ulaanbaatar-36 Mongolia (left side, Gobi Factory)	1. Cahsmere,

Time	Name	Title	Organization Company	Phone/Fax	E-mail/Website	Address	Legend
17:15-18:00	Mr. Ariunbold	President	Bishrelt Holding	Tel: 326250 Fax: 326250, 313798 Cell: 99119956	bishrelt@magicnet.mn; www.bishrelt holding..mn	Sambuu Street 48 P.O.Box 104 Ulaanbaatar 210644 Mongolia	1. Group company, owner of Capital bank, core bus. Trade, 2. Yes, 3. No, 4. No, 5. LLC
September 29, 2004							
10:00-11:00	Mr. Norovdondog	Head, Market Regulation Department	Securities and Exchange Commission of Mongolia	Tel: 311703 Fax: 329084 Cell: 99179625	sec_nora@yahoo.com		
16:30-17:30	Mr. Barry Hitchcock Mr. Graham Settle	Country Director and Resident Representative Senior Governance Specialist	Asian Development Bank (ADB) Governance & Regional Cooperation Division	Tel: 329836, 323507 Fax: 311795 Tel: 632-5313, 632-5752 (direct) Fax: (632) 636-2193	bhitchcock@adb.org; www.adb.org/mnrm gsettle@adb.org	Asian Development Bank Mongolia Resident Mission MCS Plaza, 2nd Floor 4 Natsagdorj Street P.O.Box 1083, Central Post Office Ulaanbaatar-13, Mongolia	
September 30, 2004							
14:45-15:30	Mr. A. Battushig	Representative	KFW	Tel/Fax: 315950 Cell: 99118240	Kfw_Mongolia@gmx.net	Tengeriin tsag center Olimp str.-14 Central post office,P.O.B732 Ulaanbaatar, Mongolia	
16:00-17:00	Mr. Jargalsaikhan	Board Member	Open Society Forum, Just Group	Tel: 318261 Fax: 315612 Cell: 99110595	djargal@yahoo.com	Just LLC Mongolian Youth Bldg. IV Floor, Baga Toiruu-44 Ulaanbaatar-48 Mongolia	
October 1, 2004							
11:00-12:00	Ms. Tsolmon	Executive Director	Credit Mongol, NBFI	Tel: 319333, 315143 Fax: 324901 Cell: 99116032	tsolmon@creditmongol.org	DHL House, Suite 402 Peace Avenue 15-A P.O.Box-677 Ulaanbaatar-13 Mongolia	1. NBFI, 2. No, 3. No, 4. Yes, 5. JSC
20:00-22:00	Mr. Byambadalai	Co-Founder & CEO	"e-Mongol.com" LLC	Tel: 462878 Cell: 99277037	Byamba@e-mongol.com www.e-mongol.com	Oin Street, 5 13th Microdistrict Ulaanbaatar, Mongolia	1. Tourism, 2. Yes, 3. No, 4. Yes, 5. LLC
October 5, 2004							

Time	Name	Title	Organization	Phone/Fax	E-mail/Website	Address	Legend
9:00-10:00	Veronica & Barry	Headquarter	ADB	Tel: 329836	vljohn@adb.org		
10:30-11:30	Mr. G. Bahdal	Lawyer	Tsets	Tel: 312707 Cell: 99115700	tsetse@mbox.mn	Ulaanbaatar, Mongolia P.O.B 49/27	1. Law firm, 2. No, 3. No, 4. No, 5. LLC
16:30-17:30	Mr. G. Bayanmunkh Mr. L. Bayartsogzol	General Director, Partner Translator & Assistant auditor	Itgelt audit Co. , Ltd	Tel: 454026 Fax: 451150 Cell: 91114040 Cell: 91914232	itgelt_audit@mbox.mn Bayanmunkh@mol.mn itgelt_audit@mbox.mn	Enkhtaivan Avenue, 18A-1 NAMAC house, #201 Ulaanbaatar-49, P.O.Box-710 Mongolia	1. Auditing firm, 2. No, 3. No, 4. No, 5. LLC
October 6, 2004							
9:00-10:00	Mr. L. Davaajargal Mr. S. Erdene	President Investment Consultant	Bridge Group	Tel: 450520 Fax: 458005 Cell: 99111397 Tel: 450941 Cell: 91918763	bridge@bridgegroup.mn davaajargal@bridgegroup.mn erdene_counsel@bridgegroup.mn	Ulaanbaatar-51, Mongolia Bayanzurkh District 14th horoo Enhtaivan Avenue “Bridge Plaza”	
10:30-11:30	Mr. L. Zundui	Executive Director	Uguuj Sweet&Bisquits Co., Ltd of production and trade	Tel: 325206 Fax: 322790	uguuj@mobinet.mn www.uguuj-bakery.com	Mongolia, Ulaanbaatar-210644 Seoul Street-35	1. Food processing, 2. No, 3. No, 4. No, 5. LLC
11:40-12:40	Mr. O. Damba	General Director	Pharmaceutical Factory	Tel/Fax: 323188 Cell: 99116233	monemu@mongol.net	Ikh Toirog-55 Ulaanbaatar 28 Mongolia	1. Pharmaceutical manufacturing, 2. Yes, 3. No, 4. Yes, 5. LLC
14:15-15:00	Mr. D. Dayanbilguun	Director	BDSec., ltd	Tel: 321763 Fax: 321763 Cell: 99198760	BDSec@yahoo.com	Ulaanbaatar, Mongolia Baga Toiruu 26/1	1. Securities firm, 2. No, 3. No, 4. No, 5. LLC
	Mr. B. Purevdorj	Representative in UB	Baruun Mongol International LLC	Fax: 366845 Cell: 99112122	bminter@mbox.mn	Ulaanbaatar 210613 Central P.O.Box-322 Mongolia	1. Group company, core bus. Meat processing, 2. Yes, 3. No, 4. Yes, 5. LLC
	Mr. E. Ganbold	Deputy director	SJ Group LCC	Fax: 311751 Cell: 99117555 95159738	ganbold23@yahoo.com	Mongolia, Ulaanbaatar-13 Central Post Office, P.O.Box 310	1. Group company, core bus. Meat processing, 2. Yes, 3. No, 4. Yes, 5. LLC

Time	Name	Title	Organization	Phone/Fax	E-mail/Website	Address	Legend
October 7, 2004							
9:30-10:30	Mr. A. Battushig	Representative	KFW	Tel/Fax: 315950 Cell: 99118240	Kfw_Mongolia@gmx.net	Tengeriin tsag center Olimp str.-14 Central post office,P.O.B732 Ulaanbaatar, Mongolia	
11:00-12:00	L. Dorjnamjim	Country Officer	International Finance Corporation (IFC)	Tel: 312694 Fax: 312696 Cell: 99114828	dlhaajav@ifc.org; www.ifc.org	IFC Ulaanbaatar Office 11-A Peace Avenue Ulaanbaatar 210648 Mongolia	
October 8, 2004							
9:30-10:30	Mr. M. Battulga	Executive director	KOMIT service	Tel: 345477, 341415 Fax: 341338 Cell: 99091413	Battulga_komit@komatsu.mn www.kommit.com	Mongolia, Ulaanbaatar-36 Chinggis khan avenue, Khan-Uul district 2nd horoo	1. Mining service, 2. No, 3. No, 4. No, 5. JSC
10:40-11:30	Mr. Ganbaatar		Incom Net (Iridium Satellite Phone)				1. Telecom, 2. Yes, 3. No, 4. No, 5. LLC
October 15, 2004							
9:00-10:00	Mr. Leon Waskin Ms. Sukhgerel D.	USAID Representative CTO / Program Specialist	U.S. Agency for International Development	976-11-312390 976-11-312384	LWaskin@usaid.gov dsukhgerel@usaid.gov	USAID/Mongolia c/o U.S. Embassy Big Ring Road 11th Microdistrict Ulaanbaatar, Mongolia	

ANNEX C: PRIVATE EQUITY FUND CASES

ANNEX C: PRIVATE EQUITY FUND CASES

Kula Fund

- Countries: Pacific Islands (Cook Islands, Fiji, Kiribati, Marshall Islands, Micronesia, Nauru, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu
- Total investment $11.4 million
- Financed by: ADB, EIB, IFC, etc.
- Investment objectives:
  - Provide risk capital to private sector
  - Assist business with a sustainable competitive advantage with higher than average returns, sales and profitability
  - Focus on most sectors: agro-processing, fishing and fish-processing, warehouse retailing, mining services, printing, palm oil production, and aviation charter services.
  - Make investment decision locally
- Investment policy:
  - Invest equity capital between $200,000 and $2 million; exit after – 3-7years
  - Be a supportive minority shareholder
  - Meaningful financial contribution from sponsors
  - Be an active Board member
  - Contribute to the profitability of the company
  - Meet international health, environment and safety standards
- Successful divestments: IRRs of 26-27%
- Return on invested capital: 30% so far, additional 10% to be achieved
- A follow-on fund to be raised in 2005

Central Asia Small Enterprise Assistance Fund

- Total initial investment $8.6 million to be followed by subsequent investments
- Countries: Kazakhstan, Uzbekistan, Tajikistan, Turkmenistan, and Kyrgyzstan
- Sources of funds: international financial institutions, development agencies, private foundations and private investors that support SEAF's mission
- Mission:
  - Provide risk capital to medium and small enterprises in underserved markets
  - Provide business and management services
- Investment strategy:
  - Invest in SMEs through limited partnerships: JVs, wholly or partially owned subsidiaries, managed funds, etc.
  - Investments between $200,000 and $1.5 million per business for a stake between 20% and 49%
  - Minority equity participations often combined with quasi-equity financial instruments and subordinated debt
  - Investment is combined with technical assistance provided through local offices
  - Operate according to commercial principles
- Investment policy
  - Enterprises that have difficulty securing funds from conventional commercial sources due to their small size or location is less developed capital markets
  - Entrepreneurs who are able to develop growing and profitable businesses and comply with all laws
  - Businesses who have developed a product in a niche market with a sustainable competitive advantage
  - Businesses with a positive impact on the local community
  - Companies in which at least 51% of ownership interest is held by locally resident nationals
  - Restrictions: tobacco, armament, some alcoholic beverages, gambling, immoral activities, etc.

ANNEX D: COUNTRY COMPARISONS

ANNEX D: COUNTRY COMPARISONS

	Sri Lanka	Bhutan	Mongolia	Romania
Population	19.9 mil	2.2 mil	2.8 mil	21.7 mil
Started reforms	1977	-	1990	1990
GDP per capita PPP	$3,700	$1,300	$1,800	$6,900
GDP growth rate 2003	5.2%	7.7%	5.0%	4.9%
GDP composition	Agriculture 19% Industry 25% Services 56%	Agriculture 45% Industry 10% Services 45%	Agriculture 21% Industry 21% Services 58%	Agriculture 15% Industry 35% Services 50%
Natural resources:	Limestone, graphite, mineral sands, gems and phosphate.	Hydroelectric power, timber, gypsum, calcium carbide.	Coal, copper, iron, phosphates, gold, uranium, petroleum.	Oil, timber, natural gas, coal, salt, iron ore
Exports	Garments and footwear, tea, rubber products, jewelry and gems, refined petroleum, coconuts.	Hydroelectricity, fruits and vegetables, minerals, food products, minerals, textiles, machinery.	Livestock, animal products, minerals, cashmere, cooper gold and textiles.	Textiles, chemicals, light manufactures, wood products, fuels, processed metals.
Inflation rate 2003	7%	3%	5%	14%
Commercial lending rate	9%	15%	10%-72%	25%
Stock market capitalization	$1.5 billion	$147 million	$42.4 million	$6 billion
Regional Development Bank portfolio	ADB Loans and TA: $3.3 bill Agriculture 30% Social infrastructure 19% Finance 16% Transport & Comm. 15% Energy 13% Multisector 4% Industry 3%	ADB Loans and TA: $111 mil Social infrastructure 30% Energy 24% Transport & Comm. 17% Finance 11% Multisector 11% Agriculture 7% Industry 1%	ADB Loans and TA: $569 mil Transport and comm. 24% Social infrastructure 18% Energy 17% Agriculture 13% Industry and minerals 11% Finance 9% Multisector 2%	EBRD Total Loan and Equity Financing: $2.6 bill
Total WB Loans and Technical Assistance	$2.87 billion	$64.3 million	$320 million	$3.3 billion
IFC portfolio	14 companies Exposure: $74 million Financial sector 29% Infrastructure 27% Telecom 20% Power 9% Tourism 7% Health 4%	Bhutan has become a member of IFC in Jan 2003. To date, IFC has only one investment project in Bhutan in the tourism industry.	Loans of $0.4 mil in 2002 Trade and Development Bank equity participation $1.5mil and TA for SMEs in the mining in sector Possible participation AgBank and Mobicom	Commitments $390 mil Banking SMEs & Microfinance Manufacturing Housing loans, leasing Mobile Comm.
Private Equity Funds	Olympus Capital Holding South Asia Regional Investment Fund ($200 mil) Aureos Capital - SME focus - $300m capital	South Asia Regional Investment Fund ($200 mil)	NA	Allied Capital, Emerging Europe Fund, Soros Investment Capital, New Century Capital Partners, Aqua International Partners, etc.

ANNEX E: PRIVATE EQUITY COMPANY QUESTIONNAIRE

ANNEX E: PRIVATE EQUITY COMPANY QUESTIONNAIRE

1. Company name:

    ____

2. Contact person's name and function:

    ____

3. Is your company listed on the Mongolian Stock Exchange?

   Yes No

4. What is your industry classification (live stock, agriculture, mining service)?

    ____

5. Primary product line:

    ____

6. Secondary product lines:

    ____

7. Number of employees:

    ____

8. What are the sources of financing your business? (Check all that apply)

    Personal & family funds — Domestic private equity investment

    Foreign private equity investment — Government funds

    NGO grants/ credits — Bank lending

    Stock flotation — Bond issuance

    Other (please specify) ……………………………………………………………..

9. In your view, how will your industry perform over the next 5 years?

    ____
    ____
    ____

____
____

10. What are your expectations for your company's future sales and sales growth rates?

____
____
____
____
____

11. Do you plan to expand your activity over the next 5 years?

☐ Yes No

If yes, how do you plan to expand your activity? (Check all that apply)

Introduce new product lines Expand capacity on current product line

Penetrate new domestic markets Penetrate new foreign markets

Move current products upscale Make technological improvements

Other (please specify) …………………………………………………………………..

12. If you plan to expand your activity, what are your investment requirements (in USD)?

____

13. What are the sources of financing you plan to use in your business expansion?

Reinvested profits Personal & family funds

Bank lending Private equity investment

Stock flotation Bond issuance

Foreign investment partnership

Other (please specify) ………………………………………………………………….

14. What rate of return would you pay for borrowing from private investors?

____

15. What is your average cost of borrowing and maturity of date?

____

16. It will be helpful to have summary of the financial data to assess possibilities for establishing an investment fund. Please fill the attached.

THANK YOU!

ANNEX F: PRIVATE EQUITY INVESTOR QUESTIONNAIRE

ANNEX F: PRIVATE EQUITY INVESTOR QUESTIONNAIRE

1. Investor name:

____

2. Type of investor:

- High net-worth individual
- Private company
- Development bank
- International financial institution
- Local financial institution, etc.

3. Do you currently hold some type of investments in Mongolia? If yes, what type of investments do you hold (portfolio investments, direct investments, etc)?

4. What industries did you invest in?

5.What is the size of your investment?

6. What are your expectations for sales/ profit growth rates for your investments in Mongolia?

7. What is your minimum required rate of return for investments in Mongolia?

8. How do you perceive the risk on your Mongolian investments?

9. Are you taking any measures to mitigate the risk on your Mongolian investments? If so, what kind of risk mitigating measures do you employ?

10. Do you plan to make more investments in Mongolia? If so, which do you perceive to be the most promising sector of the economy?

11. What is the size of investments you plan to make in the country in the future?

12. What is your preferred term for the investments you hold or plan to make in Mongolia in the future?

13. What are your preferred exit strategies for the investments you hold or plan to make in Mongolia?

THANK YOU!

ANNEX G: HYPOTHETICAL SOFTWARE COMPANY

ANNEX G: HYPOTHETICAL SOFTWARE COMPANY

Assumptions:

- Company XYZ operates in Mongolia in the software business
- Company XYZ is a publicly traded company
- Projected balance sheet and income statement are stated in US $
- PEF makes investment in Year 0 by buying 20% of XYZ shares
- Capital stock consists of 100,000 shares at $100 each
- Investment is held 5 years
- Exit at the end of Year 5 through selling at the Stock Exchange
- Price per share doubles at the end of Year 5

Projected Balance Sheet:

- Cash grows at 5% per year and through reinvestment of net profit
- Inventory grows at 5% per year
- Receivables reduce at 10% per year
- Fixed assets grow at 5% per year
- Accounts payable grow at 15% per year
- Current liabilities grow at 10% per year
- Long-term debt grows

Projected Income Statement:

- Sales grow at 20% per year
- Cost of sales grows at 19% per year
- Gross margin = Sales – Cost of sales
- Operating expenses grow proportionately at 19% per year
- Operating margin = Gross margin – Operating expenses
- Non-operating income grows at 15% per year
- Non-operating expenses grow proportionately at 15% per year
- Profit before tax = Operating margin + Non-operating income – Non-operating expenses
- Tax equals 40% of Profit before tax
- Net profit = Profit before tax – Tax
- Dividend payout: 60% of Net profit
- Plowback: 30%
- Retain: 10%

Projected Balance Sheet For 5-Year Investment

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Cash	4,656,000	5,698,800	6,974,910	8,535,956	10,444,860	12,778,282
Inventory	7,000,000	7,350,000	7,717,500	8,103,375	8,508,544	8,933,971
Receivables	2,344,000	2,109,600	1,898,640	1,708,776	1,537,898	1,384,109
Fixed assets	6,000,000	6,300,000	6,615,000	6,945,750	7,293,038	7,657,689
Total Assets	**20,000,000**	**21,458,400**	**23,206,050**	**25,293,857**	**27,784,340**	**30,754,051**
Accounts Payables	7,569,200	8,704,580	10,010,267	11,511,807	13,238,578	15,224,365
Other Current Liabilities	644,800	709,280	780,208	858,229	944,052	1,038,457
Long Term Liabilities	786,000	774,540	815,184	919,329	1,103,181	1,388,973
Total Liabilities	**9,000,000**	**10,188,400**	**11,605,659**	**13,289,365**	**15,285,811**	**17,651,795**
Capital Stock	10,000,000	10,000,000	10,000,001	10,000,002	10,000,003	10,000,004
100,000 shares at T 100 each						
Retained Earnings	1,000,000	1,270,000	1,600,390	2,004,490	2,498,526	3,102,252
Total Stockholders' Equity	**11,000,000**	**11,270,000**	**11,600,391**	**12,004,492**	**12,498,529**	**13,102,256**
Liabilities & Stockholders' Equity	**20,000,000**	**21,458,400**	**23,206,050**	**25,293,857**	**27,784,340**	**30,754,051**
Investment, 20% of shares	2,000,000					
20,000 shares						
Cash flows	-2,000,000	396,468	484,920	592,842	724,472	4,884,960
IRR	**37%**					

Projected Income Statement For 5-Year Investment

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Sales	**16,090,000**	**19,308,000**	**23,169,600**	**27,803,520**	**33,364,224**	**40,037,069**
Cost of sales	10,500,000	12,495,000	14,869,050	17,694,170	21,056,062	25,056,713
Gross margin	**5,590,000**	**6,813,000**	**8,300,550**	**10,109,351**	**12,308,162**	**14,980,355**
Operating expenses	1,325,000	1,576,750	1,876,333	2,232,836	2,657,074	3,161,919
Operating margin	**4,265,000**	**5,236,250**	**6,424,218**	**7,876,515**	**9,651,088**	**11,818,437**
Non-operating income	685,000	787,750	905,913	1,041,799	1,198,069	1,377,780
Non-operating expenses	450,000	517,500	595,125	684,394	787,053	905,111
Profit before tax	**4,500,000**	**5,506,500**	**6,735,005**	**8,233,920**	**10,062,104**	**12,291,106**
Tax	1,800,000	2,202,600	2,694,002	3,293,568	4,024,842	4,916,442
Net profit	**2,700,000**	**3,303,900**	**4,041,003**	**4,940,352**	**6,037,263**	**7,374,663**
Dividend	1,620,000	1,982,340	2,424,602	2,964,211	3,622,358	4,424,798
Plowback	810,000	991,170	1,212,301	1,482,106	1,811,179	2,212,399
Retained	270,000	330,390	404,100	494,035	603,726	737,466
Earnings per share		19.82	24.25	29.64	36.22	44.25
Dividend for 20% of shares		396,468	484,920	592,842	724,472	884,960

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