

PERFORMANCE AND COMMENTARY

Published on 29 Jan 2021 | Prices as at end of day

We estimate our NAV to be 590.5 at the end of January, up 4.1% from an estimated 567.1 at the end of December. In Jan, we estimate our equity portfolio was up 7.5% for the month in USD terms.

As is the norm for this time of year, our estimated NAV incorporates independently appraised real estate values for end 2019, not end 2020. The independent real estate valuers are scheduled to start their work next week and we aim to incorporate their appraised values for end 2020 at the end of February. The NAV will therefore likely change materially at the end of February.

Real Estate Valuations

This month, we begin our monthly letter with a discussion of our real estate assets. As we have mentioned in several of our 2020 letters, with Mongolia was affected by COVID restrictions earlier than other countries in 1Q2020, at the same time as our valuers were deriving our 2019 real estate values. Our 2019 values, down 21% in MNT in aggregate vs. 2018 (and -24% in USD) include at least some, if not most, of the impact from COVID.

While Mongolia spent 2020 shut off from most of the outside world and, as a result, had very few COVID cases, 4Q2020 saw an increase in cases, albeit much less than other countries. This increase led to a closure of most types of retail outlets for over two months from 11 Nov 2020 to 25 Jan 2021.

Markets

Since the Nov 2020 lockdown, our two covered markets, Marketplace and Blue Bazaar (32% and 13% of our estimated NAV before debt, respectively) have only been able to operate their food sections, which account for 50-70% of their pre-lockdown gross rental income (before expenses). Overall, despite the disruption caused, rent net of expenses increased 13% in MNT for Marketplace and 11% for Blue Bazaar in FY2020 vs. 2019. This was helped by lower expenses due to government subsidies on social security expenses, electricity, heating, water and garbage collection, as well as some rent increases and efficiency gains.

Given that a) 2019 valuations already incorporate some Covid impact (values down 27% in MNT for Marketplace vs. 2018 and down 20% for Blue Bazaar), b) rents have risen in 2020, and c) 2020 rents (net of expenses) are high, especially for such land-rich assets, relative to 2019 appraised values (6.0% yield for Marketplace at 75% occupancy and 8.2% for Blue Bazaar at 95% occupancy), we believe our 2020 valuations could go either way.

Stand-alone Properties

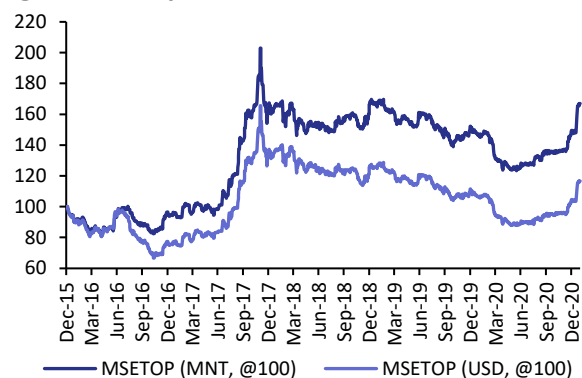
Our standalone properties, 12% of our estimated NAV, have been entirely closed since the Nov 2020 lockdown, and no rent has been collected. Unlike our two covered markets, our standalone properties (12% of our estimated NAV, consisting of 5 shops and 2 apartments) saw both an 8% rise in their 2019 values vs. 2018 and a big decline in their rental income in 2020, so we would expect to their 2020 appraised values to be down vs. 2019.

Stock Market

Market records second month of strong gains

In January, the MSE TOP20 Index gained 11.6% in both MNT and USD terms (Fig. 1), as the MNT was flat against the USD (Fig. 2). This comes on the back of a gain of 9.2% (9.6% in USD) in December.

Fig. 1: MSE Top 20 Index

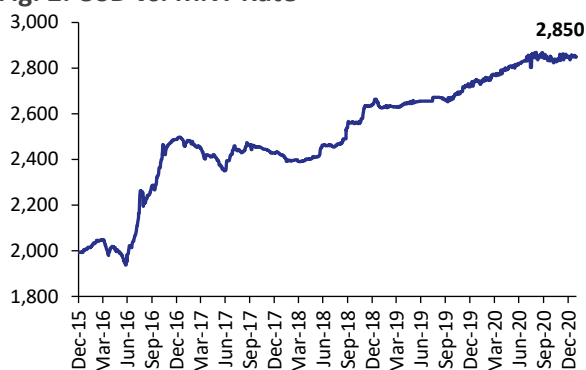


Source: Bloomberg, latest data point: 29.01.2021

This month, Gobi Cashmere (+14%), our biggest holding, led the market among the large caps as investors seem to be starting to price in a recovery. The math behind the 11.6% monthly gain in the MSE TOP20 index in Jan remains a mystery to us:

Gobi had a weight of c.7% at end of Dec 2020 and was the 3rd best performer, contributing c.+1% to the index. It was surpassed only by Ard Financial and State Department Store, +71% and +26%, respectively, each c.2% of the index as at end 2020. The two largest constituents, APU (beverage) and TTL (coking coal) with weights of c.30% and c.17% were +3% and -0% for Jan, respectively.

Fig. 2: USD vs. MNT Rate



Source: Bloomberg, latest data point: 29.01.2021

Companies

Oyu Tolgoi (OT) Related Developments

In January, the news flow on Oyu Tolgoi (OT), Mongolia’s flagship copper/gold mine, continued. On 11 Jan, Turquoise Hill (Rio Tinto subsidiary that owns 66% of OT) disclosed that the Government of Mongolia (GoM) communicated its dissatisfaction to Rio Tinto, the operator of the project, regarding the results of the Definitive Estimate (DE), and asked for talks to improve its cash flow.

The Definitive Estimate relates to the remaining capital expenditure necessary to bring the large underground portion of the mine to production, expected in late 2022. It was nothing new to the market, as the additional investment required was within the range previously guided by TRQ. However, as the final official document on the matter, it formed the basis of the GoM’s argument on cost overruns and delays. Since day one, GoM’s share of the CAPEX in the mine has been financed by TRQ, to be repaid with cashflows from the mine in the future. The GoM will only start receiving dividends on its 34% equity stake after its debt has been fully repaid. The expected repayment period has been lengthened by cost overruns and delays.

It looks as if GoM and Rio Tinto will soon be at the negotiating table again, this time hopefully to find a comprehensive solution and amend the 2015 Dubai Agreement, which paved the way for construction of the underground mine. While both sides will likely play hardball, we believe that a final resolution will be reached in 2021 as OT is now too important a project for both parties, with the underground mine so close to production.

Many options are on the table but, ultimately, we expect Mongolia to reduce its equity stake in return for a higher mineral royalty so as to enjoy more immediate benefits from the mine. Whether Rio or TRQ, with its funding challenges, would pick up the government’s 34% stake is an interesting question and leads to the possibility (likelihood we believe) that Rio would also tender for the minorities in TRQ to increase its economic stake in the project from the current low 33%.

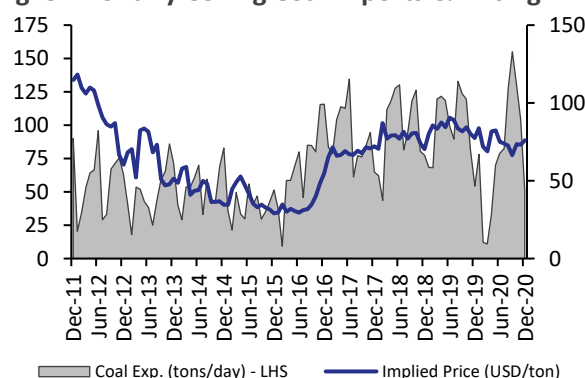
Interestingly, Jakob Stausholm, the newly appointed CEO of Rio Tinto, recently announced [changes](#) in Rio’s executive team and appointed Bold Baatar, a Mongolian and a former investment banker, to head the Copper and Diamond division. We see this as a very timely and constructive move in Rio’s discussions with the GoM.

Economy

Coal exports close 2020 with a promising outlook

With the start of the low season in December, Mongolian coal exports averaged c.51k tons per day, down c.51% m/m (Fig. 3) and c.6% y/y.

Fig. 3: Monthly Coking Coal Exports & Pricing

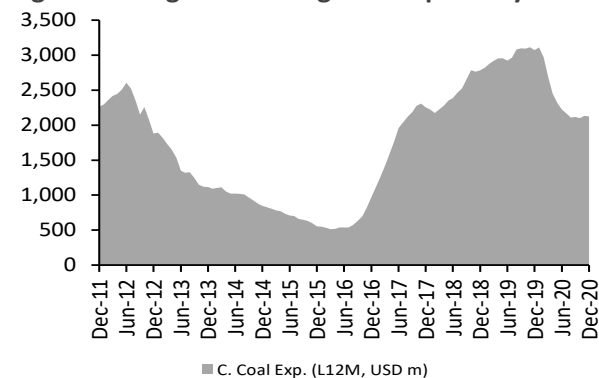


Source: National Statistical Office, latest data point: Dec 2020

The average implied price increased by c.4% m/m to USD 76 per ton. As usual, the low season will end at the end of the Chinese New Year in February.

2020 was a year of two halves, with a depressed 1H2020, when coal exports were down 52% y/y as COVID led to a shutdown of the Mongolia-China border, and 2H2020, when exports were up 8% y/y as Mongolia and China normalized the coal trade over the summer with strict hygiene protocols. In 2H2020, exports also benefitted from the intensifying China-Australia dispute that led to a significant decline in Australian coal purchases by China. Overall, in FY2020, exports were -22% y/y in volume to c.29m tons and -31% y/y in value to USD 2.1bn due to softer pricing (Fig. 4).

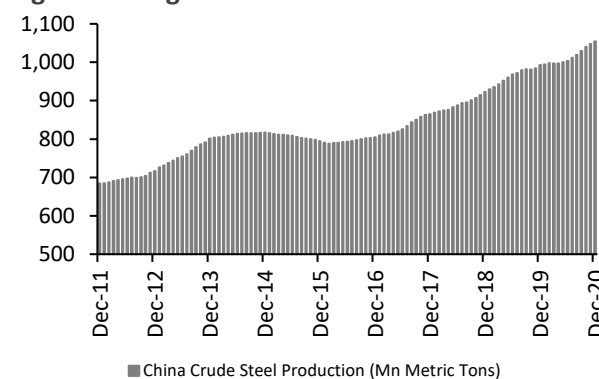
Fig. 4: Trailing 12M Coking Coal Exports by Value



Source: National Statistical Office, latest data point: Dec 2020

In Dec, the Chinese steel sector continued to perform strongly, supporting coking coal fundamentals, as output was c.+7% to 91.2m tons in Dec and c.+6% to over 1bn tons in 2020 (Fig. 5).

Fig. 5: Trailing 12 Month China Steel Production



Source: Bloomberg, latest data point: Dec 2020

In light of all the above, we expect to see significant y/y growth in 1H2021 due both to the low base effect and the displacement of Australian imports. For 2021, the likelihood is high that Mongolian coal exports surpass their 2019 peak of c.36m tons.

Politics

Government Resigns Over Health Crisis

In late January, Prime Minister Khurelsukh and his cabinet resigned following protests sparked by viral video footage showing a COVID patient and her newborn baby being asked to leave a maternity hospital at night without proper clothing to withstand the harsh winter conditions.

While Mongolia has been relatively successful in controlling the pandemic, with only 1,710 cumulative cases and 2 fatalities, this event sparked protests due to a prolonged strict lockdown period, inadequate compensation for people who work in the service sector and lost their jobs, and a ban on border traffic. While the number of protestors was limited, they demanded the resignations of the health minister and deputy prime minister.

Surprisingly, given the small scale of the protests, this led to an acceptance of responsibility by the PM Khurelsukh himself. Some analysts have interpreted this as a move by Khurelsukh to use this opportunity to resign, strengthen his image as a politician responsive to public demands, and position himself as a candidate for the upcoming presidential election in June 2021.

We do not think the cabinet’s resignation will lead to significant policy changes as the new cabinet should also act within the general framework established by the Mongolian People’s Party (MPP), which won the general election in June 2020 by a landslide for the 2nd time. Ironically, this victory was thanks to a successful handling of the pandemic and actions taken to improve air quality in Ulaanbaatar. Following Khurelsukh’s resignation, the MPP nominated as PM [Oyun-Erdene](#), a Western educated and leading young politician who had been the chief cabinet secretary since 2019.

INVESTMENT STRATEGY

Impera Mongolia invests in both listed equities and real estate in Mongolia, apportioned approximately 50/50, at cost. It owns equity stakes in some of the most promising companies listed on the Mongolia Stock Exchange and owns c.6,000 sqm of retail space built on c.5,000 sqm of land located in Central Ulaanbaatar, concentrated in two properties; Marketplace and Blue Bazaar.

PERFORMANCE

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2Q20	3Q20	4Q20	Nov'20	Dec'20	Jan'21	YTD***	ITD ***
NAV*	1,024.3	993.8	972.5	1,030.0	695.1	923.4	797.8	618.5	567.1	539.9	548.3	567.1	546.3	567.1	590.5		
Perf.	2.4%	-3.0%	-2.1%	5.9%	-32.5%	32.8%	-13.6%	-22.5%	-8.3%	2.6%	1.5%	3.4%	-0.3%	3.8%	4.1%	4.1%	-41.0%
Perf.(adj) **	2.1%	-2.6%	-2.1%	5.5%	-32.2%	32.8%	-13.6%	-22.5%	-8.3%	2.6%	1.5%	3.4%	-0.3%	3.8%	4.1%	4.1%	-41.0%
MNT/USD	1,391	1,663	1,889	1,993	2,487	2,427	2,639	2,718	2,850	2,816	2,852	2,850	2,849	2,850	2,850		
MNT Chg.	0.3%	-16.4%	-11.9%	-5.2%	-19.9%	2.5%	-8.0%	-2.9%	-4.6%	-1.7%	-1.3%	0.1%	-0.2%	0.0%	0.0%	0.0%	-51.1%
MSE20	-18.8%	-7.4%	-9.1%	-13.0%	-3.4%	66.5%	3.4%	-8.5%	-1.7%	-4.1%	8.2%	10.0%	1.5%	9.2%	11.7%	11.7%	-0.7%
MSE20 \$	-18.6%	-22.6%	-19.9%	-17.6%	-22.6%	70.6%	-4.9%	-11.2%	-6.3%	-5.8%	6.8%	10.1%	1.2%	9.1%	11.7%	11.7%	-51.4%
MSCI Fron.^	8.9%	25.9%	6.8%	-14.5%	2.7%	27.7%	-19.1%	13.5%	-2.4%	13.4%	7.4%	10.9%	4.0%	5.6%	-0.8%	-0.8%	21.4%

* Start NAV is 1000 at Dec 2011. Investors joining on other dates, making additional contributions, may have different returns.
NAV excludes carried interest (CI). ** "Perf. adj" takes into account carried interest accrual, *** Year-To-Date (2020), Inception-To-Date
Data in italics are Impera Capital Estimates and are subject to change. ^ to 28-Jan

HOLDINGS SUMMARY

	Sector	Description	MCap USDm	P / E 'TTM	Yield '19	Position Size		
						% Co.	% NAV	
Top 5 Equity Positions							45.9%	
Gobi	Cashmere, Retail	Dominant, 80% of mkt.	60	n/m	0.0%	2.5%	23.1%	
APU	Beverages	Dominant Beverage Co.	232	7.2	11.4%	0.3%	9.3%	
SUU	Milk	Largest Milk Co., 50% of mkt.	24	19.6	2.5%	1.4%	5.3%	
Mongolia Mining	Metallurgical Coal	Leading Private Sector Producer	226	4.3	0.0%	0.1%	4.3%	
Talkh Chikher	Bread / Biscuits	50% of bread mkt.	5.6	6.3	1.5%	4.6%	3.9%	
Other Equity Positions (12)							13.8%	
Net Debt Equities							-3.0%	
Total Net Equity Positions							56.6%	
	Built Up Area sqm	Description	NAV ** USD k	NAV /SqM ***	Yield /NAV	Position Size		
						% Asset	% NAV	
Covered Markets		5,355	2,913	544	6.6%	89.7%	44.1%	
"Marketplace"	3,755	Market on 3,330 sqm land	2,085	619	6.0%	89.7%	31.5%	
"Blue Bazaar"	1,600	Market on 2,330 sqm land	828	577	8.2%	89.7%	12.5%	
Retail Units	596	5 units	696	1,167	8.7%	100.0%	10.5%	
Residential Units	165	2 units	115	697	2.6%	100.0%	1.7%	
Net Debt Real Estate							-10.0%	
Total Real Estate Net of Debt							46.3%	
Other Assets Net of Other Liabilities							-2.9%	
Total							100.0%	

SUMMARY TERMS AND SERVICE PROVIDERS

Size:	USD 6.6 million (closed since end 2013)	Jurisdiction / Form:	Lebanon / Offshore company
Type / Life:	Private equity structure / 10 years to end 2021	Auditor:	Grant Thornton
Management / Performance Fees:	1.00% per annum / 15% Carried Interest	Administrator:	Apex Fund Services
Contact Details:	philip.khoury@imperacapital.com or gamze.alpar@imperacapital.com	Lawyers:	Aboulsleiman & Partners, Lebanon

DISCLAIMER This Newsletter is not intended as an offer or solicitation with respect to the purchase or sale of any security. No such offer or solicitation will be made prior to the delivery of the Offering Documents. Before making an investment decision, potential investors should review the Offering Documents and inform themselves as to the legal requirements and tax consequences within the countries of their citizenship, residence, domicile and place of business with respect to the acquisition, holding or disposal of shares, and any foreign exchange restrictions that may be relevant thereto. This newsletter is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law and regulation, and is intended solely for the use of the person to whom it is intended and may not be reproduced or distributed to any other person. The information and opinions contained in this Newsletter have been compiled from or arrived at in good faith from sources deemed reliable. Opinions expressed are current as of the date appearing in this Newsletter only. Neither Impera Capital Ltd, nor any of its subsidiaries or affiliates or parent company will make any representation or warranty to the accuracy or completeness of the information contained herein. Past results are not necessarily indicative of future performance.