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### **Mongolia Growth Group Ltd.**

is a holding company owning subsidiaries engaged in the businesses of real estate leasing, and property and casualty insurance. The company’s real estate holdings are held in various limited liability companies in Mongolia. The company’s insurance subsidiary is licensed in Mongolia to underwrite retail and commercial lines of business, under the name Mandal General Daatgal LLC.

Operational decisions for MGG subsidiary businesses are made by managers at each business unit. Investment and capital allocation decisions are made by Mongolia Growth Group’s CEO, Harris Kupperman, in consultation with the holding company’s management and board of directors.

# Mongolia Growth Group

## To The Shareholders of Mongolia Growth Group;

2012 was another successful year for your company. In the two years since present management took control of the company, we have;

- Redirected the company's strategy towards the rapidly growing economy of Mongolia
- Crystallized our strategy to focus on property and insurance
- Grown from two employees to 98 today
- Raised CDN \$51.5 million to pursue our investment objectives
- Laid the groundwork for substantial growth in future years.

As we look forward to our third year in business, we see our strategy continually evolving.

Prices in Ulaanbaatar property have increased significantly over the past two years. These increases in prices have substantially lowered the long-term investment return potential of many existing structures. Much more importantly to us, we find that much of the existing construction is of a poor quality, especially the assets offered for sale. We feel strongly that we can build better, safer, and more aesthetically pleasing buildings if we were to dedicate resources to it. Jordan and I are conservative investors, we intend to start slowly, rather than rushing off into construction—however, we see it as almost inevitable that if we are going to grow this company intelligently, we will have to own top quality buildings. Fortunately, we have spent considerable capital purchasing older structures that are strategically situated in areas that make them ideal for redevelopment. We currently have four such redevelopment sites in the heart of downtown. While these sites yield negligible revenues today, we didn't purchase them based on the current yields.

When we could still buy office buildings for only a few hundred dollars per meter over the cost of building them, they represented great value. Now, building new structures offers the best value. We intend to spend the remainder of 2013 building our internal team, acquiring the necessary permits, and seeking joint venture partners so that we can begin constructing our first structure in 2014. At the same time, we continue to search out development sites that we can transform in the future. Given the very small footprint of downtown Ulaanbaatar (three square kilometers and very few through streets), these sites are extremely rare and that means that our existing four sites are quite unique.

From a corporate governance standpoint, we have made a promise to provide you with absolute transparency and confidence that our numbers are accurate. PWC completed our audit again, and Cushman & Wakefield completed our year-end independent property valuation report. Using these two world-class firms has substantially increased our operating costs. We find this to be an unfortunate but necessary expense. I hope that you will agree. As always, management is committed to doing everything in a manner that is as shareholder friendly as possible.

Outside of these two sizable expenses, we have done everything possible to keep our costs down. I should point out that neither Jordan, I, nor any of our board members receive cash compensation for their time. We are here because of our investment in MGG, not because of our desire for a job.

The only negative that I can point out is that we have struggled to achieve positive cash flow.

There are various factors for this and they include; sizable expenses related to our infrastructure build-out, substantial expenses to upgrade our stock exchange listing to the TSX Venture exchange, sizable costs at the corporate level that are needed to support a public company, substantial non-recurring legal and accounting fees, marketing expense at Mandal to support its rapid growth, and a general focus on property assets with exposure to the growing Mongolian GDP at the expense of current cash flow. In summary, we have the fixed expenses of a company that has many times our current property assets. As we continue to add to our portfolio, our expenses are not expected to increase substantially from current run-rates. This should eventually translate into positive cash flow. I would like to remind all shareholders that we run this business with the view of maximizing value creation over long periods of time. Often, this means that we are focused on investments that have minimal cash flow today, but will be highly valuable in the future. That said, we always want to be at least moderately cash flow positive and we have set that as a goal for 2013. We also feel that in time our shareholders will see the fruits of our labor, through materialized value creation.

In summary, we have high expectations for 2013 and hope that you are impressed with our accomplishments in 2012. I want to finish by thanking everyone who has helped to make this company so successful.

Sincerely,

A handwritten signature in black ink, appearing to read 'H. Kupperman', written in a cursive style.

Harris Kupperman

# MONGOLIA GROWTH GROUP LTD.

## Management Discussion & Analysis December 31, 2012

The management of Mongolia Growth Group Ltd. (“MGG” or “the Company”) presents the Company’s management discussion and analysis for the year ended December 31, 2012 (the “MD&A”), compared with the year ended December 31, 2011. As of January 1, 2011, the Company adopted International Financial Reporting Standards (“IFRS”). This MD&A provides an overall discussion, followed by analyses of the performance of the Company’s major reportable segments. The reporting and presentation currency in the consolidated financial statements and in this discussion and analysis is the Canadian dollar, unless otherwise noted.

This MD&A is dated April 30, 2013 and incorporates all relevant information and considerations to that date.

*The following discussion and analysis should be read in conjunction with the audited consolidated financial statements of the Company for the year ended December 31, 2012 and December 31, 2011 together with all of the notes, risk factors and information contained therein, available on SEDAR at [www.sedar.com](http://www.sedar.com).*

### Non-IFRS Financial Measures

This MD&A makes reference to earnings before interest, taxes, depreciation and amortization (“EBITDA”) and book value per share. MGG uses EBITDA as a measure of the performance of its operating subsidiaries as it excludes depreciation and interest charges, which are a function of the company’s specific capital structure, and also excludes entity specific tax expense. MGG uses book value per share as a measure of the performance of the Company as a whole. Book value per share is measured by dividing shareholders’ equity at the date of the statement of financial position by the number of common shares of the Company (“Common Shares”) outstanding at that date. MGG’s method of determining these amounts may differ from other companies’ methods and, accordingly, these amounts may not be comparable to measures used by other companies. These amounts are not performance measures as defined under IFRS and should not be considered either in isolation of, or as a substitute for, net earnings prepared in accordance with IFRS. The Company refers to “funds used in operations”, “operating losses” and “re-valuation of investment properties” within this analysis. “Funds used in operations” is computed by calculating the cash flow from operations before changes to non-cash working capital from operations.

### Forward Looking Statements

This MD&A contains forward-looking statements relating to future events. In some cases, forward-looking statements can be identified by words such as “anticipate”, “continue”, “estimate”, “expect”, “forecast”, “may”, “will”, “project”, “should”, “believe”, or similar expressions. These statements represent management’s best projections but undue reliance should not be placed upon them as they are derived from numerous assumptions. These assumptions are subject to known and unknown risks and uncertainties, including the “Risks and Uncertainties” as discussed herein. Actual performance and financial results will differ from any projections of future performance or results expressed or implied by such forward looking statements and the difference may be material.

Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted. From time to time, the Company’s management may make estimates and have opinions that form the basis for the forward-looking statements. The Company assumes no obligation to update such statements if circumstances, management’s estimates or opinions change.

## Overall Performance

Mongolia Growth Group Ltd. is a Canadian holding company that invests in both the real estate and financial services industries in Mongolia. MGG is presently engaged in the business of: (i) the ownership of retail, office and residential investment properties; (ii) the management of investment properties; (iii) the repair, construction and development of investment properties; (iv) the underwriting of property and casualty insurance risks; and (v) the sales of property and casualty insurance.

## Property

In all its investment property operations, MGG strives to provide the highest quality locations to tenants, which augments their accommodations, business sales or office environment. MGG's strategy is to acquire the best-located properties in Ulaanbaatar, to repair and redevelop as needed, then to lease the properties to the tenant which benefits most from their location and quality.

The Company's property portfolio has grown through acquisition and to a lesser extent, through additions of space via construction. As new footage is integrated into the MGG model, the Company's ability to offer a unique product, multi-unit retail platforms, or large format office space has led to relationships with some of the largest businesses operating in Mongolia. The Company believes that by working with such successful firms, it will add value to the local firms which will benefit from such unique offerings and will lead to excess profitability to the company, vis-à-vis above market rental net yields.

As the Mongolian consumer has benefited from an increase in gross and disposable income, the tenancies of the Company's investment properties have been able to support increased rents. This market improvement in the rental business has supported company results as most re-let properties have seen double-digit increases in rents and overtime, a commensurate increase in property value.

The general property market continues to be influenced by improvement in the overall Mongolian economy. During 2012, moves by the Mongolian Central Bank to raise interest rates and reserve requirements amongst banks led to a slowdown in terms of overall price appreciation. This has led to increases in capitalization rates as rental rates have continued to increase. Management feels that during the first half of 2012, property prices increased substantially in price. The third quarter of 2012 showed no noticeable increase in property prices, while the fourth quarter showed a significant decline in prices due to liquidity issues in the marketplace. Subsequent to the year-end, the Mongolian Central Bank lowered interest rates which resulted in increases in property prices in early 2013, and as of today, prices in land, land-like assets and downtown soviet apartments are at or above prices seen at the peak in the early summer of 2012. Prices in other markets are still below 2012 peak prices. Management cautions shareholders that property prices have historically been, and continue to be, very volatile. With the June Presidential election looming, as well as other unknown events that may arise, additional volatility is highly probable.

The Company believes that increases in nominal gross domestic product will lead to further increases in both the rental rates and valuations of properties in Mongolia. MGG's property division should benefit from such increases in nominal gross domestic product due to the operational leverage inherent in a property business with relatively fixed operating costs. It is expected that the majority of the organic growth in the revenue of the property division going forward should accrue to the Company's bottom line due to such embedded operating leverage.

## Insurance

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

insurance experience in both Mongolia and abroad. The sales process for the insurance company is longer term in nature. Retail sales continue to substantially lag corporate sales, which are much larger in nature and are infrequent in occurrence.

As the Mongolian consumer and business market becomes larger and more understanding of the inherent benefits of insurance, the market is expected to grow substantially. According to the Financial Regulatory Commission (“FRC”), over the past five years, nationwide underwriting has grown at over 20% per annum. Due to the small nature of the insurance market, and the newness of our insurance subsidiary as an entrant in the market, the insurance subsidiary’s primary focus has been on business systems development, product development, brand awareness and marketing.

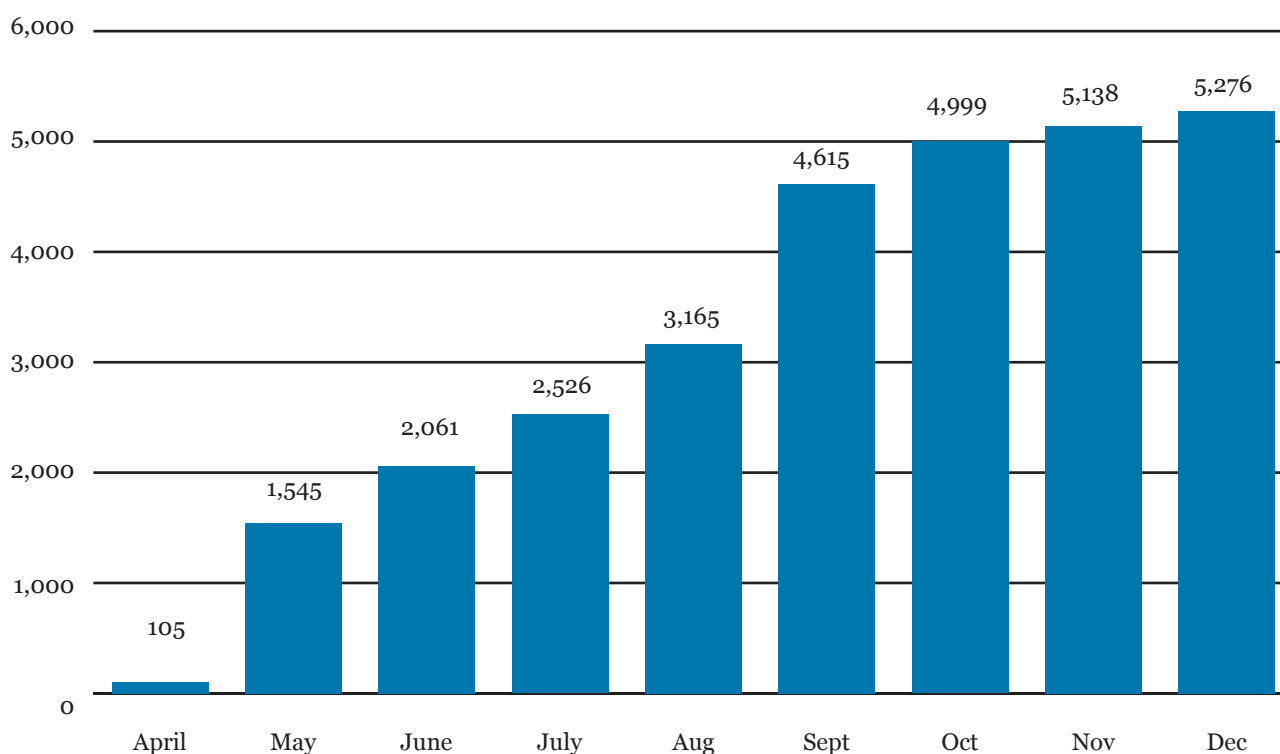
Similar to the foundation of the Company’s property business, Mandal has hired staff and incurred expenses that lead to a high level of operational leverage. Many divisions of the insurance operation would not be required to expend further resources even given a substantial increase in premiums written.

Mandal entered new lines of underwriting in 2012, many of which performed to management’s expectations. Underperforming was a financial product line of coverage, primarily comprised of one loss mitigation policy with a large National Mongolian firm. The one line of business incurred a loss ratio of 720% for the 2012 calendar year, mainly due to incurred losses in Q4 2012 being materially more than management expected. The original policy provided for certain recoveries which were not closed by year end, and as such were not accounted for. Since December 31st 2012, Mandal has achieved recoveries on the policy, as well as signed a new revised contract with the insured that is behaving more to management’s original expectations, due to claims caps and certain other loss mitigation parameters.

According to statistics produced by FRC, at the end of December 2012, Mandal represents 15.5%, 6.8%, 3.8% and 2.5% of the total equity capital, assets, gross premiums and net premiums of the Mongolian Insurance Market. This is an increase from 14.5%, 8.3%, 0.9% and 0.9% respectively at calendar year end 2011.

Mandal continues to have marketing successes, particularly in mandatory driver’s liability where the total policy count has now grown to 5,276 policies as of the end of December 2012.

## Mandal Insurance Cumulative Auto Policies Sold in 2012



## Economic Outlook

Both markets that the Company operates in, the real estate and insurance industries, have benefited from the significant economic growth achieved in Mongolia over the last few years. The majority of this recent growth is attributable to the mining and construction boom taking place in Mongolia, mainly resulting from the opening of the Oyu Tolgoi and Tavan Tolgoi deposits located in the Gobi desert. The associated infrastructure requirements for these projects have also served to strengthen the local economy. The positive impact of improving consumer and business confidence has further led to a substantive increase in the gross production of the local economy. Uncertainties due to the recent parliament election, the presidential election taking place this summer, as well as a dynamic legal environment for mining concerns and foreign investment has led to recent stress in both the local mining industry, and the local banking sector. These stresses have created a decrease in the rate at which the Mongolian economy has grown, but in spite of the decrease, the local economy still appears and quite strong. Recent metrics relating to increases in disposable income and unemployment are particularly indicative of a robust and dynamic local economy.

Given the current lack of sufficient real estate space for domestic and international tenants, and the insurance underwriting capacity within the insurance industry in Mongolia, there is room for much further expansion in the amount of business to be done in both industries, and likely increases in the profitability of these industries.

In 2012, the Mongolian government raised \$1.5 billion at interest rates of 4.125% for \$0.5 billion and 5.125% for \$1.0 billion. This money is now filtering into the economy as the government chooses various programs to finance. The Mongolian economy has been starved of capital. \$1.5 billion of low cost capital being injected into what was in 2012 a \$9.96 billion GDP economy, has gone a long way into decreasing the nation's cost of capital, as well as alleviating some of the stress of a decline in mining and FDI.

According to the National Statistics Office, residential property prices in downtown Ulaanbaatar have increased fairly significantly over the past couple of years, depending on the district and year of construction. Management believes that since the inception of the property Companies, its portfolio of assets has likely increased at a more rapid rate due to the attractive positioning of most assets on the primary streets of downtown. Meanwhile, the shortage of high quality development sites has led to an even more rapid increase in the value of well-located sites.

## Risks and Uncertainties

The Company, as part of its operations, carries financial instruments consisting of cash and cash equivalents, investments and marketable securities, accounts receivable, and trade payables and accrued liabilities. It is Management's opinion that the Company is not exposed to significant credit, interest or currency risks arising from these financial instruments except as otherwise disclosed in the notes to the consolidated financial statements.

Certain members of parliament have recently asked to re-negotiate the agreement that exists between the government and Turquoise Hill regarding the current tax and stability agreement. There can be no certainty if any changes to the agreement will be reached and how it will impact the investment climate or future GDP growth of Mongolia.

During the last year the Company has purchased apartment units in a knowingly condemned building with the intent that through control of the homeowner's association the Company can procure a lease on the land underlying the building. The process of exerting control over a homeowner's association in order to develop the underlying land-plot is an extensive legal process, is complicated, lacks precedent and is a generally risky proposition. The total investment at cost in this apartment building at December 31, 2012 was \$4,161,845. The company currently owns 50 of the 51 apartments in the building, has an agreement with the last owner to exchange his unit for space in any future building and has applied to the city for the land use permissions.



Further information related to Mongolia Growth Group Ltd. and the risks and uncertainties of MGG is filed on the System for Electronic Document Analysis and Retrieval (“SEDAR”) and can be reviewed at [www.sedar.com](http://www.sedar.com). A comprehensive set of risk disclosures are included in the Company’s most recently filed annual MD&A.

## Selected Annual Financial Information

	Year ended December 31 2012	Year ended December 31 2011	Year ended December 31 2010
	\$	\$	\$
<b>Revenue</b>			
Revenue and other income	2,237,694	589,311	1,385
<b>Income</b>			
Income (loss) from continuing operations attributable to equity holders of the Company	(6,073,750)	1,349,153	(247,846)
Net Income (loss) attributable to equity holders of the Company	(6,073,750)	1,349,153	(247,846)
Comprehensive income (loss) attributable to equity holders of the Company	(7,360,920)	107,716	(247,846)
<b>Basic earnings per share (“EPS”)</b>			
Earnings (loss) from continuing operations	(0.18)	0.06	(0.10)
Net income (loss)	(0.18)	0.06	(0.10)
<b>Diluted EPS</b>			
Earnings (loss) from continuing operations	(0.18)	0.05	(0.10)
Net Income (loss)	(0.18)	0.05	(0.10)
<b>Balance Sheet</b>			
Total Assets	51,306,531	55,336,889	156,847
Financial liabilities	4,002,971	2,040,129	9,677
Total Equity	47,303,560	53,296,760	147,170
Shares Outstanding at year end	34,143,352	34,143,352	2,964,300
Book Value per share	1.39	1.56	.05

## Results of Operations

As of December 31, 2012, MGG’s operations continued to focus on the rapid growth of the Mongolian economy. As part of its corporate strategy of aggressive growth, the Company has continued to purchase rentable property, repair and expand existing properties, lease available properties and sell property and casualty insurance.

Refer to Note 21 of the interim financial statements of the Company for a table of segmented information.

## *Revenues*

MGG's consolidated revenues for the year ended in December 31, 2012 increased to \$2,237,694 from \$589,311 during the year ended December 31, 2011. The majority of the increase in revenue is attributable to having a full year of operations in 2012 whereas 2011 the Company was in a start-up phase of business and did not have the same pool of rentable investment property in the property company for the entire year, and the insurance company only started to write policies in the fourth quarter of 2011 whereas it had a full year in 2012.

The Company's investment property business contributed the majority of the revenue for the year ended December 31, 2012 with rental income of \$1,572,603 compared to \$495,242 during the year ended December 31, 2011. As well, related to investment properties, for the full year, the Company realized a gain of \$12,768 on the disposal of investment properties which were classified as held for sale. There were no properties disposed of for the year ending 2011.

The Company's insurance business contributed \$628,424 of net premiums earned in 2012, compared to \$77,786 of net premiums earned in 2011. The insurance business did not begin selling policies until the fourth quarter of 2011.

The Company also earned \$863,313 (2011 – loss of \$344,246) of net investment income on a consolidated basis in 2012. The Company's property business earned \$282,114 (2011 – \$32,796), while the Company's insurance business earned \$574,454 (2011 – \$247,470) and the Company's corporate division earned \$6,745 (2011- loss of \$624,512).

## *Expenses*

Total expenses for the year 2012 increased to \$6,455,865 from \$3,809,334 during 2011. The increases in expenses for the year is mainly attributed to operating expenses which have increased due to increases in operations and general expenses related to the growth of the business.

In 2012, the insurance business incurred the largest share of these expenses totaling \$2,330,648 (2011 - \$1,668,561). The investment property business incurred expenses of \$2,034,674 (2011 - \$1,066,682) while the corporate division incurred expenses of \$2,090,543 (2011 - \$1,074,091).

Salaries and wages were up significantly across all divisions in 2012 as the Company's total number of employees roughly doubled from the previous years ending employee count. In 2011, the Company was in its infancy and thus had very few employees throughout most of the year. As well, with the growth in the Mongolian economy we expect to see a continual increase in this figure as wages across the country continue to climb and the standard of living improves.

Share based payments decreased from \$1,798,603 in 2011 to \$1,367,720 in 2012. This decrease is mainly attributable to 500,000 consultant options which were issued and expensed fully in 2011.

Professional fees totalled \$1,293,477 in 2012, up from \$492,953 in 2011. This increase is attributable to increases in legal expenses, audit expenses and various other professional fees including property valuation fees. A substantial portion of this increase incurred as a result of the Company's application to list its common shares on the TSX Venture Exchange (TSXV). These listing expenses are not expected to reoccur.

## *Operating Profit (Loss)*

The property business of MGG generated an Operating or EBITDA loss before the fair value adjustment on investment properties of \$341,746 during the year of 2012 (2011 – loss of \$523,511). Included in these loss calculations are share based payment expenses of \$643,857 in 2012 and \$290,800 in 2011 which significantly impact the EBITDA number. Without these share based payment expenses the property business would show a gain of \$302,111 in 2012 and a loss of only \$232,711 in 2011. The decrease in the EBITDA loss in 2012 is the result of increased rental revenue offset by an

increase in expenses associated with building a property management team, along with increased property taxes and insurance expenses associated with a larger portfolio. The Company incurred a small gain of \$12,768 (2011 - nil) on the disposal of investment properties. In addition, this division had added expenses related to due diligence on property assets that were not acquired, certain pre-development expenses that were not capitalized related to future property developments and employee education and training activities that have no offsetting revenue impact. In addition, the property business reported net investment income of \$282,114 in the year of 2012 (2011 - \$32,796).

MGG's insurance business generated an Operating or EBITDA loss of \$1,624,616 during the year of 2012 (2011 - loss of \$1,579,031). Included in these loss calculations are share based payment expenses of \$253,168 in 2012 and \$1,087,493 in 2011 which significantly impact the EBITDA number. Without these share based payment expenses the insurance business would have a loss of \$1,371,448 in 2012 and \$491,538 in 2011. In addition the insurance company reported investment income of \$574,454 for the year of 2012 (2011 - \$247,470). The majority of this is due to an increase in net premiums earned and continuing investment income offset by sizable marketing expenses associated with building the Mandal brand.

The Company's corporate overhead contributed to an Operating or EBITDA loss of \$2,080,919 during 2012 (2011 - loss of \$1,071,184). Included in these loss calculations are share based payment expenses of \$470,695 in 2012 and \$420,310 in 2011 which significantly impact the EBITDA number. Without these share based payment expenses the loss at corporate would be \$1,610,224 in 2012 and \$650,874 in 2011. The majority of this loss was incurred for legal and audit expenses and other corporate expenses associated with the general corporate activity of the Company. In addition, the Company had very substantial expenses related to changing the Company's listing from the Canadian National Stock Exchange to the TSX Venture Exchange Listing. These listing expenses are not expected to reoccur.

In total, the Company's divisions reported an Operating or EBITDA loss, before the fair value adjustment on investment properties, of \$4,047,281 during the 2012 (2011 - loss of \$3,173,726). Included in these loss calculations are share based payment expenses of \$1,367,720 in 2012 and \$1,798,603 in 2011 which significantly impact the EBITDA number. Without these share based payment expenses the loss in the consolidated Company would be \$2,679,561 in 2012 and \$1,375,123 in 2011. In addition the Company reported net investment income of \$863,313 (2011 - loss of \$344,246) during the year.

### *Fair Value Changes in Investment Property and Financial Assets*

As the Company incurred no impairments to its December 31, 2012 investment and marketable securities portfolio fair value changes were only recognized with respect to MGG's investment property portfolio. The Company had 61% of its investment property portfolio valued by an external independent valuation professional who is deemed to be a qualified appraiser holding a recognized, relevant, professional qualification and who has recent experience in the locations and categories of the investment properties valued. The remainder of the investment property portfolio was valued by management.

The properties owned by the Company are classified into three categories in the Company's 2012 consolidated financial statements; property and equipment, other assets and investment properties.

Properties that are used by the Company in the course of business are currently accounted for as property and equipment. These properties did not experience a fair value adjustment and are also subject to depreciation expense. At the end of 2012, the Company had six properties classified as property and equipment with a net book value of \$4,130,719 (2011 - \$4,223,568). Furthermore, four properties were presented as "other assets - prepaid deposits on investment properties" in the 2012 Consolidated Financial Statements - Note 7. Prepaid deposits on investment properties totalled \$1,626,240 in 2012 (2011 - nil). These four properties were fully paid, however the Company has not yet received the new titles for these properties. While these properties were each valued by a qualified appraiser, these properties were presented at the lower of cost or market resulting in an impairment provision of \$1,206,876 reflected in the unrealized gain (loss) on fair value adjustment on investment properties. The remainder of the properties were

classified as investment properties. As of December 31, 2012, investment properties had an aggregate fair value of \$ 30,786,742 (2011 - \$26,166,286). Over the course of 2012, the Company added properties at a cost base of \$8,190,935 and disposed of 20 properties for gross proceeds of \$1,656,768 which resulted in a gain of \$12,768.

Additionally one property package included in investment properties was valued at the lower of cost or market. This property consisted of the 50 apartment units described in the “Risks and Uncertainties” section. The properties were purchased with the intent that through control of the homeowner’s association, the Company can procure a lease on the land underlying the building. Management believes that valuing these properties at cost is the most conservative method of valuation as a piece of land of that size and location is extremely rare but as it is considered a redevelopment property, it is measured at cost until the earlier of the date of construction or the date at which the fair value becomes reliably measured as to be in accordance with IFRS.

Management believes that certain properties that are currently classified as property and equipment and other assets – prepaid investment property could be sold for substantially more than their carrying value if they were sold at year end market values. Management anticipates that these assets along with the investment property portfolio will continue to increase in value in the future.

The majority of the Company’s investment and marketable securities portfolio is held in non-market quoted assets which are held in callable short-term and mid-term paper of investment grade financial institutions in Mongolia. These investments are held within the Company’s insurance subsidiary and are held due to the statutory requirements of the subsidiary’s primary regulator, FRC.

### *Net Income*

For the year ended December 31, 2012, the Company incurred a net loss of \$6,073,750, compared to net income of \$1,349,153 for the year ended December 31, 2011. This year’s unfavourable result is primarily attributed to the unrealized loss on fair value adjustment on investment properties of \$2,697,212 compared to a \$5,740,919 unrealized gain in 2011. In addition, the Company recorded a significant expense for share based payments of \$1,367,720 (2011 - \$1,798,603). Finally, the Company, incurred claims and insurance benefits expenses of \$1,042,387 at Mandal. A large portion of this reserve number relates to a contract related to customer delinquencies which has experienced unusually bad results during the first months of its existence. Management is hopeful that as this product matures, losses will moderate.

Management cautions investors that property portfolio losses and stock option expenses are non-cash accounting entries caused by a decrease in the fair value of the Company’s investment portfolio and accruals for share based payments.

MGG’s property division has continued to produce positive operating cash flow; however this is insufficient to cover corporate expenses and insurance expenses. Management anticipates that this cash flow will continue to increase in future quarters as vacant properties become occupied, rents are renewed at higher rates, and expenses remain fairly constant in the property division.

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

### **Summary of Quarterly Results**

The following table provides selected financial information for the eight most recently completed quarters.

## Quarterly Consolidated Financial Information In Dollars

	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011
Revenue	618,435	577,905	571,472	469,882	360,914	186,134	42,263	0
Net income (loss)	(4,488,408)	(446,069)	(494,782)	(644,491)	2,794,533	(820,149)	(485,585)	(139,646)
Income (loss) per common share	(0.13)	(0.01)	(0.02)	(0.02)	0.11	(0.03)	(0.02)	0.00
Total Assets	51,306,531	52,048,976	56,058,108	55,783,296	55,336,889	36,439,544	36,250,423	10,353,848
Weighted Average Shares	34,143,352	34,143,352	34,143,352	34,143,352	23,902,851	21,814,422	16,617,951	10,184,185
Ending Shares	34,143,352	34,143,352	34,143,352	34,143,352	34,143,352	30,297,168	30,297,198	14,167,571

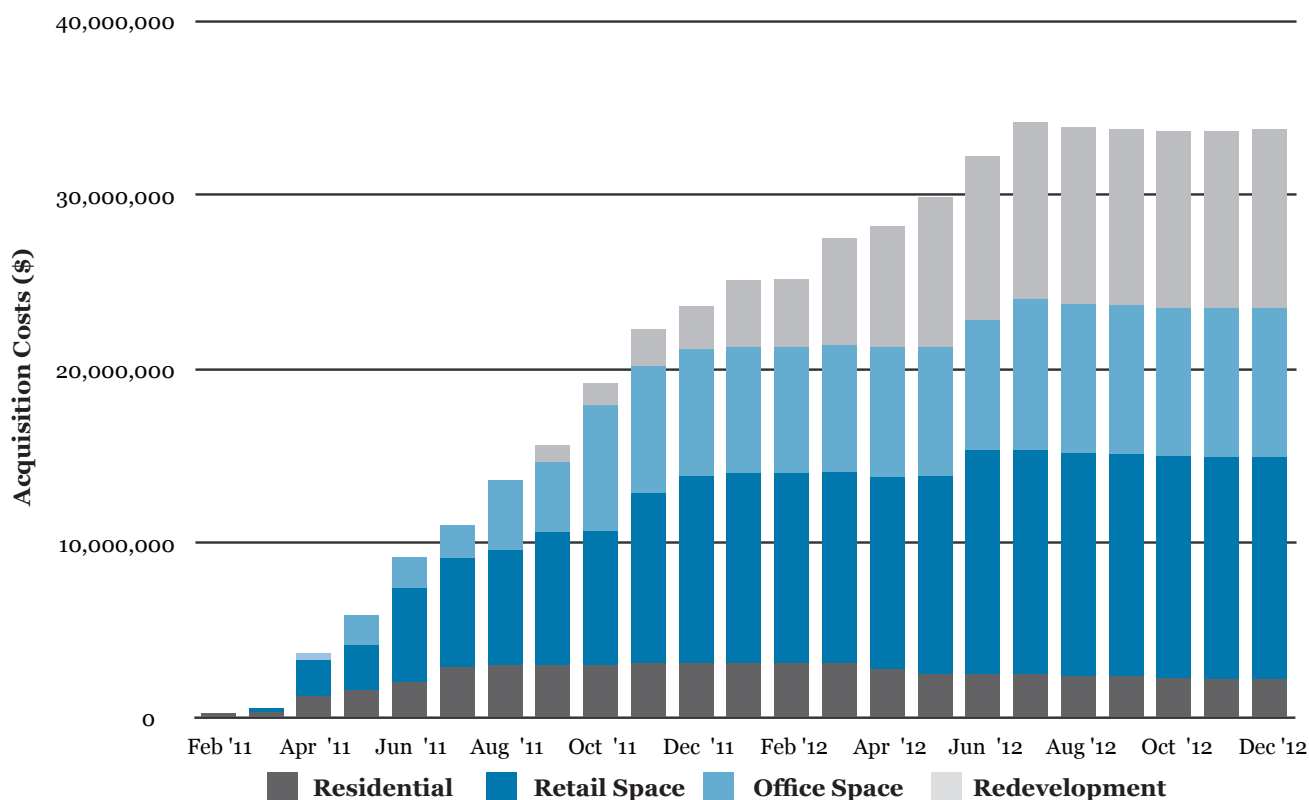
MGG's revenue continued to grow during 2012 with consolidated revenue and net investment income increasing to \$618,435 in the fourth quarter of 2012 compared to the fourth quarter of 2011 consolidated revenue and net investment income of \$360,914, an increase of 71%. The increase in revenues has been offset by an increase in expenses and a fair value loss adjustment on investment properties in the fourth quarter of 2012.

### Property

During the fourth quarter of 2012, MGG's property subsidiary earned rental income of \$397,810 compared to rental income of \$266,845 in the fourth quarter of 2011, an increase of 49%. This increase is the result of the addition of properties to the investment portfolio and increases in rental prices offset by an increase in commercial properties being renovated, certain property revenues related to Mandal being eliminated on consolidation and the sale of certain residential units.

During the quarter, the property subsidiary was subject to a \$2,697,212 unrealized loss on fair value adjustment on investment properties compared to a \$5,740,919 unrealized gain during the Q4 2011.

### MGG Property Acquisition Chart



Acquisition Costs were translated from Mongolian Tögrög into Canadian dollars at the December 31, 2012 rate of 1383.57

## Insurance

The fourth quarter of 2012 represents the Company's fifth complete quarter of operations since policies were approved by FRC. During the fourth quarter, MGG's insurance subsidiary earned net premiums of \$330,734, compared to net earned premiums of \$77,786 in the fourth quarter of 2011, an increase of 325%. This increase is attributable to having a full year of operations in 2012 versus only one quarter in 2011.

The insurance subsidiary has spent aggressively to develop the Mandal brand name through marketing and advertising. The Company expects this marketing spending to increase nominally in the future, but decline relative to premiums written. The management team at Mandal continues to explore ways to leverage marketing spend through creative partnerships.

Similar to the foundation of the Company's property business, Mandal has hired staff and incurred expenses that lead to a high level of operational leverage. Many divisions of the insurance operation would not be required to expend further resources even given a substantial increase in premiums written. As expected, the largest expense within the insurance business is reserving. During 2012, claims and reserves amounted to \$1,042,387 compared to \$51,591 in 2011.

## Liquidity

As at December 31, 2012, MGG had working capital of \$12,554,733 (2011 - \$21,059,481) comprised of cash and cash equivalents, investments and marketable securities, other assets, reinsurance assets, deferred acquisition expenses, net of trade payable and accrued liabilities, income taxes payable and insurance contract liabilities. Management considers the funds on hand to be sufficient to meet its ongoing obligations.

## Related Party Transactions

Related party transactions for fiscal 2012 were as follows:

For the year ending December 31, 2012, Mandal General Insurance paid \$122,528 (2011 – nil) to property subsidiaries of MGG, as payment for their office rental and a retail outlet. Also for the year ended December 31, 2012, the Company's various property subsidiaries paid a total of \$25,856 to Mandal General Insurance for insurance coverage on MGG's portfolio of investment properties along with various auto insurances. 90% of the property related risks associated to these coverages were ceded to an A.M. Best A+ rated German re-insurer and 9% were ceded to a well-rated direct lines insurer in China. These related party transactions are not expressed in segmented reporting of either the insurance business or the property business as both the revenue and expenses associated to them are eliminated upon consolidation.

## Critical Accounting Estimates

The preparation of financial statements in accordance with IFRS required management to make assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated based on historical experiences and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

The critical estimates made in the preparation of the consolidated financial statements include the following:

- Fair value of investment properties - The estimate of fair value of investment properties is the most critical accounting estimate to the Company. An external appraiser estimates the fair value of investment properties annually. The fair value of investment properties is based on the nature, location and condition of the specific asset. The fair value of



investment properties represents an estimate of the price that would be made in an arm's length transaction between knowledgeable, willing parties. The Company operates in the emerging real estate market of Mongolia, which given its current economic and industry conditions, has an increased inherent risk given the lack of reliable and comparable market information. At December 31, 2012, the unrealized fair value adjustment was a loss of \$2,697,212 (2011 – gain of \$5,740,919).

- Valuation of insurance contract liabilities - The estimate of the ultimate liability arising from claims made under insurance contracts is another critical accounting estimate. There are several sources of uncertainty that need to be considered in the estimate of the liability that the Company will ultimately pay for such claims. The ultimate cost of claims liabilities is estimated by using a range of standard actuarial claims projection techniques in accordance with Canadian accepted actuarial practice. At December 31, 2012, the insurance contract liabilities totaled \$2,300,604 (2011 – \$361,820).
- Accuracy of share based compensation expense - The estimate of the ultimate expense arising from share based compensation plans is another critical accounting estimate. There are several sources of uncertainty that need to be considered in the estimate of the share based compensation expense recorded by the Company. The ultimate expense is estimated by using a number of key assumptions such as the expected volatility of the share price, the dividends expected on the shares, the riskfree interest rate for the expected life of the option and future forfeiture rates. For the year ending December 31, 2012, the cost of the share based payments totaled \$1,367,720 (2011 - \$1,798,603).
- Operating environment of the Company - Mongolia displays many characteristics of an emerging market including relatively high inflation and interest rates. The tax and customs legislation in Mongolia is subject to varying interpretations and frequent changes. The future economic performance of Mongolia is tied to the continuing demand from China and continuing high global prices for commodities as well as being dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government of Mongolia together with tax, legal, regulatory and political developments. Management is unable to predict all developments that could have an impact on the Mongolian economy and consequently what effect, if any, they could have on the future financial position of the Company.

## Capital Risk Management

The Company's objective when managing capital is to ensure the Company is capitalized in a manner which provides a strong financial position for its shareholders.

The Company's capital structure includes equity and working capital. In managing its capital structure, the Company considers future investment and acquisition opportunities, potential credit available and potential issuances of new equity. The Company's objective is to maintain a flexible capital structure that will allow it to execute its stated business. Upon acquiring investment properties and operating businesses, the Company will strive to balance its proportion of debt and equity within its capital structure in accordance with the needs of the continuing business. The Company may, from time to time, issue shares and adjust its spending to manage current and projected proportions as deemed appropriate.

The method used by the Company to monitor its capital is based on an assessment of the Company's working capital position relative to its projected obligations. At December 31, 2012, the Company's working capital was \$12,554,733 (2011 - \$21,059,481) and the Company had no debt.

## Off-Balance Sheet Items

As at December 31, 2012, the Company has no off-balance sheet items.

## **Financial Risk Management**

### *Credit risk*

The Company's exposure to credit risk is managed through risk management policies and procedures with emphasis on the quality of the investment portfolio. For the year, most of the Company's investments consisted of institutional deposits. The majority of the funds invested are held in reputable Barbadian, Canadian or Mongolian banks. The Company is in the early stages of development and is continually improving its policies regarding monitoring its credit risk.

The Company is exposed to credit risk as an owner of real estate in that tenants may become unable to pay the contracted rents. The Company mitigates this risk by carrying out due diligence on significant tenants and limiting the Company's exposure to each tenant. The Company's properties are diversified across residential and commercial classes.

Amounts due from policy holders are short-term in nature and are not subject to material credit risk.

### *Liquidity risk*

As at December 31, 2012, the Company does not believe the current maturity profile of the Company lends itself to any material liquidity risk, taking into account the level of cash and cash equivalents, investments and marketable securities as at December 31, 2012. The Company does not have material liabilities that can be called unexpectedly at the demand of a client.

### *Currency risk*

The Company owns properties located in Mongolia and marketable securities in Mongolia and Barbados, and is therefore subject to foreign currency fluctuations that may impact its financial position and results. Changes in the Mongolian Tögrög and U.S. to Canadian dollar foreign currency exchange rate impact the fair value of securities denominated in Mongolian Tögrög and in U.S. dollars. The Mongolian operations hold their investments in Mongolian Tögrög denominated securities and the Canadian operations hold securities denominated in Canadian and U.S. dollars.

The approximate impact of an increase of 10% in the Mongolian Tögrög against the Canadian dollar would increase the Other Comprehensive Income ("OCI") of the Company by \$4,828,959 (2011 - \$3,581,255). The approximate impact of a decrease of 10% in the Mongolian Tögrög against the Canadian dollar would decrease OCI of the Company by \$4,828,959 (2011 - \$3,581,255).

The approximate impact of an increase of 10% in the U.S. dollar against the Canadian dollar would increase net income of the Company by \$87,994 (2011- \$367,962).

## **Internal Controls over Financial Reporting**

Changes in securities laws no longer require the Chief Executive Officer and Chief Financial Officer of junior reporting issuers to certify that they have designed internal control over financial reporting, or cause it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards.

Instead, an optional form of certification has been made available to junior reporting issuers and has been used by the Company's certifying officers for the December 31, 2011, annual filings. The new certification reflects what the



Company considers to be a more appropriate level of CEO and CFO certification given the size and nature of the Company's operations. This certification requires the certifying officers to state that:

[i] they have reviewed the annual MD&A and consolidated financial statements;

[ii] they have determined that there is no untrue statement of a material fact, or any omission of material fact required to be stated which would make a statement or its omission misleading in light of the circumstances under which it was made within the annual MD&A and consolidated financial statements;

[iii] based on their knowledge the annual filings, together with the other financial information included in the annual filings, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of the date and for the periods presented in the filings.

## **Strategy**

MGG separates its operations into three reporting segments for ease of management oversight. These segments are property, insurance and corporate.

At all three reporting segments, the Company's focus has been on hiring key employees, implementing reporting systems and setting the Company up for continued growth in the future. A significant challenge that the Company has encountered is finding skilled employees, given the growth experienced during the past two years. The growth in senior employees has moderated now that the majority of key positions are filled. The Company plans to spend more time and energy on training employees, rather than hiring many new employees, as the Company grows in the near future.

## **Property**

MGG's property division slowed the pace at which it acquired assets in 2012. Management and employees have worked hard to aggressively build up the infrastructure needed to manage this division. The Company was successful in filling several key positions within its property division reducing the need for Management to be involved in the daily operations of the business, allowing them to spend more time on the corporate operations of the Company. Management plans on continuing to spend time training and guiding employees in Mongolia, but expects this to decrease throughout the year.

Due to the rapid growth of the Mongolian economy and a shortage of high quality rental locations, property rents continue to increase, particularly in office and prime retail locations. When leases have been reviewed, many of them are at rates that are substantially below market rents. These leases should reset over the short-term and should substantially increase revenues if rental rates stay current. The Company has maintained most leases on short durations. The Company also includes rent escalation clauses in most of its leases with tenants that are over one year in duration. MGG's property investment subsidiary plans on further expanding via the investment of additional capital into income producing and redevelopment properties in Ulaanbaatar. The Company's plan is contingent on procuring further funds for investment and on finding suitable investment targets which meet or exceed MGG's stringent investment criteria.

Since inception, MGG has acquired a number of redevelopment properties. To date, the Company has only remodeled, rebuilt and completed additions on properties. It is Management's intent to begin small-scale denovo property development on both company owned brownfield and greenfield sites. MGG's intent is to remain a substantial owner of the properties, post-completion.

During the third quarter, MGG began the substantial renovation of its corporate headquarters and two other office buildings. This renovation resulted in certain tenants leaving the buildings or reconfiguring their office space usage.

These renovations were effectively completed during the fourth quarter of 2012. The spaces are substantially improved and should lead to higher rental revenues for the property division upon lease out.

To date, only minimal work has been done in evaluating the potential economics of our development properties, but based on rough estimates, the following numbers would appear to be representations of the potential economics of these projects based on estimates of December 2012 market prices for construction costs, average market rents and sale prices observed in Ulaanbaatar. Management cautions investors that these numbers will change dramatically based on future changes in building costs in Ulaanbaatar and changes in market rents and sale prices. In addition, Management is looking for ways to expand these land packages which will potentially impact the economics of the projects.

<b>Approx. Meters of</b>	<b>Develop-ment</b>	<b>Type</b>	<b>Approx. Fished Size</b>	<b>Approx. Build Cost</b>	<b>Current Monthly Rent</b>	<b>Expected Payback on Development</b>
Asset 1	2,200	Class A Office	30,000 Meters	\$1,500-\$1,700 Per Meter	\$45-\$65 Per Meter	2.5 To 4 Years
Asset 2	2,600	Class A Office	40,000 Meters	\$1,500-\$1,700 Per Meter	\$45-\$65 Per Meter	2.5 To 4 Years
Asset 3	1,300	Residential	300 Units	\$900-\$1,200 Per Meter	\$2,500-\$3,500 Per Meter Sale Price	Pre-Sales Should Fund It
Asset 4	8,000	Mixed Use	30,000 Meters	\$1,200-\$1,500 Per Meter	\$20-\$40 Per Meter	3 To 6 Years
Asset 5	900	Mixed Use	10,000 Meters	\$1,200-\$1,500 Per Meter	\$45-\$65 Per Meter	2.5 To 4 Years
Asset 6	1,700	3 Floor Retail	5,000 Meters	\$700-\$900 Per Meter	\$15-\$25 Per Meter	2.5 To 4.5 Years

MGG has labeled some properties as “held for sale.” These properties are primarily small retail or residential properties. MGG has chosen to sell these properties as the revenues derived from them are insufficient to offset the costs of managing them. During the year, twenty of these properties were sold and four of these properties remained as held for sale as of December 31, 2012. Over time, the Company intends to continue the practice of disposing of smaller properties that are no longer core to the Company’s strategy.

## *Insurance*

The Company’s insurance subsidiary received its insurance license on June 2, 2011, and began to aggressively target customers in October 2011. To date, it has focused its operations on both the retail and corporate market. The focus at Mandal is to underwrite conservatively so that all stakeholders are confident that insureds will be compensated on all legitimate claims. Through the use of reinsurance, Mandal attempts to ensure that it can cover losses due to high severity and rare catastrophic events.

The Company’s expectation is that the insurance company will incur operating losses for at least the next year. Anticipated losses will likely be caused by the sizable costs of marketing and growing the business, against insufficient earned premium revenue. Some of these losses will be offset by the insurance company’s investment portfolio. It is expected that the investment portfolio will grow as the Company increases sales and associated reserves, which generate investible float. Due to Mongolia’s high interest rate environment, float is incredibly valuable.

*The following section outlines the significant events that have taken place within the insurance company during the 2012 year;*

On April 5, 2012, Mandal sold a sizable bankers blanket bond to Khan Bank, the largest bank in Mongolia based on branch count. This transaction was 100% reinsured by syndicates of the Society of Lloyd's. Mandal's strategy is to greatly expand its commercial fronting business over the coming year.

On April 18, 2012, Mandal received a special permit to write auto liability coverages and is actively marketing these products to the consumer segment of the market. At the end of December, Mandal had sold a total of 5276 mandatory liability insurance policies. Management expects that after an initial drive to acquire customers, the growth of this business will subside in 2013, followed by annual increases in premiums due to substantial future increases in the total sum insured.

On May 16, 2012, MGG announced that it signed a binding term sheet agreeing to sell shares of Mandal General Insurance LLC to UMC Capital LLC, at a purchase price equivalent to MGG's original funding cost in June 2011. Following the closing of this transaction, MGG and UMC Capital will respectively own approximately 84% and 16% of Mandal's outstanding shares. In addition, UMC Capital will retain the right to purchase an additional 25% of Mandal at the higher of stated book value or funding cost. At the end of Q4 2012, this transaction has not been closed.

On August 20, 2012, Mandal signed an agreement with Khan Bank to distribute insurance products through its network of over 500 branches throughout Mongolia. Management expects that the roll-out of these products will begin in 2012 and grow substantially through 2013.

On November 6, 2012, Mandal was recognized by the Business Council of Mongolia as the "Best Local Company in Mongolia".

## Outlook

The Mongolian economy continues to be one of the best performing economies globally based on data from The National Statistics Office of Mongolia ("NSO") – December 2012 edition, with preliminary estimates of annualized 2012 GDP growth of 12.3% at constant prices compared to the previous year. The Mongolian Consumer Price Index increased 14.0% during the year, based on data from the NSO. This growth is being funded by Foreign Direct Investment inflows to a number of sizable mining projects, the re-investment of earnings from existing projects, and general increases in economic activity within the consumer and governmental sectors of the economy.

MGG has been a beneficiary of these trends in both its property and insurance operations. Continuing increases in market rental rates for commercial properties are expected to eventually lead to increases in property value of the Company's holdings.

As Mongolians see a higher standard of living, they will likely seek protection for their valuables. Additionally, corporations are beginning to understand the necessity of using insurance to avoid business volatility. These two trends have been important in seeing the Company's insurance subsidiary grow since inception in June 2011.

It is anticipated that the Mongolian economy will remain strong through 2013, which should bode well for the Company.

It is anticipated that the Company will continue to seek ways to raise additional equity capital to further the development of its businesses. MGG is also exploring utilizing conservative levels of debt funding for its property investments however, there can be no certainty that capital can be borrowed at rates that are attractive to the company.

## Reorganization Transaction

On December 1, 2010, Mongolia Growth Group Ltd. announced the signing of an agreement that Harris Kupperman and Jordan Calonego planned to purchase 320,500 common shares of the Corporation on a post-consolidated basis from the founding board members. The transaction was completed on February 2, 2011. The Corporation also

completed the following transactions on February 2, 2011, which were approved by the shareholders at the annual and special meeting of shareholders on January 17, 2011:

- A private placement of the Corporation which raised gross proceeds of \$4,611,253 from the sale of 12,685,452 common shares on a post-consolidated basis;
- The filing of articles of amendment renaming the Corporation “Mongolia Growth Group Ltd.” and consolidating the common shares of the Corporation at a ratio of 1:2;
- The filing of an application for the de-listing of the common shares from the NEX board of the TSXV and an application for the listing of the common shares on the CNSX; and
- The appointment of Paulo Bilezikjian, Jordan Calonego, Bill Fleckenstein, Harris Kupperman and Paul Sweeney as the new directors of the Corporation.

## Liquidity

As at December 31, 2012, MGG had working capital of \$12,554,733 (2011 - \$21,059,481) comprised of cash and cash equivalents, investments and marketable securities, other assets, reinsurance assets, deferred acquisition expenses, net of trade and accrued liabilities, income taxes payable and insurance contract liabilities. Management considers the funds on hand to be sufficient to meet its ongoing obligations.

## Economic Volatility and Uncertainty

The past economic volatility and uncertainty in Canada and around the world has contributed to dramatically restricted access to capital and reduced capital markets activity. The Company’s management believes that the Company has sufficient resources to carry on its business and remain a going concern.

MGG holds the majority of its assets, investments and operations in the nation of Mongolia. Mongolia is presently experiencing drastic changes in its fast growing economy. Economic volatility and uncertainty in Mongolia could result in inflation, hyperinflation, economic stagnation, adverse taxation, political extremism, negative policy amendments and other similarly detrimental scenarios which would materially harm the Company.

Substantial risk and uncertainty exists due to the level of economic growth in Mongolia. According to the Bank of Mongolia, money supply (M2) increased 8.3% in the last 12 months ending December 31, 2012. Loans outstanding in the banking industry also increased substantially during the last 12 months, rising 23.9%, though this has slowed in recent months. Such changes in money supply and lending may be warranted due to the growth of the local economy. However, historical economic disequilibrium of such magnitude in other nations has frequently led to hyperinflation, unstable economic conditions, hardship and strife.

Depending on the requirements of MGG’s businesses, additional funds may be required to be raised in the capital markets and there is no guarantee that sufficient funds raised will be available to complete a financing.

## Events Subsequent to Year End

Subsequent to year end, MGG purchased \$1,594,000 worth of properties.

The Company’s shares began trading on the TSX Venture on January 9, 2013, and were simultaneously delisted from the CNSX.

MGG announced the appointment of John Shaw to the board of directors of the Company on January 17, 2013.

350,000 5-year Options and 125,000 3-year Options at a price of \$4.13 were issued to MGG's employees, Directors and Consultants on March 1, 2013.

MGG announced that Paulo Bilezikjian has resigned from the board of directors of the Company on March 4, 2013.

Management granted a three month extension on March 15, 2013, to UMC Capital to both complete and close the Share Purchase Agreement transaction. The deadline for both was extended to June 15, 2013, due to regulatory delays, and delays in UMC Capital funding the acquisition costs.

## **Financial Instruments**

The Company's financial instruments consist of cash and cash equivalents, investments and marketable securities, accounts receivable and trade and accrued payables. The Company is subject to interest risk as it earns interest income from its cash deposits. It is management's opinion that the Company is not exposed to significant credit risks arising from these financial instruments and that the fair value of these financial instruments approximates their carrying values. Management believes that there are material currency risks associated to the majority of the Financial Instruments of the Company as they are held in Mongolian Tögrög. For further discussion of financial instrument risks, see the Insurance and Financial Risk Management note.

## **Changes in Accounting Policies**

The consolidated financial statements of the Company were prepared in accordance with IFRS, as issued by the International Accounting Standards Board (IASB). For all periods up to and including the period ended December 31, 2010, the Company prepared its financial statements in accordance with Part V PreChangeover Accounting Standards, of the Canadian Institute of Chartered Accountants Handbook, Canadian generally accepted accounting principles (Canadian GAAP). Explanations of the impact of the transition to IFRS as of December 31, 2010 and January 1, 2010 on the financial position, financial performance and cash flows can be found in note 23 of the financial statements.

In 2010, the Company had no operations. With the simplistic nature of the Company in the previous year, IFRS did not result in any change to the Company's reported financial position at January 1, 2010, or December 31, 2010, results of operations and cash flows for the year ended December 31, 2010, thus no reconciliation information was presented.

## **Outstanding Share Data**

As at December 31, 2012, the Company had 34,143,352 common shares issued and outstanding. As at December 31, 2012, 11,372,500 of the Company's common shares, or approximately 33.4% of the issued and outstanding shares, were directly or indirectly controlled by the Company's directors and officers. As of December 31, 2012, the Company had 600,000 stock options outstanding with an exercise price of \$1.64 per share (500,000 have an expiry date of March 9, 2021, and 100,000 have an expiry date of March 9, 2014). The Company also had 722,000 stock options outstanding with an exercise price of \$4.20 per share, (at issuance, 825,000 had an expiry date of April 25, 2016, and 75,000 had an expiration date of April 25, 2014, of these a total of 128,000 were forfeited during 2011 and 50,000 were forfeited during the quarter). In addition, the Company had 170,000 options outstanding with an expiry date of September 7, 2016, and an exercise price of \$4.77 (175,000 options were issued initially, 5,000 were forfeited during the quarter). Furthermore, the Company had 150,000 options with an expiry date of December 2, 2016, and an exercise price of \$4.25. Lastly, the Company had 190,000 5-year stock options to purchase shares of MGG at a price of \$4.00 per share with an expiry of March 23, 2017.

At period-end, the Company has 358,000 options that are exercisable (2011 - nil).

## Outstanding as at December 31,2012

Common Shares	34,143,325
Options to buy common shares	1,782,000

### **Additional Information**

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



# **Mongolia Growth Group Ltd.**

Consolidated Financial Statements  
**December 31, 2012**  
(expressed in Canadian dollars)





April 30, 2013

## **Independent Auditor's Report**

### **To the Shareholders of Mongolia Growth Group Ltd.**

We have audited the accompanying consolidated financial statements of Mongolia Growth Group Ltd. and its subsidiaries, which comprise the consolidated statement of financial position as at December 31, 2012 and 2011, and the consolidated statements of operations, comprehensive income (loss), changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

#### **Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

#### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Mongolia Growth Group Ltd. and its subsidiaries as at December 31, 2012 and 2011 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

*PricewaterhouseCoopers LLP*

**Chartered Accountants**

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**Mongolia Growth Group Ltd.**  
Consolidated Statements of Financial Position  
As at December 31

(expressed in Canadian dollars)

	2012 \$	2011 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents (note 5)	8,702,253	20,078,948
Investments and marketable securities (note 6)	3,992,547	2,569,778
Other assets (note 7)	2,471,498	427,949
Reinsurance assets (note 8)	684,285	7,760
Deferred acquisition expenses (note 9)	93,175	15,175
	15,943,758	23,099,610
<b>Non-current assets</b>		
Investments and marketable securities (note 6)	-	1,446,983
Investment properties (note 10)	30,786,742	26,166,286
Property and equipment (note 11)	4,576,031	4,624,010
	51,306,531	55,336,889
<b>Liabilities</b>		
<b>Current liabilities</b>		
Trade payables and accrued liabilities (note 12)	996,314	859,213
Income taxes payable (note 13)	92,107	819,096
Insurance contract liabilities (note 14)	2,300,604	361,820
	3,389,025	2,040,129
<b>Non-current liabilities</b>		
Deferred income tax liability (note 13)	613,946	-
	4,002,971	2,040,129
<b>Equity</b>		
Share capital (note 15)	51,681,818	51,681,818
Contributed surplus	3,214,195	1,846,475
Accumulated other comprehensive loss	(2,528,607)	(1,241,437)
Retained earnings (deficit)	(5,063,846)	1,009,904
	47,303,560	53,296,760
<b>Total equity and liabilities</b>	51,306,531	55,336,889

**Approved by the Board of Directors**

\_\_\_\_\_  
“Paul Sweeney” Director “William Fleckenstein” Director

The accompanying notes are an integral part of these consolidated financial statements.

**Mongolia Growth Group Ltd.**  
**Consolidated Statements of Operations**  
**For the years ended December 31**

(expressed in Canadian dollars)

	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
<b>Revenue</b>		
Net premiums earned (note 14)	628,424	77,786
Rental income	1,572,603	495,242
Other revenue	36,667	16,283
	<u>2,237,694</u>	<u>589,311</u>
<b>Expenses</b>		
Salaries and wages	1,034,975	376,460
Other expenses (note 22)	3,882,280	1,584,692
Share based payment	1,367,720	1,798,603
Depreciation (note 11)	170,890	45,757
Financing charges	-	3,822
	<u>6,455,865</u>	<u>3,809,334</u>
<b>Operating loss</b>	(4,218,171)	(3,220,023)
<b>Net investment income (loss)</b> (note 6)	863,313	(344,246)
<b>Unrealized gain (loss) on fair value adjustment on investment properties</b> (note 10)	(2,697,212)	5,740,919
<b>Net income (loss) before income taxes</b>	(6,052,070)	2,176,650
<b>Provision for income taxes</b> (note 13)	(21,680)	(827,497)
<b>Net income (loss) for the year</b>	<u>(6,073,750)</u>	<u>1,349,153</u>
<b>Net income (loss) per share</b> (note 15)		
Basic	\$(0.18)	\$0.06
Diluted	\$(0.18)	\$0.05

The accompanying notes are an integral part of these consolidated financial statements.

## **Mongolia Growth Group Ltd.**

### **Consolidated Statements of Comprehensive Income (Loss)**

**For the years ended December 31**

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(expressed in Canadian dollars)

	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
<b>Net income (loss) for the year</b>	(6,073,750)	1,349,153
<b>Other comprehensive loss - net of taxes</b>		
Unrealized losses on translation of financial statement operations with Mongolian MNT functional currency to Canadian dollar reporting currency	(1,287,170)	(1,241,437)
<b>Total comprehensive income (loss)</b>	<u>(7,360,920)</u>	<u>107,716</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Mongolia Growth Group Ltd.**  
**Consolidated Statements of Changes in Equity**  
**For the years ended December 31**

(expressed in Canadian dollars)

	Share capital \$	Contributed surplus \$	Accumulated other comprehensive loss \$	Retained earnings (deficit) \$	Total \$
<b>Balance at January 1, 2011</b>	438,547	47,872	-	(339,249)	147,170
Net income for the year	-	-	-	1,349,153	1,349,153
Other comprehensive loss	-	-	(1,241,437)	-	(1,241,437)
	438,547	47,872	(1,241,437)	1,009,904	254,886
Share based payment	-	1,798,603	-	-	1,798,603
Share capital issued (note 15)	51,571,284	-	-	-	51,571,284
Share issue costs (note 15)	(328,013)	-	-	-	(328,013)
<b>Balance at December 31, 2011</b>	<b>51,681,818</b>	<b>1,846,475</b>	<b>(1,241,437)</b>	<b>1,009,904</b>	<b>53,296,760</b>
<b>Balance at January 1, 2012</b>	51,681,818	1,846,475	(1,241,437)	1,009,904	53,296,760
Net loss for the year	-	-	-	(6,073,750)	(6,073,750)
Other comprehensive loss	-	-	(1,287,170)	-	(1,287,170)
	51,681,818	1,846,475	(2,528,607)	(5,063,846)	45,935,840
Share based payment	-	1,367,720	-	-	1,367,720
<b>Balance at December 31, 2012</b>	<b>51,681,818</b>	<b>3,214,195</b>	<b>(2,528,607)</b>	<b>(5,063,846)</b>	<b>47,303,560</b>

The accompanying notes are an integral part of these consolidated financial statements.

**Mongolia Growth Group Ltd.**  
**Consolidated Statements of Cash Flows**  
**For the years ended December 31**

(expressed in Canadian dollars)

	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net income (loss) for the year	(6,073,750)	1,349,153
Items not affecting cash		
Net realized loss on sale of financial assets (note 6)	-	592,277
Depreciation of property and equipment (note 11)	170,890	45,757
Share based payment	1,367,720	1,798,603
Deferred taxes (note 13)	(187,727)	-
Realized gain on disposal of investment properties (note 10)	(12,768)	-
Realized loss on disposal of property and equipment	24,913	-
Unrealized loss (gain) on fair value adjustment on investment properties (note 10)	2,697,212	(5,740,919)
	<u>(2,013,510)</u>	<u>(1,955,129)</u>
Net change in non-cash working capital balances (note 20)	(1,802,137)	1,598,214
	<u>(3,815,647)</u>	<u>(356,915)</u>
<b>Financing activities</b>		
Proceeds from share issuance (note 15)	-	51,571,284
Cost of issue of shares (note 15)	-	(328,013)
	<u>-</u>	<u>51,243,271</u>
<b>Investing activities</b>		
Purchase of investments	(3,068,667)	(48,706,825)
Disposition of investments	3,092,881	44,097,787
Net acquisition of property and equipment	(433,710)	(4,666,159)
Net acquisition of investment properties	(6,896,289)	(20,425,367)
	<u>(7,305,785)</u>	<u>(29,700,564)</u>
<b>Effect of exchange rates on cash</b>	<u>(255,263)</u>	<u>(1,245,045)</u>
<b>Increase (decrease) in cash and cash equivalents</b>	(11,376,695)	19,940,747
<b>Cash and cash equivalents - Beginning of year</b>	20,078,948	138,201
<b>Cash and cash equivalents - End of year</b>	<u>8,702,253</u>	<u>20,078,948</u>
Income taxes paid	122,902	-

The accompanying notes are an integral part of these consolidated financial statements.

# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

December 31, 2012

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(expressed in Canadian dollars)

### 1 Corporate information

Mongolia Growth Group Ltd. (formerly Summus Capital Corp.) (MGG or the Company) was incorporated in Alberta on December 17, 2007, and is an early stage real estate and financial conglomerate, focusing its operations in the emerging economy of Mongolia.

On February 2, 2011, present management of the Company purchased 320,500 common shares of the corporation formerly known as Summus Capital Corp. (Summus), from the founding management. The Company also filed articles of amendment renaming the Corporation "Mongolia Growth Group Ltd.", cancelled all stock options and consolidated the common shares of the corporation at a ratio of 1:2; as well as filed an application for the de-listing of the common shares from the NEX board of the Toronto Stock Exchange Venture (TSXV) and filed an application for the listing of common shares on the Canadian National Stock Exchange (CNSX). On January 9, 2013, the Company filed an application for the de-listing of the common shares from the CNSX and filed an application for the listing of common shares on the TSXV. The Company is now listed on the TSXV, having the symbol YAK.

MGG has two wholly-owned subsidiaries, Mongolia Barbados Corp. and Mandal General Insurance LLC. Mongolia Barbados Corp. owns the wholly-owned subsidiaries Mongolia Fidelity Holding Corp., its wholly-owned subsidiary Mandal Universal LLC and Big Sky Capital LLC. Big Sky Capital LLC owns the wholly-owned subsidiaries Chaos LLC, Carrollton LLC, Biggie Industries LLC, Orpheus LLC, Endymion LLC, Zulu LLC, Crescent City LLC and Oceanus LLC (together "the investment property operations"). The insurance operations are conducted in Mandal General Insurance LLC and the investment property operations are conducted in Big Sky Capital LLC and its subsidiaries. No active business operations occur in Mongolia Barbados Corp., Mongolia Fidelity Holding Corp. Mandal Universal LLC, Crescent City LLC, Chaos LLC and Oceanus LLC at this time.

The Company is registered in Alberta, Canada, with its Head Office at its registered address at 1400, 700-2<sup>nd</sup> Street W, Calgary, Alberta, Canada. The Company is domiciled out of the Company's corporate office and principal place of business which is located at 706 - 34 Cumberland St. N., Thunder Bay, Ontario, P7A 4L3, Canada. The Company also has a business office for the Mongolian investment property and insurance companies at the corner of Chinggis Ave. and Seoul St. in Ulaanbaatar, Mongolia.

The Company is organized into three business units based on the business operations:

- Big Sky Capital LLC and its subsidiaries own investment properties which are located in Ulaanbaatar, Mongolia and are held for the purpose of generating rental revenue, capital appreciation or both;
- Mandal General Insurance offers insurance products in Mongolia covering all common general insurance types. The Company's main lines of business are motor insurance, including voluntary motor third party liability, property, accident medical and travel and liability insurance;
- The MGG Corporate office is located in Thunder Bay, Canada and administers the financial resources, investment portfolio and corporate reporting and legal functions of the Company.

# **Mongolia Growth Group Ltd.**

## Notes to Consolidated Financial Statements

### **December 31, 2012**

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(expressed in Canadian dollars)

## **2 Basis of presentation**

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). The significant accounting policies used in the preparation of these consolidated financial statements are summarized in note 3.

The consolidated financial statements' values, including the notes to the consolidated financial statements, are presented in Canadian dollars (\$) which is the Company's presentation currency and the functional currency of the parent company. The functional currency of the Company's operating subsidiaries is the Mongolian National Tögrög (MNT).

These consolidated financial statements were approved by the Board of Directors of the Company for issue on April 30, 2013.

## **3 Significant accounting policies**

### **a) Basis of measurement**

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of investment properties and available-for-sale (AFS) financial assets with the exception of insurance contract liabilities which are measured on a discounted basis in accordance with accepted actuarial practice (which in the absence of an active market provides a reasonable proxy of fair value) as explained throughout this note.

### **b) Basis of consolidation**

These financial statements include the assets, liabilities, equity, revenues, expenses and cash flows of MGG and its wholly-owned subsidiaries. Subsidiaries are entities controlled by MGG. Control exists when MGG has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of the subsidiaries are prepared for the same reporting year as MGG, using consistent accounting policies. Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.



# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

December 31, 2012

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(expressed in Canadian dollars)

### c) Financial instruments

#### *Financial assets*

Financial assets are classified into one of the following categories: AFS, fair-value through profit or loss (FVTPL), or loans and receivables. The classification depends on the purpose for which the asset was acquired. All transactions related to financial instruments are recorded on a trade date basis. The Company's accounting policy for each category is as follows:

#### i) Available-for-sale financial assets

AFS financial assets are non-derivatives that are either designated in this category or do not fit into any other category. AFS financial assets are initially measured at fair value on the consolidated statement of financial position from the trade date. Subsequent to initial recognition, AFS financial assets are carried at fair value with changes in fair values recorded, net of income taxes, in other comprehensive income (OCI) until the AFS financial asset is disposed of or has become impaired. When the AFS financial asset is disposed of or has become impaired, the accumulated fair value adjustments recognized in accumulated other comprehensive income (AOCI) are transferred to the consolidated statement of operations.

#### ii) Fair value through profit or loss

Financial assets at FVTPL are financial assets held for trading. A financial asset is classified in this category if it is acquired principally for selling in the short term. Derivatives are also categorized as held for trading unless they are designated as hedges. FVTPL instruments are carried at fair value in the consolidated statement of financial position with changes in fair value recorded in the consolidated statement of operations.

#### iii) Loans and receivables

These assets are non-derivative financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for a promise to repay on a specific date or dates, or on demand. They are initially recognized at cost, being the fair value of the consideration paid for the acquisition of the investment. After initial measurement, loans and receivables are measured at amortized cost, using the effective interest rate method, less any impairment losses. Amortized cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs.

**Mongolia Growth Group Ltd.**  
Notes to Consolidated Financial Statements  
**December 31, 2012**

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(expressed in Canadian dollars)

***Impairment on financial assets***

All financial assets other than FVTPL instruments are assessed for impairment at each reporting date. The Company assesses whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or group of financial assets is deemed to be impaired, if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset and that event has an impact on the estimated future cash flows of the financial asset or group of financial assets.

***AFS debt instruments***

An AFS debt security would be identified as impaired when there is objective evidence suggesting that timely collection of the contractual principal or interest is no longer reasonably assured. This may result from a breach of contract by the issuer, such as a default or delinquency in interest or principal payments, or evidence that the issuer is in significant financial difficulty. Impairment is recognized through net income or loss in the consolidated statement of operations. Subsequent declines in value continue to be recorded through net income or loss in the consolidated statement of operations. Impairment losses previously recorded through net income or loss in the consolidated statement of operations are to be reversed if the fair value subsequently increases and the increase can be objectively related to an event occurring after the impairment loss was recognized.

***AFS equity instruments***

Objective evidence of impairment exists if there has been a significant or prolonged decline in the fair value of the investment below its cost or if there is a significant adverse change in the technological, market, economic, political or legal environment in which the issuer operates or the issuer is experiencing financial difficulties.

The accounting for an impairment that is recognized in net income or loss in the consolidated statement of operations is the same as described for AFS debt securities above with the exception that impairment losses previously recognized in net income or loss in the consolidated statement of operations cannot be subsequently reversed until the instrument is disposed of. Any subsequent increase in value is recorded in OCI.

***Financial liabilities***

Financial liabilities are classified as other financial liabilities, based on the purpose for which the liability was incurred, and are comprised of trade payables and accrued liabilities. These liabilities are initially recognized at fair value net of any transaction costs directly attributable to the issuance of the instrument and subsequently carried at amortized cost using the effective interest rate method. This ensures that any interest expense over the period to repayment is at a constant rate on the balance of the liability carried in the statement of financial position. Interest expense in this context includes initial transaction costs and premiums payable on redemption, as well as any interest or coupon payable while the liability is outstanding.

# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

December 31, 2012

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(expressed in Canadian dollars)

Trade payables and accrued liabilities represent liabilities for goods and services provided to the Company prior to the end of the period which are unpaid. Trade payable amounts are unsecured and are usually paid within 30 days of recognition.

### ***Fair value of financial instruments***

Fair value represents the price at which a financial instrument could be exchanged in an orderly market, in an arm's length transaction between knowledgeable and willing parties who are under no compulsion to act. Financial assets and liabilities recorded at fair value in the consolidated statement of financial position are measured and classified in a hierarchy consisting of three levels for disclosure purposes. The three levels are based on the priority of the inputs to the respective valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). An asset or liability's classification within the fair value hierarchy is based on the lowest level of significant input to its valuation. The input levels are defined as follows:

- Level 1 fair value measurements are those derived from unadjusted quoted prices in an active market for identical assets or liabilities.
- Level 2 fair value measurements are those derived from quoted prices in markets that are not active or inputs that are observable for the asset or liability, either directly (i.e., as price) or indirectly (derived from prices).
- Level 3 fair value measurements are those derived from unobservable inputs that are supported by little or no market activity and are significant to the estimated fair value of the assets or liabilities.

The Company has implemented the following classifications:

#### **Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities**

- The Company defines active markets based on the frequency of valuation and any restrictions or illiquidity on disposition of investments. The size of the bid/ask spread is used as an indicator of market activity for fixed maturity securities. Assets measured at fair value and classified as Level 1 include cash and cash equivalents, and investments and marketable securities. Fair value is based on market price data for identical assets obtained from the investment custodian, investment managers or dealer markets. The Company does not adjust the quoted price for such instruments.

#### **Level 2: Quoted prices in markets that are not active or inputs that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices)**

- Level 2 inputs include observable market information, including quoted prices for assets in markets that are considered less active. Assets measured at fair value and classified as Level 2 include investments and marketable securities. Fair value is based on or derived from market price data for same or similar instruments obtained from the investment custodian, investment managers or dealer markets.

**Mongolia Growth Group Ltd.**  
Notes to Consolidated Financial Statements  
**December 31, 2012**

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(expressed in Canadian dollars)

**Level 3: Unobservable inputs that are supported by little or no market activity and are significant to the estimated fair value of the assets or liabilities**

- Level 3 assets and liabilities would include financial instruments whose values are determined using internal pricing models, discounted cash flow methodologies, or similar techniques that are not based on observable market data, as well as instruments for which the determination of estimated fair value requires significant management judgement or estimation.

**d) Investment properties**

Investment properties include properties held to earn rental revenue, for capital appreciation or both. Investment properties are initially measured at fair value which is the purchase price plus any directly attributable expenditures. Investment properties are subsequently measured at fair value, which reflects market conditions at the date of the statement of financial position. Gains or losses arising from changes in the fair value of investment properties are recognized in the consolidated statement of operations in the year they arise. A key characteristic of an investment property is that it generates cash flows largely independently of the other assets held by an entity. Subsequent expenditure is included in the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the consolidated statement of operations during the financial period in which they occur. Substantially all of the Company's income properties and properties under development are investment properties.

The fair value of investment properties was based on the nature, location and condition of the specific asset. The fair value is calculated at December 31, 2012 on the majority of investment properties by an independent, professional, qualified appraisal firm, whose appraisers hold recognized relevant, professional qualifications and who have recent experience in the locations and categories of the investment properties valued. The remaining investment properties' fair value was calculated by management and was performed by qualified individuals with recent experience in the locations and categories of the investment properties valued.

Overall, the external appraisal firm performed valuations on 61% of the total carrying value of investment properties and management valued the remaining 39%. For investment properties valued by the appraiser and management, the carrying value of the investment properties that were valued at December 31, 2012 agree to the valuation reports by the external appraisal firm and management.

Investment property purchases where the Company has paid either the full or partial purchase proceeds to the seller, but the Company has not yet received the official land or building title from the Mongolian Property office are recorded at cost as Prepaid deposits on investment properties and classified within other assets.

# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

December 31, 2012

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(expressed in Canadian dollars)

Property held under an operating lease is not classified as investment properties. Instead, these leases are accounted for in accordance with Leases (IAS 17). However, certain land leases held under an operating lease are classified as investment properties when the definition of an investment property is met. At inception these leases are recognized at the lower of the fair value of the property and the present value of the minimum lease payments and an equivalent obligation is recognized as a lease liability.

Some properties may be partially occupied by the Company, with the remainder being held for rental income or capital appreciation. If that part of the property occupied by the Company can be sold separately, the Company accounts for the portions separately. The portion that is owner-occupied is accounted for under IAS 16, and the portion that is held for rental income, capital appreciation or both is treated as investment property under IAS 40. When the portions cannot be sold separately, the whole property is treated as investment property only if an insignificant portion is owner-occupied. The Company considers the owner-occupied portion as insignificant when the property is more than 90% held to earn rental income or capital appreciation. In order to determine the percentage of the portions, the Company uses the size of the property measured in square metres.

### e) Assets held for sale

Assets, or disposal groups comprising assets and liabilities, are categorized as held for sale at the point in time when the asset or disposal group is available for immediate sale, management has committed to a plan to sell and is actively locating a buyer at a sales price that is reasonable in relation to the current fair value of the asset, and the sale is probable and expected to be completed within a one year period.

Investment property that is to be disposed of without redevelopment has been determined to not have a change in use and continues to be recorded in investment property. Investment property that has evidence of commencement of redevelopment with a view to sell is transferred to assets held for sale. Investment properties are measured by the guidelines of IAS 40 - Investment Property. All other assets held for sale are stated at the lower of carrying amounts and fair value less selling costs. An asset that is subsequently reclassified as held and in use, with the exception of investment property measured under the fair value model, is measured at the lower of its recoverable amount and the carrying value that would have been recognized had the asset never been classified as held for sale.

The results of operations associated with disposal groups sold, or classified as held for sale, are reported separately as income or loss from discontinued operations

# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

### December 31, 2012

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(expressed in Canadian dollars)

#### **f) Revenue recognition**

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable. The Company's specific revenue recognition criteria are as follows:

##### **i) Rental revenue**

The Company has not transferred substantially all of the benefits and risk of ownership of its investment properties and, therefore, the Company accounts for leases with its tenants as operating leases. Rental revenue includes all amounts earned from tenants related to lease agreements including property tax and operating cost recoveries.

The Company reports minimum rental revenue on a straight-line basis, whereby the total amount of cash to be received under a lease is recognized into earnings in equal periodic amounts over the term of the lease.

Contingent rents are recognized as revenue in the period in which they are earned.

Amounts payable by tenants to terminate their lease prior to their contractual expiry date (lease cancellation fees) are included in rental revenue at the time of cancellation.

Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset. Tenant incentives are recognized as a reduction of rental revenue on a straight-line basis over the term of the lease.

##### **ii) Insurance revenues**

Revenue from insurance operations is comprised of net premiums earned.

Premiums written are deferred as unearned premiums and recognized in the consolidated statement of operations over the terms of the underlying policies on a pro rata basis. Premiums written are gross of any commissions and amounts ceded to reinsurers.

Premiums ceded on insurance contracts are recognized as a reduction of gross premiums when payable or on the date the policy is effective.

##### **iii) Investment income**

Investment income is recorded as it accrues using the effective interest method. Dividend income on shares is recorded on the ex-dividend date. Gains and losses are determined and recorded as at the trade date, and are calculated on the basis of average cost. The effective interest rate method is used to amortize premiums or discounts on the purchase of AFS bonds.

# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

December 31, 2012

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(expressed in Canadian dollars)

### **g) Product classification**

Insurance contracts are those contracts where the Company has accepted significant insurance risk from another party (the policyholders) by agreeing to indemnify the policyholders if a specified uncertain future event (the insured event) adversely affects the policyholders. As a general guideline, the Company determines if it has significant insurance risk by comparing benefits paid with benefits payable if the insured event did not occur. All of the Company's insurance contracts are classified as insurance contracts as defined by IFRS.

Liability insurance contracts protect the Company's customers against the risk of causing harm to third parties as a result of their legitimate activities. Damages covered include both contractual and non-contractual events. The typical protection offered is designed for employers who become legally liable to pay compensation to injured employees (employers' liability) and for customers (individuals and legal entities) who become liable to pay compensation to a third party for bodily harm or property damage (public liability).

The Company's motor portfolio comprises both voluntary third party liability insurance (driver liability insurance) and motor insurance. Motor third party liability insurance covers bodily injury claims and property claims. Property damage under motor insurance, as well as bodily injury claims, are generally reported and settled within a short period of the accident occurring.

Property insurance ensures that Company's customers are paid compensation for the damage caused to their property or ensures their financial interests.

### **h) Claims and insurance benefits incurred**

Gross claims and insurance benefits incurred include all claims and insurance benefits occurring during the year, whether reported or not, related internal and external claims handling costs that are directly related to the processing and settlement of claims, reduced for the value of salvage and subrogation.

Reinsurance claims and insurance benefits are recognized when the related gross insurance claim is recognized according to the terms of the relevant reinsurance contracts.

### **i) Insurance contract liabilities**

Insurance contract liabilities include unearned premiums and unpaid claims. Unpaid claims are initially established by the case method as claims are reported. The estimates are regularly reviewed and updated as additional information on the estimated unpaid claims becomes known and any resulting adjustments are included in the consolidated statement of operations as incurred. Insurance contract liabilities are determined using accepted actuarial practices. The bases used for estimating the Company's insurance contract liabilities are described below:

# **Mongolia Growth Group Ltd.**

## **Notes to Consolidated Financial Statements**

### **December 31, 2012**

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(expressed in Canadian dollars)

#### ***Unearned premiums***

Unearned premiums are calculated on a pro rata basis, from the unexpired portion of the premiums written and are recognized over the term of the insurance contract in Net premiums earned on the consolidated statement of operations.

At the end of each reporting period, a liability adequacy test is performed, in accordance with IFRS, to validate the adequacy of unearned premiums and deferred acquisition expenses. A premium deficiency would exist if unearned premiums are deemed insufficient to cover the estimated future costs associated with the unexpired portion of written insurance policies. A premium deficiency would be recognized immediately as a reduction of deferred acquisition expenses to the extent that unearned premiums plus anticipated investment income is not considered adequate to cover all deferred acquisition expenses and related insurance claims and expenses. If the premium deficiency is greater than the unamortized deferred acquisition expenses, a liability is accrued for the excess deficiency.

#### ***Unpaid claims***

A provision is also made for management's calculation of factors affecting future development of unpaid claims including claims incurred but not reported (IBNR). IBNR is determined for each line of business under the expected loss method. Under the expected loss method, ultimate losses are based upon some prior measure of the anticipated losses as a percentage of earned premium. The expected loss ratios were based on Mongolian industry experience and the estimates used in setting the insurance subsidiary's premium rates. Estimates of salvage and subrogation recoveries are included in the estimated unpaid claims. The unpaid claims are discounted for the time value of money utilizing a discount rate based on the expected return of the investment portfolio and prevailing inflation rates that approximates the cash flow requirements of the unpaid claims. To recognize the uncertainty inherent in determining the unpaid claims amounts, the Company includes a Provision for Adverse Deviations (PFADs) relating to claim development and future investment income.

#### ***Reinsurance contracts held***

The Company cedes reinsurance in the normal course of business. Ceded reinsurance contracts do not relieve the Company from its obligations to policyholders. Contracts entered into by the Company with reinsurers under which the Company is compensated for losses on one or more contracts issued by the Company and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held.

The benefits to which the Company is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers as well as longer term receivables that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities are primarily premiums payable for reinsurance contracts.



**Mongolia Growth Group Ltd.**  
Notes to Consolidated Financial Statements  
**December 31, 2012**

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(expressed in Canadian dollars)

Reinsurance premiums ceded and reinsurance recoveries on losses incurred are recorded as reductions of the respective income and expense accounts.

The Company assesses its reinsurance assets for impairment on an annual basis. If there is objective evidence that the reinsurance asset is impaired the Company reduces the carrying amount of the reinsurance asset to its recoverable amount and recognises that impairment loss in the consolidated statement of operations. The Company gathers the objective evidence that a reinsurance asset is impaired using the same process adopted for financial assets held at amortised cost. The impairment loss is calculated following the same method used for these financial assets.

***Deferred acquisition expenses***

Certain costs of acquiring and renewing insurance contracts, such as commissions and other acquisition costs, are deferred to the extent they are considered recoverable and are expensed in the accounting period, in which the related premiums are recognized as revenue.

**j) Cash and cash equivalents**

Cash and cash equivalents include cash at bank, deposits held at call with banks, other short-term bank deposits and highly liquid investments with an original term to maturity of three months or less at the date of purchase that are readily convertible to known amounts of cash and subject to an insignificant risk of change in value.

**k) Property and equipment**

On initial recognition, property and equipment are valued at cost, being the purchase price and directly attributable cost of acquisition or construction required to bring the asset to the location and condition necessary to be capable of operating in a manner intended by the Company, including appropriate borrowing costs and the estimated present value of any future unavoidable costs of dismantling and removing items.

Property and equipment is subsequently measured at cost less accumulated depreciation, less any accumulated impairment losses. All repairs and maintenance costs are charged to the consolidated statement of operations during the period in which they occur.

Depreciation is recognized in the consolidated statement of operations and is provided on a straight-line basis over the estimated useful life of the assets as follows:

Buildings	Straight-line over 40 years
Furniture and fixtures	Straight-line over 5 to 10 years
Equipment	Straight-line over 1 to 5 years
Vehicles	Straight-line over 10 years

# **Mongolia Growth Group Ltd.**

## **Notes to Consolidated Financial Statements**

### **December 31, 2012**

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(expressed in Canadian dollars)

Impairment reviews are performed when there are indicators that the net recoverable amount of an asset may be less than the carrying value. The net recoverable amount is determined as the higher of an asset's fair value less cost to sell and value in use. Impairment is recognized in the consolidated statement of operations, when there is objective evidence that a loss event has occurred which has impaired future cash flows of an asset. In the event that the value of previously impaired assets recovers, the previously recognized impairment loss is recovered in the consolidated statement of operations at that time.

An item of property and equipment is derecognized upon disposal or when no further economic benefits are expected from its use. Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of operations in the period the asset is derecognized.

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

#### **D) Income taxes**

Income taxes are comprised of both current and deferred taxes. Current tax and deferred tax are recognized in the statement of operations except to the extent that it relates to items recognized in OCI or directly in equity. In this case, the tax is recognized in OCI or directly in equity respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the consolidated statement of financial position date in the countries where the Company and its subsidiaries operate and generate taxable income and are measured at the amount expected to be recovered from or paid to the taxation authorities for the current and prior periods.

Deferred income tax assets and liabilities are recorded for the expected future income tax consequences of events that have been included in the consolidated financial statements or income tax returns. Deferred income taxes are provided for using the liability method. Under the liability method, deferred income taxes are recognized for all significant temporary differences between the tax and financial statement bases for assets and liabilities and for certain carry-forward items, such as losses and tax credits not utilized from prior years. However, if the deferred income tax arises from initial recognition of an asset or a liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable income, it is not accounted for.

Recognition of deferred tax assets for unused tax losses, tax credits and deductible temporary differences is restricted to those instances where, in the opinion of management, it is probable that future taxable profit will be available against which the deferred tax asset can be realized. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates, on the date the changes in tax laws and rates have been enacted or substantively enacted.

**Mongolia Growth Group Ltd.**  
Notes to Consolidated Financial Statements  
**December 31, 2012**

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(expressed in Canadian dollars)

**m) Foreign exchange transactions**

Foreign currency transactions are translated at the rate of exchange in effect on the dates they occur.

Gains and losses arising as a result of foreign currency transactions are recognized in the current year consolidated statement of operations.

***Translation of foreign operations***

For the purpose of the consolidated financial statements, the results and financial position of the Mongolian operations are expressed in Canadian dollars, which is the functional currency of the parent, and the presentation currency of the consolidated financial statements.

The Company translates the assets, liabilities, income and expenses of its Mongolian operations which have a functional currency of MNT, to Canadian dollars on the following basis:

- Assets and liabilities are translated at the closing rate of exchange in effect at the consolidated statement of financial position date.
- Income and expense items are translated using the average rate for the month in which they occur, which is considered to be a reasonable approximation of actual rates.
- Equity items are translated at their historical rates.
- The translation adjustment from the use of different rates is included as a separate component of equity.

**n) Comprehensive income**

Comprehensive income consists of net income (loss) and OCI. OCI includes unrealized gains or losses on AFS financial assets, net of amounts reclassified to the statement of operations, and unrealized gains (losses) on the translation of financial statement operations with Mongolian MNT functional currency.

**o) Share capital and deferred share issuance costs**

Ordinary shares issued by the Company are classified as equity.

Costs directly identifiable with the raising of capital will be charged against the related share issue, net of any tax effect. Costs related to shares not yet issued are recorded as deferred financing costs. These costs will be deferred until the issuance of the shares to which the costs relate, at which time the costs will be charged against the related share issuance or charged to operations if the shares are not issued.

# **Mongolia Growth Group Ltd.**

## **Notes to Consolidated Financial Statements**

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#### **p) Share based payment**

The Company offers share based payment plans for directors, executive management, key employees and other key service providers. The purpose of the share based payment plan is to enhance the ability of the Company to attract and retain Directors, executive management, key employees and other key service providers whose training, experience and ability will contribute to the effectiveness of the Company and to directly align their interests with the interests of shareholders.

The Company's share based payment plans provide for the granting of stock options to independent Directors, executive management, key employees and other key service providers. Each stock option entitles the participant to receive one common share and can only be settled with the issuance of common shares, and as a result, is deemed to be an equity-settled share based payment transaction. Share based payment expense is measured based on the fair market value of the Company's shares at the grant date. The associated compensation expense is recognized over the vesting period or service period, whichever is shorter based on the number of rewards that are expected to vest. Fair value of the goods and services received has been determined based on management's estimate of current market rates for those services that could be exchanged by independent willing third parties.

Share based payment arrangements to other key service providers in which the Company receives properties, goods or services as consideration for its own equity instruments are measured at the fair value of the properties, goods or services received. Fair value of the goods and services received has been determined based on management's estimate of current market rates for those services that could be exchanged by independent willing third parties. If the identifiable consideration received by the Company appears to be less than the fair value of the stock options granted, the Company will perform an assessment to determine if unidentifiable goods or services has been, or will be, received by the Company. The unidentifiable goods or services are then measured at the grant date.

The fair value of stock options granted is measured using the Black-Scholes option pricing model.

Agent options granted as compensation for the issuance of shares are charged to share issue costs.

Any consideration received upon the exercise of stock options is credited to common shares. In the event that vested stock options expire without being exercised, previously recorded compensation costs associated with such options are not reversed.

#### **q) Earnings (loss) per share**

The Company presents basic and diluted earnings (loss) per share (EPS) data for its common shares. Basic EPS is calculated by dividing the results of operations attributable to ordinary shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is determined by adjusting the results of operations attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive potential common shares, which comprise share options.

# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

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### **r) Segment reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of operations, has been identified as the Chief Executive Officer. The Company is managed as three operating segments based on how information is produced internally for the purpose of making operating decisions. The segments are defined as investment property operations, insurance operations and corporate.

### **s) Leases**

The Company has entered into Mongolian government land leases on some of its investment properties. The Company, as a lessee, has determined, based on an evaluation of the terms and conditions of the arrangements, that these land leases meet the definition of an investment property and has classified them as such. At inception, these leases are recognized at the lower of the fair value of the property and the present value of the minimum lease payments and an equivalent lease obligation is recognized.

The Company has entered into commercial and residential property leases on its investment properties. The Company as a lessor, has determined, based on an evaluation of the terms and conditions of the arrangements, that it retains the significant risks and rewards of ownership of these properties and therefore accounts for these agreements as operating leases.

### **t) Provisions and contingent liabilities**

Provisions are recognized when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. When the Company expects some or all of the provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense of any provision is recognized in the consolidated statement of operations net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a borrowing cost.

Contingent liabilities are disclosed if there is a possible future obligation as a result of a past event, or if there is a present obligation as a result of a past event but either a payment is not probable or the amount cannot be reasonably estimated.

### **u) Accounting standards and amendments issued but not yet adopted**

The following is an overview of accounting standard changes that the Company will be required to adopt in future years. Except as noted for IFRS 7, IFRS 9 and IAS 1, the standards are applicable for periods beginning on or after January 1, 2013 with earlier adoption permitted.

**Mongolia Growth Group Ltd.**  
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(expressed in Canadian dollars)

***IFRS 7 - “Financial Instruments: Disclosures”***

IFRS 7 was amended by the IASB in October 2010, and requires entities to provide the disclosures for all transferred financial assets that are not recognized and for a continuing involvement in a transferred financial asset, existing at the reporting date, irrespective of when the related transfers transaction occurred. The amendment is effective for annual periods beginning on or after January 1, 2012. IFRS 7 was further amended by the IASB in December 2011. The amendment requires entities to provide disclosures related to offsetting financial assets and liabilities. The amendment is effective for annual periods beginning on or after January 1, 2014.

***IFRS 9 - “Financial Instruments”***

IFRS 9 was issued in November 2009 and contained requirements for financial assets. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 “Financial Instruments: Recognition and Measurement” for debt instruments with a new model only having two categories: amortized cost and fair value. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at FVTPL or at fair value through OCI. Where such equity instruments are measured at fair value through OCI that do not clearly represent a return of investment, the dividends are recognized in net income (loss) under net investment income; however, other gains and losses associated with such instruments remain in AOCI indefinitely.

Requirements for financial liabilities were added in October 2010 which largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at FVTPL would generally be recorded in OCI.

The IASB recently issued an amendment to this standard that delays the effective date from accounting periods beginning on or after January 1, 2013 to January 1, 2015. The amendment also modifies the relief from restating prior periods. As part of this relief, the IASB published an amendment to IFRS 7 to require additional disclosure on transition from IAS 39 to IFRS 9. The Company continues to monitor developments in this area.

***IFRS 10 - “Consolidated Financial Statements”***

IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. The IFRS defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. The Company is in the process of evaluating the impact of the new standard on the Company’s consolidated financial statements.

**Mongolia Growth Group Ltd.**  
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(expressed in Canadian dollars)

***IFRS 11 - “Joint Arrangements”***

IFRS 11 provides a new definition of joint arrangement focusing on the rights and obligations of the arrangement, rather than its legal form. The IFRS classifies joint arrangements into two types, joint operations and joint ventures. The Company is in the process of evaluating the impact of the new standard on the Company’s consolidated financial statements.

***IFRS 12 - “Disclosure of Interests in Other Entities”***

IFRS 12 requires the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with, its interest in other entities and the effects of those interests on its financial position, financial performance and cash flows.

Early adoption of IFRS 12 is only permitted if IFRS 10, IFRS 11, IFRS 12 and the consequential amendments to IAS 17 and IAS 18 are adopted at the same time, with the exception of early adopting only the disclosure provision for IFRS 12 without the other new standards. The Company is in the process of evaluating the impact of the new standard on the Company’s consolidated financial statements.

***IFRS 13 - “Fair Value Measurement”***

IFRS 13 provides a definition of fair value, a single framework for measuring fair value and disclosure requirements about fair value measurements. The Company is in the process of evaluating the impact of the new standard on the Company’s consolidated financial statements.

***IAS 1 - “Presentation of Financial Statements”***

IAS 1 was amended in 2011 to require earnings (loss) and OCI to be presented together either as a single statement of comprehensive income or separate income statement and statement of comprehensive income. The amendments also requires presentation of OCI based on whether or not the balance may subsequently be reclassified to net income, with the tax associated with each type of OCI based on whether or not the balance may subsequently be reclassified to net income (loss), with the tax associated with each type of OCI balance to be presented separately. IAS 1 amendments are to be applied for annual periods beginning on or after July 1, 2012 with earlier adoption permitted. The impact of the adoption of this standard on the components of the financial statements cannot be reasonably estimated at this time.

**4 Significant accounting estimates and judgements**

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated based on historical experiences and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

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## Notes to Consolidated Financial Statements

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(expressed in Canadian dollars)

The effect of a change in an accounting estimate is recognized prospectively by including it in net income (loss) in the period of the change, if the change affects that period only, or in the period of the change and future periods, if the change affects both.

Significant estimates made in the preparation of these consolidated financial statements include the following areas:

- Fair value of investment properties - The estimate of fair value of investment properties is the most critical accounting estimate to the Company. An external appraiser estimates the fair value of the majority of investment properties annually. The fair value of investment properties is based on the nature, location and condition of the specific asset. The fair value of investment properties represents an estimate of the price that would be made in an arm's length transaction between knowledgeable, willing parties. The Company operates in the emerging real estate market of Mongolia, which given its current economic, political and industry conditions, gives rise to an increased inherent risk given the lack of reliable and comparable market information. The significant estimates underlying the fair value determination are disclosed in note 10. Changes in assumptions about these factors could materially affect the carrying value of investment properties.
- Valuation of insurance contract liabilities - The estimate of the ultimate liability arising from claims made under insurance contracts is another critical accounting estimate. There are several sources of uncertainty that need to be considered in the estimate of the liability that the Company will ultimately pay for such claims. The ultimate cost of claims liabilities is estimated by using a range of standard actuarial claims projection techniques in accordance with Canadian accepted actuarial practice. Further information on methodology of the calculation and assumptions involved in estimating insurance contract liabilities including sensitivity analysis are disclosed in note 14.
- Accuracy of share based compensation expense - The estimate of the ultimate expense arising from share based compensation plans is another critical accounting estimate. There are several sources of uncertainty that need to be considered in the estimate of the share based compensation expense recorded by the Company. The ultimate expense is estimated by using a number of key assumptions such as the expected volatility of the share price, the dividends expected on the shares, the risk-free interest rate for the expected life of the option and future forfeiture rates. Further information on key assumptions including sensitivity analysis is included in note 15.
- Operating environment of the Company - Mongolia displays many characteristics of an emerging market including relatively high inflation and interest rates. The tax and customs legislation in Mongolia is subject to varying interpretations and frequent changes. The future economic performance of Mongolia is tied to the continuing demand from China and continuing high global prices for commodities as well as being dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government of Mongolia together with tax, legal, regulatory and political developments. Management is unable to predict all developments that could have an impact on the Mongolian economy and consequently what effect, if any, they could have on the future financial position of the Company.



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### 5 Cash and cash equivalents

Cash at banks earns interest at floating rates based on daily bank deposit rates. The component of cash and cash equivalents account currently consists only of cash amounts held in banks or on hand.

The following table discloses the geographical location of cash and cash equivalents:

	2012 \$	2011 \$
Barbados	39,443	1,867,474
Canada	1,515,119	15,298,986
Mongolia	7,147,691	2,912,488
	<u>8,702,253</u>	<u>20,078,948</u>
	2012 \$	2011 \$
Cash	8,702,253	19,145,052
Cash equivalents	-	933,896
	<u>8,702,253</u>	<u>20,078,948</u>

Cash and cash equivalents are not collateralized. All amounts are classified as neither past due and not impaired.

Term deposits with banks included in cash and cash equivalents have original maturities of less than three months and bear interest at a rate of nil (2011 - 6.6%) per annum. The settlement and term deposits are placed in commercial banks operating in Mongolia. The carrying amount of cash and cash equivalents approximates fair value.

The credit quality of cash and cash equivalents balances may be summarized based on Standard and Poor's ratings or equivalents of Moody's and/or Fitch ratings. The credit quality at December 31 was as follows:

	2012 \$	2011 \$
Cash on hand	10,146	3,016
A or A+ rated	1,550,838	17,160,922
-B or B+ rated	6,981,315	2,773,791
Unrated	159,954	141,219
	<u>8,702,253</u>	<u>20,078,948</u>

The unrated balance relates to five (2011 - one) commercial banks in Mongolia, which have not been rated by any rating agency and one private bank in Barbados which is also unrated.

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**6 Investments and marketable securities**

**a) Carrying and fair value of investments and marketable securities**

The carrying and fair values of the Company's investment portfolio by financial instrument categories are as follows:

				<b>2012</b>
	<b>Classified as loans and receivables \$</b>	<b>Designated as FVTPL \$</b>	<b>Total carrying value \$</b>	<b>Total fair value \$</b>
Money market fund				
Barbados	-	100	100	100
Term deposits				
Mongolia	3,992,447	-	3,992,447	3,992,447
	<u>3,992,447</u>	<u>100</u>	<u>3,992,547</u>	<u>3,992,547</u>
				<b>2011</b>
	<b>Classified as loans and receivables \$</b>	<b>Designated as FVTPL \$</b>	<b>Total carrying value \$</b>	<b>Total fair value \$</b>
Money market fund				
Barbados	-	511,253	511,253	511,253
Term deposits				
Canada	40,305	-	40,305	40,305
Mongolia	3,465,203	-	3,465,203	3,465,203
	<u>3,505,508</u>	<u>511,253</u>	<u>4,016,761</u>	<u>4,016,761</u>

Deposits with Mongolian banks are denominated in Mongolian National Tögrögs and are placed with five (2011 - four) commercial banks operating in Mongolia. Deposits with Mongolian banks are neither past due nor impaired and are not collateralized. All deposits bear fixed interest rates ranging from 13.8% to 16.2% (2011 - 11.0% to 15.6%).

Deposits with financial institutions in Canada bear a fixed interest rate of nil (2011 - 0.8%).

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**b) Fair value hierarchy**

The Company has categorized its assets measured at fair value into the three-level fair value hierarchy as summarized below, based upon the priority of the inputs to the respective valuation technique as defined in note 3:

	<b>2012</b>	
	<b>Level 1</b>	<b>Total</b>
	\$	\$
FVTPL		
Money market fund	100	100
	<b>2011</b>	
	<b>Level 1</b>	<b>Total</b>
	\$	\$
FVTPL		
Money market fund	511,253	511,253

The Company has not adjusted the quoted price for any instruments included in Level 1. There are no investments that meet the Level 2 or 3 fair value measurement criteria. No investments were transferred between levels in 2012 and 2011.

**c) Credit quality of investments and marketable securities**

The credit quality of investments and marketable securities may be summarized based on Standard and Poor's ratings or equivalents of Moody's and/or Fitch ratings. The credit quality at December 31 was as follows:

	<b>2012</b>	<b>2011</b>
	\$	\$
A+ rated	-	40,305
-B or B+ rated	1,445,637	2,666,708
Unrated	2,546,910	1,309,748
	3,992,547	4,016,761

The unrated balance relates to three (2011 - one) commercial banks in Mongolia, which have not been rated by any rating agency and one (2011 - one) private bank in Barbados which is also unrated.

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Notes to Consolidated Financial Statements  
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(expressed in Canadian dollars)

**d) Maturity schedule of fixed-term investments**

			<b>2012</b>
	<b>One year or less \$</b>	<b>One to five years \$</b>	<b>Total \$</b>
Money market fund			
Barbados	100	-	100
Term deposits			
Mongolia	3,992,447	-	3,992,447
	<u>3,992,547</u>	<u>-</u>	<u>3,992,547</u>
			<b>2011</b>
	<b>One year or less \$</b>	<b>One to five years \$</b>	<b>Total \$</b>
Money market fund			
Barbados	511,253	-	511,253
Term deposits			
Canada	40,305	-	40,305
Mongolia	2,018,220	1,446,983	3,465,203
	<u>2,569,778</u>	<u>1,446,983</u>	<u>4,016,761</u>

The carrying amount of investments and marketable securities approximates fair value due to their short-term maturity. The carrying amount of the term deposits maturing in more than one year approximates their fair value as they were placed with the bank close to the end of fiscal 2011. Although these investments are classified as long-term, they are callable at any time.

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**e) Net investment income (loss)**

	<b>2012</b>	<b>2011</b>
	\$	\$
Net realized loss on sale of AFS financial assets	-	(592,277)
Interest income		
Term deposits and money market fund	847,548	252,946
Cash and cash equivalents	16,468	34,976
	<u>864,016</u>	<u>(304,355)</u>
Investment expense	<u>(703)</u>	<u>(39,891)</u>
	<u>863,313</u>	<u>(344,246)</u>

**f) Realized loss on sale of AFS financial assets**

	<b>2012</b>	<b>2011</b>
	\$	\$
Barbados AFS financial assets	<u>-</u>	<u>(592,277)</u>

**7 Other assets**

	<b>2012</b>	<b>2011</b>
	\$	\$
Amounts due from policyholder	222,011	197,550
Accounts receivable	255,628	94,539
Prepaid expenses	367,619	135,860
Prepaid deposits on investment properties	1,626,240	-
	<u>2,471,498</u>	<u>427,949</u>

**8 Reinsurance assets (note 14)**

	<b>2012</b>	<b>2011</b>
	\$	\$
Reinsurers' share of provision for unearned premiums	261,853	7,760
Reinsurers' share of loss provision	422,432	-
	<u>684,285</u>	<u>7,760</u>

The entire balance of reinsurance assets is considered to be current.

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**9 Deferred acquisition expenses**

The movement in deferred acquisition expenses during the year was as follows:

	2012 \$	2011 \$
Carrying amount at January 1	15,175	-
Acquisition expenses deferred	119,251	16,555
Acquisition expenses amortized	(40,857)	(1,379)
Foreign exchange adjustment	(394)	(1)
	<hr/>	<hr/>
At December 31	93,175	15,175
	<hr/>	<hr/>

The Company did not have any commission income from reinsurance during the period.

**10 Investment properties**

	2012 \$	2011 \$
Balance - beginning of period	26,166,286	-
Additions		
Acquisitions	8,190,935	21,621,505
Capital expenditures	374,890	819,698
Transfer from property and equipment	140,251	-
Disposals	(1,656,768)	-
Unrealized fair value adjustment <sup>(1)</sup>	(1,490,336)	5,740,919
Foreign exchange adjustments	(938,516)	(2,015,836)
	<hr/>	<hr/>
Balance - end of period	30,786,742	26,166,286
	<hr/>	<hr/>

<sup>(1)</sup> Unrealized gain (loss) on fair value adjustment on investment properties recorded in the consolidated statement of operations includes an impairment provision of \$1,206,876 for investment properties classified as prepaid deposits.

Included in investment properties are properties actively being marketed for sale that are to be disposed of without redevelopment with a fair value of \$775,559 (2011 - \$1,757,511). During the year, the Company sold investment properties for gross proceeds of \$1,669,536. A gain of \$12,768 on these transactions has been recorded in other revenue on the consolidated statement of operations.

Investment properties with an aggregate fair value of \$18,819,566 (2011 - \$21,555,999) at December 31, were valued by an external independent valuation professional who is deemed to be qualified appraiser who holds a recognized, relevant, professional qualification and who has recent experience in the locations and categories of the investment properties valued. The carrying value of investment properties valued by the external appraiser at December 31, 2012 and 2011 agrees to the valuations reported by the external appraiser.

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## Notes to Consolidated Financial Statements

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(expressed in Canadian dollars)

The Company determined the fair value of investment properties using the sales comparison approach and the income approach, which are generally accepted appraisal methodologies.

Under the income approach, the methodology used was the direct capitalization approach which is based on rental income and yields. Rental incomes were based on current rent and reasonable and supportable assumptions that represent what knowledgeable, willing parties would assume about rental income from future rent in light of current conditions adjusted for non-recoverable property costs. Yields were determined using data from real estate agencies, market reports and property location among other things in determining the appropriate assumptions.

Under the overall capitalization method, year one income is stabilized and capped at a rate deemed appropriate for each investment property. Commercial property has been fair valued under this approach.

The sales comparison approach analyzes all available information of sales of comparable properties that have recently taken place and adjusts the price to reflect differences in the property valued and sold. Residential property has been fair valued under this approach.

The key valuation assumptions for investment properties are as follows:

	<b>2012</b>		
	<b>Maximum</b>	<b>Minimum</b>	<b>Weighted-average</b>
Capitalization rate	14.2%	7.6%	10.8%

	<b>2011</b>		
	<b>Maximum</b>	<b>Minimum</b>	<b>Weighted-average</b>
Capitalization rate	15.6%	7.6%	10.6%

Additional valuation assumptions include the rental revenue per square meter, grade quality of the property and comparable market data.

Investment properties held by the Company are leased out under operating leases. The future minimum lease payments under non-cancellable leases are as follows:

	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Less than 1 year	2,011,716	688,026
Between 1 and 5 years	2,011,052	2,911,911
	4,022,768	3,599,937

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Investment properties include land held under operating leases with an aggregate fair value of \$9,458,693 (2011 - \$3,670,841) at December 31.

Direct operating expenses arising from investment properties that generated rental income during the year was \$764,440 (2011 - \$623,615). Direct operating expenses arising from investment properties that did not generate rental income during the year was \$222,967 (2011 - \$13,892).

**11 Property and equipment**

	<b>2012</b>				
	<b>Furniture and fixtures \$</b>	<b>Equipment \$</b>	<b>Vehicles \$</b>	<b>Buildings \$</b>	<b>Total \$</b>
<b>Cost</b>					
<b>At January 1</b>	109,122	81,605	234,039	4,241,393	4,666,159
Additions	66,104	55,517	36,666	275,423	433,710
Disposals	(35,996)	(4,012)	-	-	(40,008)
Transfer to investment properties	-	-	-	(140,251)	(140,251)
Foreign exchange adjustment	(340)	(7,373)	(2,354)	(137,858)	(147,925)
<b>At December 31</b>	<b>138,890</b>	<b>125,737</b>	<b>268,351</b>	<b>4,238,707</b>	<b>4,771,685</b>
	<b>2012</b>				
	<b>Furniture and fixtures \$</b>	<b>Equipment \$</b>	<b>Vehicles \$</b>	<b>Buildings \$</b>	<b>Total \$</b>
<b>Accumulated depreciation</b>					
<b>At January 1</b>	5,780	9,926	8,618	17,825	42,149
Depreciation	16,508	30,744	23,859	99,779	170,890
Disposals	(4,460)	(1,159)	-	(9,476)	(15,095)
Foreign exchange adjustment	(222)	(1,541)	(387)	(140)	(2,290)
<b>At December 31</b>	<b>17,606</b>	<b>37,970</b>	<b>32,090</b>	<b>107,988</b>	<b>195,654</b>
<b>Net book value at December 31</b>	<b>121,284</b>	<b>87,767</b>	<b>236,261</b>	<b>4,130,719</b>	<b>4,576,031</b>



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	<b>2011</b>				
	<b>Furniture and fixtures \$</b>	<b>Equipment \$</b>	<b>Vehicles \$</b>	<b>Buildings \$</b>	<b>Total \$</b>
<b>Cost</b>					
<b>At January 1</b>	-	-	-	-	-
Additions	118,186	86,324	287,584	4,750,289	5,242,383
Disposals	-	-	(32,521)	-	(32,521)
Foreign exchange adjustment	(9,064)	(4,719)	(21,024)	(508,896)	(543,703)
<b>At December 31</b>	<b>109,122</b>	<b>81,605</b>	<b>234,039</b>	<b>4,241,393</b>	<b>4,666,159</b>
	<b>2011</b>				
	<b>Furniture and fixtures \$</b>	<b>Equipment \$</b>	<b>Vehicles \$</b>	<b>Buildings \$</b>	<b>Total \$</b>
<b>Accumulated depreciation</b>					
<b>At January 1</b>	-	-	-	-	-
Depreciation	6,251	10,604	9,392	19,510	45,757
Foreign exchange adjustment	(471)	(678)	(774)	(1,685)	(3,608)
<b>At December 31</b>	<b>5,780</b>	<b>9,926</b>	<b>8,618</b>	<b>17,825</b>	<b>42,149</b>
<b>Net book value at December 31</b>	<b>103,342</b>	<b>71,679</b>	<b>225,421</b>	<b>4,223,568</b>	<b>4,624,010</b>

**12 Trade payables and accrued liabilities**

	<b>2012 \$</b>	<b>2011 \$</b>
Trade and accrued payables	833,349	688,808
Premiums received in advance	4,949	5,007
Security deposit	130,084	78,039
Unearned revenue	27,932	87,359
	<b>996,314</b>	<b>859,213</b>

The carrying amounts above reasonably approximate fair value at the balance sheet date. All trade and other payables are current.

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(expressed in Canadian dollars)

**13 Income taxes**

**a) Effective tax rate**

The provision for income taxes reflects an effective tax rate that differs from the combined tax rate for Canadian federal and provincial corporate taxes for the following:

	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Net income (loss) before income taxes	(6,052,070)	2,176,650
Combined statutory tax rate	26.5%	28.25%
Tax payable (recoverable) based on statutory tax rate	(1,603,799)	614,904
Effect of:		
Permanent differences	189,128	142,573
Tax rate variances of foreign subsidiaries	923,247	(397,239)
Deferred tax assets not recognized	303,697	373,505
Other	209,407	93,754
	<u>21,680</u>	<u>827,497</u>
Provision for (recovery of) income taxes		
Current	209,407	827,497
Deferred	(187,727)	-
	<u>21,680</u>	<u>827,497</u>

**b) Deferred income taxes**

Differences between IFRS and statutory taxation regulations in Mongolia give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases.

The Company did not recognize a deferred tax asset in these consolidated financial statements as there is uncertainty with regard to the recoverability of the asset for both the Canadian and Mongolian entities.

There are \$1,861,000 (2011 - \$36,000) of non-capital loss carryforwards relating to the Mongolian entities that will expire in 2013. The Company also did not recognize deferred tax assets related to taxable temporary differences of \$81,000. In accordance with Mongolian tax law, the taxable losses can be carried forward for two years and are deductible up to 50% of the taxable income of that year.

In accordance with Canadian tax law, the taxable losses can be forward twenty years. There are \$2,953,429 (2011 - \$1,293,266) of non-capital losses relating to the Canadian entity.

**Mongolia Growth Group Ltd.**  
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(expressed in Canadian dollars)

The losses expire as follows:

Year of expiry	Non-capital loss \$
2028	8,572
2029	75,387
2030	275,393
2031	933,914
2032	1,660,163

No future tax benefit has been recorded on these non-capital loss carry forwards as the timing for potential realization of these future benefits is uncertain.

Components of the deferred tax liabilities are as follows:

	2012 \$	2011 \$
Deferred tax liabilities		
Investment properties	557,903	-
Investment in related party	56,043	-
	613,946	-

In 2011, the deferred tax liabilities of \$801,673 were included in income tax payable.

## 14 Insurance contract liabilities

### a) Insurance contract liabilities consist of:

	2012		
	Insurance contract liabilities \$	Reinsurers' portion \$	Net \$
Property and casualty			
Unearned premiums	1,031,176	(261,853)	769,323
Unpaid claims	1,269,428	(422,432)	846,996
	2,300,604	(684,285)	1,616,319
Insurance contract liabilities			
Current	2,300,604	(684,285)	1,616,319
Non-current	-	-	-
	2,300,604	(684,285)	1,616,319

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	<b>2011</b>		
	<b>Insurance contract liabilities</b>	<b>Reinsurers' portion</b>	<b>Net</b>
	\$	\$	\$
Property and casualty			
Unearned premiums	310,993	(7,760)	303,233
Unpaid claims	50,827	-	50,827
Insurance contract liabilities	<u>361,820</u>	<u>(7,760)</u>	<u>354,060</u>
Current	361,820	(7,760)	354,060
Non-current	-	-	-
Insurance contract liabilities	<u>361,820</u>	<u>(7,760)</u>	<u>354,060</u>

**b) The movements in unearned premiums for the year were:**

	<b>2012</b>		
	<b>Insurance contract liabilities</b>	<b>Reinsurers' portion</b>	<b>Net</b>
	\$	\$	\$
<b>At January 1</b>	310,993	(7,760)	303,233
Gross premiums written	2,004,415	(889,222)	1,115,193
Premiums earned	(1,263,553)	635,129	(628,424)
Foreign currency adjustment	(20,679)	-	(20,679)
<b>At December 31</b>	<u>1,031,176</u>	<u>(261,853)</u>	<u>769,323</u>

	<b>2011</b>		
	<b>Insurance contract liabilities</b>	<b>Reinsurers' portion</b>	<b>Net</b>
	\$	\$	\$
<b>At January 1</b>	-	-	-
Gross premiums written	391,702	(10,683)	381,019
Premiums earned	(80,709)	2,923	(77,786)
<b>At December 31</b>	<u>310,993</u>	<u>(7,760)</u>	<u>303,233</u>

Gross premiums written and premiums earned include respective instalment service charges.

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**c) Property and casualty unpaid claims**

	<b>2012</b>		
	<b>Gross unpaid claims \$</b>	<b>Reinsurers' portion \$</b>	<b>Net \$</b>
Provision for reported claims undiscounted	1,152,238	(373,011)	779,227
Effect of discounting and PFADs	117,190	(49,421)	67,769
	<b>1,269,428</b>	<b>(422,432)</b>	<b>846,996</b>
	<b>2011</b>		
	<b>Gross unpaid claims \$</b>	<b>Reinsurers' portion \$</b>	<b>Net \$</b>
Provision for reported claims undiscounted	46,995	-	46,995
Effect of discounting and PFADs	3,832	-	3,832
	<b>50,827</b>	<b>-</b>	<b>50,827</b>

Management believes that the unpaid claims provision is appropriately established in the aggregate and is adequate to cover the ultimate net cost on a discounted basis. The determination of this provision, which includes unpaid claims, adjustment expenses and expected salvage and subrogation requires an assessment of future claims development. This assessment takes into account the consistency of the Company's claim handling procedures, the amount of information available, the characteristics of the line of business from which the claims arise and the delay inherent in claims reporting. This provision is an estimate and as such is subject to variability that may arise from future events, such as the receipt of additional claims information, changes in judicial interpretation of contracts or significant changes in frequency and severity of claims. As the insurance company is at a start-up stage, there is no historical loss information available. As a result, the Company has calculated the unpaid claims provision based on the expected loss method. Under the expected loss method, ultimate losses are based upon some prior measure of the anticipated losses relative to some measure of exposure, which the Company has used earned premium. The expected loss ratios were based on Mongolian industry experience and expected loss ratios used in determining the Company's premium rates. Any such changes in assumptions will be reflected in the consolidated statement of operations for the period in which the change occurred.

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The loss ratios used in the calculations are as follows:

	<b>2012</b>	<b>2011</b>
	%	%
Accident insurance	70	70
Automobile insurance	55	55
Property insurance	60	60
Drivers' insurance	115	70
Liability insurance	60	60
Construction insurance	60	60
Cargo insurance	60	60
Finance insurance	720	-
Aviation	60	-

This estimate does not reflect the time value of money. In that respect, the Company determines the discount rate based upon the expected return of investments held in the portfolio that approximates the cash flow requirements of the unpaid claims. The discount rate applied was 1% (2011 - 3%) and then again at 0.5% (2011 - 2%) to allow a margin for adverse deviations in the interest rate. To recognize the uncertainty inherent in determining unpaid claim amounts, the Company includes provision for PFADs relating to claim development, reinsurance recoveries and future investment income. Margins for claims development used for calculating the provision for adverse deviation range from 10% to 15% depending on the line of business.

Significant estimates used in the valuation of insurance contract liabilities are the discount rate and the expected loss ratios. A change in the discount rate by 2% or in the expected loss ratios by 10% would not have a material impact.

**d) Net premiums earned for the year ended December 31 consist of:**

	<b>2012</b>	<b>2011</b>
	\$	\$
Gross premiums written	2,004,415	391,702
Premiums ceded	(889,222)	(10,683)
Increase in unearned premiums	(769,323)	(303,233)
Foreign exchange adjustment	282,554	-
	<hr/>	<hr/>
Net premiums earned	628,424	77,786
	<hr/>	<hr/>

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**15 Share capital and contributed surplus**

**a) Authorized**

The Company is authorized to issue an unlimited number of common and preferred shares.

**b) Common shares**

The issued and outstanding common shares are as follows:

	<b>Number of shares</b>	<b>Amount \$</b>
Balance, December 31, 2010	2,964,300	438,547
Consolidation of common shares (1:2)	1,482,150	-
Issued for cash	32,661,202	51,571,284
Share issue costs	-	(328,013)
	<hr/>	<hr/>
Balance December 31, 2011	34,143,352	51,681,818
	<hr/>	<hr/>
Balance, December 31, 2012	34,143,352	51,681,818
	<hr/>	<hr/>

***Common shares issued***

The common shares issued during the previous year were completed through a series of four private placements. The shares issued and proceeds raised were as follows:

	<b>Number of shares issued</b>	<b>Amount \$</b>
February 2, 2011 <sup>(1)</sup>	12,685,452	4,611,253
April 8, 2011	11,257,923	14,860,458
June 22, 2011	4,871,673	17,099,573
December 23, 2011	3,846,154	15,000,000
	<hr/>	<hr/>
	32,661,202	51,571,284
	<hr/>	<hr/>

<sup>(1)</sup> 25,370,904 shares were issued on February 2, 2011. Following this private placement there was a 2:1 share consolidation.

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**c) Stock options**

	Number of options	Weighted average exercise price \$
Balance, December 31, 2010	296,430	0.20
Cancelled - prior share based payment plan	(296,430)	(0.20)
Granted	1,825,000	3.42
Forfeited - current share based payment plan	(128,000)	(4.20)
	<hr/> 1,697,000	<hr/> 3.36
Balance, December 31, 2011	1,697,000	3.36
Cancelled - prior share based payment plan	(5,000)	(4.25)
Granted	190,000	4.00
Forfeited - current share based payment plan	(100,000)	(4.36)
	<hr/> 1,782,000	<hr/> 3.40
December 31, 2012		

The Company has established a share based payment plan (the “Plan”) to encourage ownership of its shares by key management personnel (directors and executive management), employees and other key service providers, and to provide compensation for certain services. The Plan provides for the issuance of stock options in an aggregate number of up to 10% of the Company’s issued and outstanding shares, calculated from time to time. At December 31, 2012, the Company had 1,632,335 (2011 - 1,717,335) common shares available for the granting of future options under the new plan. The Company does not have any cash-settled transactions.

Pursuant to the Company’s previous stock option plan, 351,428 stock options were granted to directors and officers on October 9, 2008. These options allowed the holder to acquire common shares at a price of \$0.20 per share for each option exercised. The options were fully vested and were exercisable at any time prior to their expiry on October 9, 2013. Concurrent with the cancellation of the common shares of the Company on February 2, 2011, the Company also cancelled 296,430 of the stock options issued to its directors and officers.

On March 9, 2011, 600,000 options were granted to consultants of the Company. These options allow the holder to acquire common shares at a price of \$1.64 per share for each option exercised. 500,000 of these options vest and become exercisable on March 9, 2014 and are exercisable up until their expiry on March 9, 2021. 100,000 of these options vest and become exercisable on March 9, 2013 up until their expiry on March 9, 2014. On May 16, 2012, the Company approved a Board resolution that allowed for 200,000 of the options to vest immediately at a modified price of \$1.90 per share for each option issued.



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On April 25, 2011, 900,000 options were granted to employees and consultants of the Company. These options allow the holder to acquire common shares at a price of \$4.20 per share for each option exercised. 650,000 of these options vest in four equal annual tranches each year over four years and expire on April 25, 2016. 75,000 of these options shall vest on April 25, 2013 and expire April 25, 2014. 175,000 of these options shall vest on April 25, 2013 and expire April 25, 2016.

On September 7, 2011, 175,000 options were granted to employees and consultants of the Company. These options allow the holder to acquire common shares at a price of \$4.77 per share for each option exercised. 55,000 of these options vest in four equal annual tranches each year over four years and expire on September 7, 2016. 120,000 of these options shall vest and become exercisable on September 7, 2013 and expire on September 7, 2016.

On December 2, 2011, 150,000 options were granted to employees. These options allow the holder to acquire common shares at a price of \$4.25 per share for each option exercised. These options vest in four equal annual tranches each year over four years and expire on December 2, 2016.

On March 23, 2012, 190,000 options were granted to employees. These options allow the holder to acquire common shares at a price of \$4.00 per share for each option exercised. 170,000 of these options vest in four equal annual tranches each year over four years and expire on March 23, 2017. 20,000 of these options shall vest and become exercisable on March 23, 2014 and expire on March 23, 2017.

At period-end, the Company had 358,000 options that were exercisable (2011 - nil).

A summary of the Company's options as at December 31 and changes during the periods then ended follows:

	December 31, 2012	Weighted average exercise price \$	December 31, 2011	Weighted average exercise price \$
Balance, beginning of the year	1,697,000	3.36	296,430	0.20
Options cancelled	(5,000)	4.25	(296,430)	(0.20)
Options granted	190,000	4.00	1,825,000	3.42
Options forfeited	(100,000)	4.36	(128,000)	(4.20)
Balance, end of the year	1,782,000	3.40	1,697,000	3.36
Exercisable	358,000	2.94	-	
Weighted remaining average life (years)		3.84		5.70

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The fair value associated with the options issued was calculated using the Black-Scholes model for options valuation, assuming volatility of 90% on the underlying units, a risk free interest rate ranging from 1.44% to 2.9% depending on the date the options were granted and a forfeiture rate of nil based on the composition of the option holders. Share prices for the calculation were the closing price on the CNSX on the date of issue of the options. The Company has assumed the options will be exercised at the end of the term of the option.

Being a newly listed entity, the Company considered its historical share price over the last twenty months. However, given the lack of sufficient information on historical volatility, it also considered historical volatility of similar entities following a comparable period in their lives.

The approximate impact of an increase of 10% in the volatility assumption would decrease net income of the Company by \$103,000. The approximate impact of a decrease of 10% in the volatility assumption would increase net income of the Company by \$115,000.

The following options were issued, outstanding and exercisable at December 31:

<b>Options outstanding 2012</b>			
<b>Number outstanding</b>	<b>Weighted average remaining life (years)</b>	<b>Weighted average exercise price \$</b>	<b>Weighted average at grant date</b>
400,000	6.50	1.64	1.78
200,000	8.25	1.90	1.78
722,000	3.33	4.20	4.04
150,000	3.67	4.77	4.70
120,000	3.92	4.25	4.14
190,000	4.33	4.00	4.00
<b>1,782,000</b>	<b>3.84</b>	<b>3.40</b>	<b>3.35</b>

<b>Options outstanding 2011</b>			
<b>Number outstanding</b>	<b>Weighted average remaining life (years)</b>	<b>Weighted average exercise price \$</b>	<b>Weighted average at grant date</b>
600,000	8.08	1.64	1.78
772,000	4.33	4.20	4.04
175,000	4.67	4.77	4.70
150,000	4.92	4.25	4.14
<b>1,697,000</b>	<b>5.70</b>	<b>3.36</b>	<b>3.32</b>

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The following table summarizes the shares used in calculating earnings (loss) per share:

	<b>2012</b>	<b>2011</b>
	\$	\$
Weighted average number of shares - basic	34,143,352	23,902,851
Effect of dilutive stock options	1,738,913	1,101,214
	<hr/>	<hr/>
Weighted average number of shares - diluted	<u>35,882,265</u>	<u>25,004,065</u>

Basic earnings (loss) per share are derived by dividing net income (loss) for the year by the weighted average number of common shares outstanding for the period. The effect of potentially dilutive securities is excluded if they are anti-dilutive.

There have been no significant capital transactions from the reporting date to the date of this filing which have had a material impact on earnings per share.

## **16 Management of capital structure**

The Company's objective when managing capital is to ensure the Company is capitalized in a manner which provides a strong financial position for its shareholders.

The Company's capital structure includes equity and working capital. In managing its capital structure, the Company considers future investment and acquisition opportunities, potential credit available and potential issuances of new equity. The Company's objective is to maintain a flexible capital structure that will allow it to execute its stated business. Upon acquiring investment properties and operating businesses, the Company will strive to balance its proportion of debt and equity within its capital structure in accordance with the needs of the continuing business. The Company may, from time to time, issue shares and adjust its spending to manage current and projected proportions as deemed appropriate.

The method used by the Company to monitor its capital is based on an assessment of the Company's working capital position relative to its projected obligations. At December 31, 2012, the Company's working capital was \$12,554,733 (2011 - \$21,059,481) and the Company had no debt.

	<b>2012</b>	<b>2011</b>
	\$	\$
Current assets	15,943,758	23,099,610
Current liabilities	3,389,025	2,040,129
	<hr/>	<hr/>
Working capital	<u>12,554,733</u>	<u>21,059,481</u>

The Company's Mongolian insurance operations, Mandal General Insurance LLC, (Mandal) are regulated by the Mongolian insurance regulator, the Financial Regulatory Commission (FRC).

# **Mongolia Growth Group Ltd.**

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(expressed in Canadian dollars)

Mandal's objectives when managing capital are (i) to comply with capital requirements set by the Mongolian laws and FRC, and (ii) to safeguard Mandal's ability to continue as a going concern.

Insurance companies in Mongolia are subject to the following capital regulatory requirements prescribed by FRC:

- Compliance with the requirements to the minimal share capital set by FRC Order No.153 of June 25, 2009 "Order on approving minimum share capital requirement of general insurance company";
- Compliance with the requirements to the composition and structure of the assets as set by FRC Order No. 170 dating June 16, 2010 "Order on approving revised regulation on the requirement of capital allocation and investment of general insurance company".

Compliance with the above ratios is monitored by the Company on a quarterly basis with issuance of reports outlining their calculation reviewed and signed by the Chief Executive Officer of Mandal and submitted to FRC. As at December 31, 2012, Mandal complied with all aforementioned capital requirements.

Mandal's share capital amount of \$4,512,252 (2011 - \$4,628,000) was above the regulatory minimum of \$1,445,536 in accordance with the minimum set by FRC.

## **17 Insurance and financial risk management**

The Board of Directors ensures that management has put appropriate risk management processes in place. Through the Audit Committee, the Board oversees such risk management procedures and controls. Management provides updates to the Audit Committee on a quarterly basis with respect to risk management.

The principal risk the Company faces under insurance contracts is that actual claims or the timing thereof differ from expectations. This is influenced by the frequency of claims, severity of claims and subsequent development of long-term claims. Therefore the objective of the Company is to ensure sufficient reserves are available to cover these claims.

### **Insurance risk management**

The Company principally issues the following types of property and casualty contracts: motor insurance, including voluntary motor-third party liability, property, accident and liability insurance.

The most significant risks that the Company must manage with respect to unpaid claims and other financial instruments are product and pricing, underwriting and liability, claim settlement, catastrophe and reinsurance, credit, market and liquidity risks.

# Mongolia Growth Group Ltd.

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### ***Product and pricing risk***

Product and pricing risk is the risk of financial loss from entering into insurance contracts when the liabilities assumed exceed the expectation reflected in the pricing of the insurance product. The Company prices its products by taking into account several factors including claims frequency, severity trends, product line expense ratios, special risk factors, capital requirements and investment income. These factors are reviewed and adjusted as needed on a regular basis to ensure they are reflective of current trends and market climate.

In some instances, the Company may choose to adjust prices to below what it feels is acceptable in order to maintain a competitive position. However, the Company attempts to maintain a pricing level that ensures it is able to produce an acceptable return.

### ***Underwriting and liability risk***

Underwriting and liability risk is the exposure to financial loss resulting from the selection and approval of risks to be insured, the retention and transfer of risks, the reserving and adjudication of claims, and the management of contractual and non-contractual product options.

The Company has specific underwriting guidelines for declining to issue, terminating, or refusing to renew a contract for each line of business. The underwriting guidelines for risk eligibility are developed in cooperation between the Risk Management Committee, MGG corporate management team and underwriting staff and the underwriting department. These guidelines must be developed in consideration of jurisdictional underwriting rules and comply with evolving jurisdictional regulation on restricted criteria. The Company considers stability, fairness and the expectations of its existing and potential policyholders when making deliberate changes to its underwriting rules.

The Company establishes a guideline that is utilized to ensure that the limits of insurance for a particular risk do not exceed the Company's net retention or maximum written limits and the proper approval authority for the risk is obtained. Net retention is the maximum amount of insurance the Company will retain on a single exposure.

Possible accumulation of large claims in such lines as property insurance, liability insurance and others is the major factor that could have a significant impact on the Company's financial cash flows and performance indicators. Based on this, the Company chooses a risk management policy and reinsurance protection management policy, so as to minimize the impact of this factor.

The above risk exposure is mitigated by diversification across a portfolio of insurance. All risks insured relate to Mongolian customers.

Identification and responding to insurance operation risk is the responsibility of the Chief Risk Officer (CRO). The CRO has annual objectives and an annual plan agreed with the Company's Chief Executive Officer. This includes risk management activities on insurance underwriting, claim processing, IT infrastructure, re-insurance activities, and overall risk management activities of Mandal.

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Mandal has approved policies on policy underwritings, claim processing, actuarial activity, reinsurance activities, and operation of a Risk Management Committee. These policies define the procedures and approval limits for policy underwriting and claim activities for Mandal.

The Risk Management Committee is responsible for analyzing tariffs and conditions of policies, loss ratios, reinsurance and profitability assessment, as well as making decisions on claims. The meetings of the Risk Management Committee are held on a regular basis. The activities of this Committee are overseen and approved by the Board of Directors, which is responsible for making final decisions on introduction of new insurance products, approving Mandal's policies and procedures and dealing with strategic or other significant issues facing the Mandal. All significant transactions exposing Mandal to insurance risk are monitored by the Board of Directors. All insurance policies with risk above MNT 5 billion need to be approved by the Board of Directors. Mandal has defined limits for signing insurance contracts in order to ensure identification and monitoring of significant exposures. All insurance contracts are signed by the Company's CEO.

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An analysis of premiums and claims by line of business for the year ended December 31 is provided in the following table:

	December 31, 2012									
	Accident medical and travel insurance	Property insurance	Motor insurance	Cargo insurance	Construction insurance	Driver's liability insurance	General liability insurance	Finance insurance	Aviation insurance	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Gross premiums written	87,894	11,622	248,723	15,534	422,491	156,062	410,209	73,558	578,322	2,004,415
Premiums ceded	-	-	-	-	(39,038)	-	(269,713)	-	(580,471)	(889,222)
<b>Net premiums written</b>	<b>87,894</b>	<b>11,622</b>	<b>248,723</b>	<b>15,534</b>	<b>383,453</b>	<b>156,062</b>	<b>140,496</b>	<b>73,558</b>	<b>(2,149)</b>	<b>1,115,193</b>
Change in provision for unearned premiums, gross (note 14)	(60,714)	(5,337)	(184,184)	(2,222)	(245,492)	(85,477)	76,472	(44,621)	(189,287)	(740,862)
Change in reinsurer share in provision for unearned premiums (note 14)	(7,718)	-	-	-	5,053	-	66,337	-	190,421	254,093
<b>Net premiums earned</b>	<b>19,462</b>	<b>6,285</b>	<b>64,539</b>	<b>13,312</b>	<b>143,014</b>	<b>70,585</b>	<b>283,305</b>	<b>28,937</b>	<b>(1,015)</b>	<b>628,424</b>
Gross claims paid	(767)	-	(26,358)	-	-	(70,487)	(8,292)	(89,487)	-	(195,391)
Claims ceded	-	-	-	-	-	-	-	-	-	-
Net claims paid	(767)	-	(26,358)	-	-	(70,487)	(8,292)	(89,487)	-	(195,391)
Change in loss provision - net of reinsurance (note 14)	(15,173)	(422)	(10,234)	(8,949)	(100,611)	(35,268)	(194,830)	(471,422)	(10,087)	(846,996)
<b>Net claims incurred</b>	<b>(15,940)</b>	<b>(422)</b>	<b>(36,592)</b>	<b>(8,949)</b>	<b>(100,611)</b>	<b>(105,755)</b>	<b>(203,122)</b>	<b>(560,909)</b>	<b>(10,087)</b>	<b>(1,042,387)</b>

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(expressed in Canadian dollars)

	<b>December 31, 2011</b>								
	Accident medical and travel insurance \$	Property insurance \$	Motor insurance \$	Cargo insurance \$	Construction insurance \$	Driver's liability insurance \$	General liability insurance \$	Other insurance \$	Total \$
Gross premiums written	70	350	12,557	73	108,724	2,629	267,197	102	391,702
Premiums ceded	(10,683)								(10,683)
<b>Net premiums written</b>	<b>(10,613)</b>	<b>350</b>	<b>12,557</b>	<b>73</b>	<b>108,724</b>	<b>2,629</b>	<b>267,197</b>	<b>102</b>	<b>381,019</b>
Change in provision for unearned premiums, gross (note 14)	(70)	(242)	(8,824)	(67)	(98,001)	(2,058)	(201,631)	(100)	(310,993)
Change in reinsurer share in provision for unearned premiums (note 14)	7,760								7,760
<b>Net premiums earned</b>	<b>(2,923)</b>	<b>108</b>	<b>3,733</b>	<b>6</b>	<b>10,723</b>	<b>571</b>	<b>65,566</b>	<b>2</b>	<b>77,786</b>
Gross claims paid			(120)			(644)			(764)
Claims ceded									
Net claims paid			(120)			(644)			(764)
Change in loss provision - net of reinsurance (note 14)		(73)	(1,530)	(4)	(7,279)	(575)	(41,366)		(50,827)
<b>Net claims incurred</b>		<b>(73)</b>	<b>(1,650)</b>	<b>(4)</b>	<b>(7,279)</b>	<b>(1,219)</b>	<b>(41,366)</b>		<b>(51,591)</b>



# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

December 31, 2012

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(expressed in Canadian dollars)

### **Claim settlement**

Under an insurance agreement, the insured party must notify the insurance company of a loss incurred within a clearly defined time period, limited to three days, as stated in most of Mandal's insurance contracts and/or policies. This relatively short time limit represents a common practice in the Mongolian insurance market.

Claims settlement processes are carried out in accordance with Mandal's claims policy. Mandal has a special subdivision, which is responsible for claims settlement. This subdivision collects all necessary information about accidents (i.e. loss occurring events), performs registration of claims, evaluates possible exposure and proceeds with disbursement of claims within determined limits. Insurance claims are paid only upon provision to Mandal of all necessary documents supporting occurrence of an insurance event. The claims settlement subdivision is also responsible for raising subrogation claims, preparation of reports on claims paid and claims reported, which are submitted to insurance managers.

Mandal has clearly defined limits related to claims approval and settlement process.

When a loss is claimed, Mandal notifies the relevant reinsurer on the loss claimed, if the insurance agreement was reinsured. Once Mandal pays the claim, it sends the payment documents to the reinsurer.

Mandal has reinsurance in force during the year to cede 100% of the risks associated with the accident medical and travel product line.

### **Claims development**

The following table shows the estimate of cumulative incurred claims, including both claims notified and IBNR for each successive accident year at the statement of financial position date, together with cumulative payments to date. The Company has elected to present its claims development on an accident year basis as this is consistent with how the business is managed. The Company has elected to translate claims payments using the average rate for the month in which they are paid, and estimated claims at the rate of exchange applicable at the end of each valuation year.

### **Catastrophe risk**

During fiscal 2011, the Company did not have insurance coverage related to its investment property portfolio or its buildings classified as own-use and recorded in property and equipment. On March 3, 2012, the Company, through its insurance subsidiary, has obtained insurance on building and all permanent fixtures totalling approximately \$25,000,000. Subsequent to issuing this policy, the Company's insurance subsidiary obtained a reinsurance agreement to cede 99% of the risk to Hannover Rc (90%) and People's Insurance Company of China (9%) related to this coverage, and updated the policy to include all investment properties which were acquired in 2012.

**Mongolia Growth Group Ltd.**  
Notes to Consolidated Financial Statements  
**December 31, 2012**

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(expressed in Canadian dollars)

**Credit risk**

Credit risk is the risk of an unexpected financial loss to the Company if a third party fails to fulfill its performance obligations under the terms of a financial instrument. The Company's credit risk arises principally from the Company's cash and cash equivalents, investments and marketable securities and accounts receivable.

The following table summarizes the Company's maximum exposure to credit risk on the consolidated statement of financial position. The maximum credit exposure is the carrying value of the asset, net of any allowances for loss.

	2012 \$	2011 \$
Cash and cash equivalents	8,702,253	20,078,948
Investments and marketable securities	3,992,547	4,016,761
Amounts due from policyholders	222,011	197,550
Accounts receivable	255,628	94,539
Reinsurance assets	684,285	7,760
	<hr/>	<hr/>
Maximum credit risk exposure on the consolidated statement of financial position	13,856,724	24,395,558

The Company's exposure to credit risk is managed through risk management policies and procedures with emphasis on the quality of the investment portfolio. For the year, most of the Company's investments consisted of institutional deposits. The majority of the funds invested are held in reputable Barbadian, Canadian or Mongolian banks. The Company is in the early stages of development and is continually improving its policies regarding monitoring its credit risk.

The Company is exposed to credit risk as an owner of real estate in that tenants may become unable to pay the contracted rents. The Company mitigates this risk by carrying out appropriate credit checks and related due diligence on the significant tenants. The Company's properties are diversified across residential and commercial classes.

Amounts due from policy holders are short-term in nature and are not subject to material credit risk.

**Liquidity risk**

Liquidity risk is the risk of having insufficient cash resources to meet financial obligations without raising funds at unfavourable rates or selling assets on a forced basis. Liquidity risk arises from the general business activities and in the course of managing the assets and liabilities. The purpose of liquidity management is to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due. The liquidity requirements of the Company's business are met primarily by funds generated from operations, liquid investments and income and other returns received on investments. Cash provided from these sources is used primarily for claims and claim adjustment expense payments and investment property operating expenses. The timing and amount of catastrophe claims are inherently unpredictable and may create increased liquidity requirements.

# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

December 31, 2012

(expressed in Canadian dollars)

As at December 31, 2012, the Company does not believe the current maturity profile of the Company lends itself to any material liquidity risk, taking into account the level of cash and cash equivalents, investments and marketable securities as at December 31, 2012. The Company does not have material liabilities that can be called unexpectedly at the demand of a client.

The following table summarizes the undiscounted cash flows of financial assets and liabilities by contractual or expected maturity:

	December 31, 2012		
	One year or less \$	One to two years \$	No maturity date \$
<b>Financial Assets</b>			
Cash and cash equivalents	8,702,253	-	-
Receivables	255,628	-	-
Reinsurance assets	684,285	-	-
Investments	3,992,547	-	-
	<u>13,634,713</u>	<u>-</u>	<u>-</u>
<b>Financial Liabilities</b>			
Trade payables and accrued liabilities	996,314	-	-
Insurance contract liabilities	2,300,604	-	-
	<u>3,296,918</u>	<u>-</u>	<u>-</u>
	December 31, 2011		
	One year or less \$	One to two years \$	No maturity date \$
<b>Financial Assets</b>			
Cash and cash equivalents	20,078,948	-	-
Receivables	94,539	-	-
Reinsurance assets	7,760	-	-
Investments	2,569,778	1,446,983	-
	<u>22,751,025</u>	<u>1,446,983</u>	<u>-</u>
<b>Financial Liabilities</b>			
Trade payables and accrued liabilities	859,213	-	-
Insurance contract liabilities	361,820	-	-
	<u>1,221,033</u>	<u>-</u>	<u>-</u>

**Mongolia Growth Group Ltd.**  
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**December 31, 2012**

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(expressed in Canadian dollars)

**Market risk**

Market risk includes interest rate risk, currency risk and equity risk.

**i) Interest rate risk**

Interest rate risk is the potential for financial loss arising from changes in interest rates. Changes in interest rate levels generally impact the financial results to the extent that reinvestment yields are different than the original yields on fixed income securities. Changes in interest rates will affect the fair value of the fixed income securities. During periods of rising interest rates, the market value of the existing fixed income securities will generally decrease. During periods of declining interest rates the opposite is true. For investments classified as AFS, these increases and decreases in fixed income securities will result in corresponding increases and decreases in OCI until the securities are sold and any gain or loss is realized or the securities are written down to reflect an impairment loss. The primary technique for measuring interest rate risk related to fixed income securities is duration analysis.

The approximate impact of an increase of 100 basis points in interest rates would increase the net income of the Company by \$39,925 (2011 - \$40,167). The approximate impact of a decrease of 100 basis points in interest rates would decrease net income of the Company by \$39,925 (2011 - \$40,167).

Changes in interest rates also have an impact on the rate used to discount insurance contract liabilities. Consequently, changes in interest rates will affect the carrying value of the insurance contract liabilities. During periods of rising interest rates, the carrying value of insurance contract liabilities will generally decrease and profit will increase. During periods of declining interest rates the opposite is true. A change of 100 basis in interest rates points up or down would not have a material impact on the carrying value of insurance contract liabilities.

**ii) Currency risk**

Currency risk represents the risk that the Company incurs losses due to exposure to foreign currency fluctuations. The Company owns properties located in Mongolia and marketable securities in Mongolia and Barbados, and is therefore subject to foreign currency fluctuations that may impact its financial position and results. Changes in the Mongolian Tögrög and U.S. to Canadian dollar foreign currency exchange rate impact the fair value of securities denominated in Mongolian Tögrög and in U.S. dollars. The Mongolian operations hold their investments in Mongolian Tögrög denominated securities and the Canadian operations hold securities denominated in Canadian and U.S. dollars.

The approximate impact of an increase of 10% in the Mongolian Tögrög against the Canadian dollar would increase the OCI of the Company by \$4,633,059 (2011 - \$3,581,255). The approximate impact of a decrease of 10% in the Mongolian Tögrög against the Canadian dollar would decrease OCI of the Company by \$4,633,059 (2011 - \$3,581,255).

The approximate impact of an increase of 10% in the U.S. dollar against the Canadian dollar would increase net income of the Company by \$87,994 (2011 - \$367,962).

# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

December 31, 2012

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(expressed in Canadian dollars)

### iii) Other price risk

Other price risk market fluctuation risk is where fluctuations in the value of equity securities affect the level and timing of recognition of gains and losses on securities held, and cause changes in realized and unrealized gains and losses. As the Company does not have any equity investments, it does not have any exposure to equity risk.

### Economic risk

Mongolian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Company may be challenged by tax authorities.

Mongolian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged by tax authorities. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for five calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Mongolian tax legislation does not provide definitive guidance in certain areas, specifically in areas such as Value added tax (VAT), corporate income tax, personal income tax and other areas. From time to time, the Company adopts interpretations of such uncertain areas that reduce the overall tax rate of the Company. As noted above, such tax positions may come under heightened scrutiny as a result of recent developments in administrative and court practices. The impact of any challenge by the tax authorities cannot be reliably estimated; however, it may be significant to the financial position and/or the overall operations of the entity.

The Company's management believes that its interpretation of the relevant legislation is appropriate and the Company's tax positions will be sustained. Management believes that tax risks are remote at present.

Management performs regular re-assessments of tax risk and its position may change in the future as a result of the change in conditions that cannot be anticipated with sufficient certainty at present.

## 18 Related party transactions

Parties are generally considered to be related if the parties are under common control or if one party has the ability to control the other party or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

**Mongolia Growth Group Ltd.**  
Notes to Consolidated Financial Statements  
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(expressed in Canadian dollars)

Summary of significant transactions with related parties for the year ended December 31, 2012 are presented below:

	<b>2012</b>	<b>2011</b>
	\$	\$
Borrowing obtained from and paid back to related parties - Praetorian Capital Management LLC	-	137,330
Payment of rental expense - UMC Holding LLC	-	29,100
	<hr/>	<hr/>
	-	166,430
	<hr/>	<hr/>

Praetorian Capital Management LLC (“Praetorian”) is a company controlled by the Company’s CEO.

Praetorian paid the initial start-up and formation expenses of MGG and its subsidiaries. These expenses were reimbursed to Praetorian without interest.

The Company has paid rental payments to UMC Holding LLC which is owned by a director of one of the Company’s subsidiaries.

Key management personnel of the Company include all directors and executive management. The summary of compensation for key management personnel is as follows:

	<b>2012</b>	<b>2011</b>
	\$	\$
Salaries and other short-term employee benefits	125,229	44,015
Share-based payments	456,717	267,452
	<hr/>	<hr/>
	581,946	311,467
	<hr/>	<hr/>

## **19 Contingent liabilities**

From time to time and in the normal course of business, claims against the Company may be received. On the basis of management’s assessments and professional legal advice, management is of the opinion that no material losses will be incurred and no provision or disclosure has been made in these consolidated financial statements.

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law.

The Company is also subject to litigation arising in the normal course of conducting its insurance business. The Company is of the opinion that this litigation will not have a significant effect on the financial position, financial performance or cash flows of the Company.

# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

December 31, 2012

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(expressed in Canadian dollars)

The Company's Mongolian insurance operation, Mandal General Insurance LLC, was not in compliance with the solvency limit set by FRC Order No. 211 as of December 31, 2011.

The deficit under this regulation for the solvency limit was approximately \$483,000. As per Mongolian legislation, FRC had the right to take any corrective actions when an insurance company is not complying with the regulations including imposing a fine or even cancelling the insurance license. During fiscal 2012, the solvency limit under this regulation has since been adjusted and Mandal General Insurance LLC is in full compliance with the regulation as of December 31, 2012.

### 20 Supplementary cash flow information

	2012 \$	2011 \$
Changes in non-working capital arising from		
Other assets	(3,138,778)	(409,303)
Trade payables and accrued liabilities	151,262	849,536
Reinsurance assets	(691,198)	(7,760)
Deferred acquisition expense	(80,066)	(15,175)
Income tax payable	(33,102)	819,096
Insurance contract liabilities	1,989,745	361,820
	<hr/>	<hr/>
Changes in non-cash working capital from operating activities	(1,802,137)	1,598,214

### 21 Segment information

The Company's operations are conducted in three reportable segments as Investment Property Operations, Insurance Operations and Corporate. The Company reports information about its operating segments based on the way management organizes and reports the segments within the organization for making operating decisions and evaluating performance.

Investment Property operations consist of commercial and residential investment property in Mongolia held for the purposes of rental revenue, capital appreciation or both. These properties are managed by Big Sky Capital LLC and its subsidiaries.

Insurance Operations includes general property and casualty insurance products in Mongolia. Insurance underwriting and claims handling functions are administered through Mandal General Insurance LLC.

Corporate administers financial resources and the corporate investment portfolio and is comprised of investment income, corporate costs and other activities not specific to other reportable segments and is shown separately.

**Mongolia Growth Group Ltd.**  
Notes to Consolidated Financial Statements  
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(expressed in Canadian dollars)

The Company evaluates performance based on net income (loss) before income taxes.

	<b>2012</b>			
	<b>Investment Property \$</b>	<b>Insurance \$</b>	<b>Corporate \$</b>	<b>Total \$</b>
Rental income	1,572,603	-	-	1,572,603
Property operating expenses	(987,407)	-	-	(987,407)
Unrealized losses on fair value adjustment on investment properties	(2,697,212)	-	-	(2,697,212)
Net premiums earned	-	628,424	-	628,424
Claims and insurance benefits incurred	-	(1,042,387)	-	(1,042,387)
Share based payment	(643,857)	(253,168)	(470,695)	(1,367,720)
Other expenses	(275,993)	(1,001,244)	(1,610,224)	(2,887,461)
Depreciation	(127,417)	(33,849)	(9,624)	(170,890)
Net investment income	282,114	574,454	6,745	863,313
Gain on disposal of investment property	12,768	-	-	12,768
Other revenue (expense)	(19,860)	43,759	-	23,899
Net loss before income taxes	(2,884,261)	(1,084,011)	(2,083,798)	(6,052,070)

	<b>2011</b>			
	<b>Investment Property \$</b>	<b>Insurance \$</b>	<b>Corporate \$</b>	<b>Total \$</b>
Rental income	495,242	-	-	495,242
Property operating expenses	(637,507)	-	-	(637,507)
Unrealized gains on fair value adjustment on investment properties	5,740,919	-	-	5,740,919
Net premiums earned	-	77,786	-	77,786
Claims and insurance benefits incurred	-	(51,591)	-	(51,591)
Share based payment	(290,800)	(1,087,493)	(420,310)	(1,798,603)
Other expenses	(107,269)	(517,733)	(650,874)	(1,275,876)
Depreciation	(31,106)	(11,744)	(2,907)	(45,757)
Net investment income (loss)	32,796	247,470	(624,512)	(344,246)
Other revenue	16,283	-	-	16,283
Net income (loss) before income taxes	5,218,558	(1,343,305)	(1,698,603)	2,176,650



# Mongolia Growth Group Ltd.

## Notes to Consolidated Financial Statements

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(expressed in Canadian dollars)

2012

Balance as of December 31, 2012:	Investment Property \$	Insurance \$	Corporate \$	Total \$
<b>Total assets</b>	43,964,089	5,758,399	1,584,043	51,306,531
Property and equipment	4,337,876	211,250	26,905	4,576,031
Investment properties	30,786,742	-	-	30,786,742
Expenditures				
Property and equipment	318,096	113,467	2,147	433,710
Investment properties	6,896,289	-	-	6,896,289

2011

Balance as of December 31, 2011:	Investment Property \$	Insurance \$	Corporate \$	Total \$
<b>Total assets</b>	32,726,312	4,852,712	17,757,865	55,336,889
Property and equipment	4,451,542	138,086	34,382	4,624,010
Investment properties	26,166,286	-	-	26,166,286
Expenditures				
Property and equipment	4,479,040	149,830	37,289	4,666,159
Investment properties	20,425,367	-	-	20,425,367

	Revenue		Property and equipment		Investment property	
	2012 \$	2011 \$	2012 \$	2011 \$	2012 \$	2011 \$
Canada	-	-	26,905	34,382	-	-
Mongolia	2,237,694	589,311	4,549,126	4,589,628	30,786,742	26,166,286
	2,237,694	589,311	4,576,031	4,624,010	30,786,742	26,166,286

**Mongolia Growth Group Ltd.**  
Notes to Consolidated Financial Statements  
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**22 Other expenses**

	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Professional fees	1,293,477	492,953
Travel	217,092	106,341
Advertising	190,168	105,714
Net claims incurred	1,042,387	51,591
Land and property tax	209,501	55,094
Insurance	24,644	16,102
Utility expense	82,532	34,449
Other expenses	822,479	722,448
	<hr/>	<hr/>
	3,882,280	1,584,692
	<hr/>	<hr/>

## Corporate Information

### Board of Directors

#### Jordan Calonego, CFA

*COO of MGG*

*Thunder Bay, Ontario*

#### William Fleckenstein

*President of Fleckenstein Capital*

*Seattle, Washington, USA*

#### Harris Kupperman

*Chairman & CEO of MGG*

*Miami, Florida, USA*

#### Byambaa Losolsuren

*Partner at UMC Capital*

*Ulaanbaatar, Mongolia*

#### John Shaw

*President of McWhinney*

*Denver, Colorado*

#### Paul Sweeney

*Independent Business Consultant*

*Surrey, British Columbia*

### Officers

#### Harris Kupperman

*Chief Executive Officer*

#### Matthew Aiken, CA

*Chief Financial Officer*

#### Jordan Calonego, CFA

*Chief Operating Officer*

### Auditors

#### PricewaterhouseCoopers LLP

*Winnipeg, MB*

### Legal

#### Gowlings Lafleur Henderson LLP

*Calgary, AB*

#### Blakes, Cassels & Graydon LLP

*Calgary, AB*

### Registrar and Transfer Agent

#### Olympia Trust

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*Tel: (403) 261-0900*

*cssinquiries@olympiatrust.com*

### Share Listing

*TSX Venture Exchange: YAK*

*US Listing: MNGGF*

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