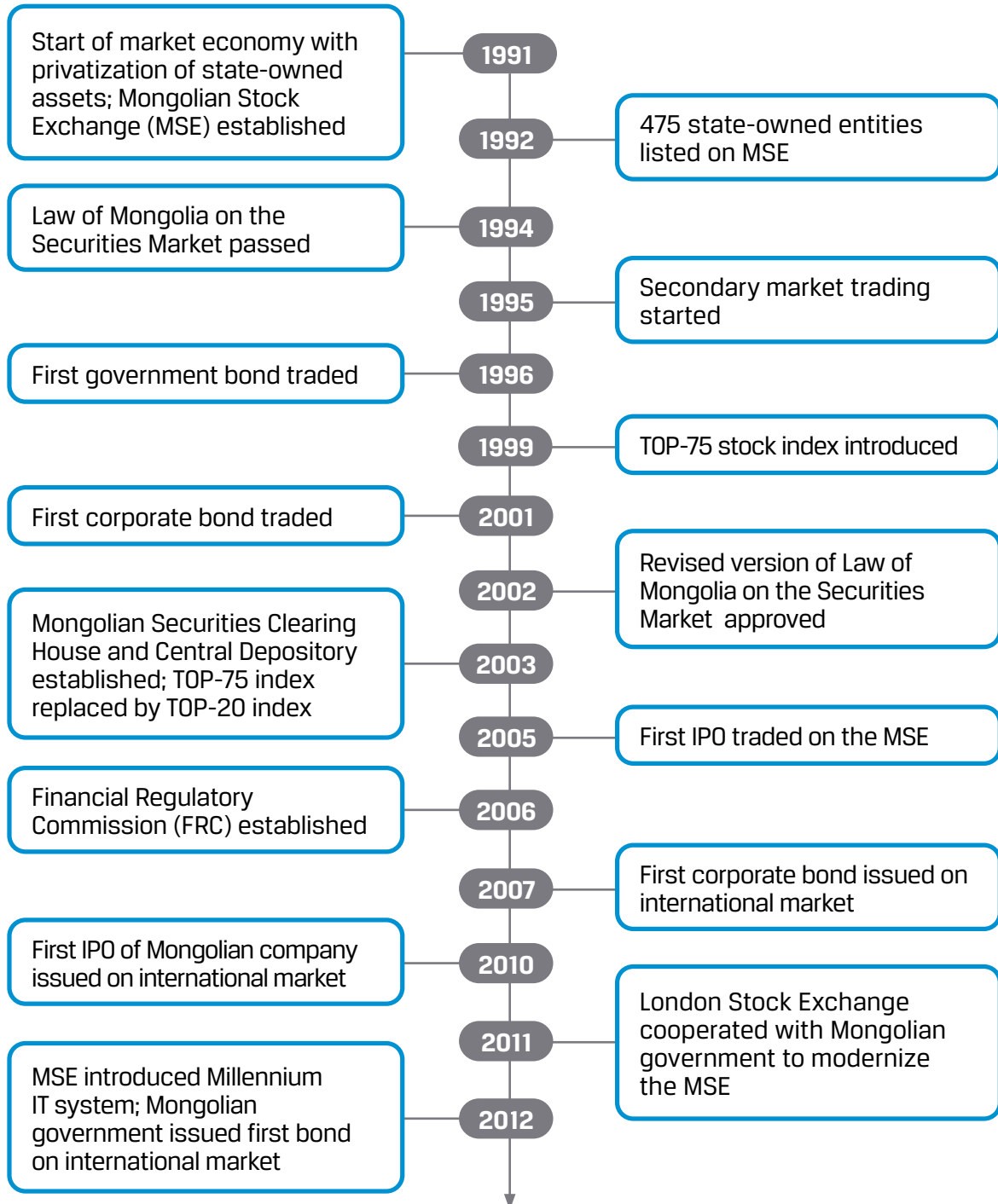


MONGOLIA



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Equity Market Capitalization (USD)	0.984 Bn
Equity Market Cap/GDP	7.3%
Equity Market Share Volume Traded (USD)	48.8 Mn
Number of Listed Companies	200

Note: As of 2019

An emerging economy, Mongolia has experienced rapid economic growth since the beginning of the 2000s. Economic growth has averaged 7% over the last 10 years, reaching a record of 17.3% in 2011. Economic growth has also been volatile, however, because of a heavy dependence on natural resources and trends in global commodity prices. There are concerns regarding the effectiveness of the government's macroeconomic policies.

Since Mongolia shifted to a market economy 30 years ago, the Mongolian banking sector has developed significantly to become the main provider of capital in the economy. Total assets of the banking sector equaled 87% of GDP at the end of 2019. The capital market, on the other hand, remains a small part of the financial market compared with the banking sector, despite the government's efforts to develop it.

OVERVIEW OF THE MARKET

The main laws that regulate the Mongolian capital market are the Law of Mongolia on the Securities Market (1994, revised in 2002 and 2013), the Company Law of Mongolia (revised 2011), the Law of Mongolia on Asset-Backed Securities (2010), and the Law of Mongolia on Investment Funds (2013). Both the corporate and securities laws were revised in 2011 and 2013, respectively, to facilitate security issuance. The other two laws introduced institutional investors and new investment instruments. The main governing body of the capital market is the Financial Regulatory Commission (FRC), established in 2006, which operates as the regulatory body. The FRC supervises more than 1,000 non-bank financial entities, including insurance companies, brokerage companies, non-bank lenders, and savings and credit cooperatives.

The Mongolian Stock Exchange (MSE) was established in 1991 to implement the privatization of state-owned entities in the early stages of transition from a centrally planned economy to a market economy. In the mid-1990s, a secondary market was established and private brokerage firms started operating on the stock exchange.

In April 2011, the Mongolian government signed a Master Service Agreement with the London Stock Exchange to modernize its trading system by improving the legal environment, financial infrastructure, and technology. Within the scope of this agreement, the Millennium IT operating system was introduced to the MSE in 2012, which brought such new capabilities as remote access and high-frequency trading, but it also increased operating costs of the exchange.

MARKET PARTICIPANTS

Figure 1 shows the participants in the Mongolian capital market as of 2019.

Securities Firms

As of 2019, 54 securities firms licensed by the FRC operated on the MSE. Most of these firms are small operations with limited staff and trading activity. The number of securities firms increased significantly in 2012, and at one point

there were more than 100 securities firms. This growth was associated with government plans to list on the MSE a state-owned mining company, Erdenes Tavan Tolgoi JSC, that owns one of the largest coking coal deposits in the world. The listing was cancelled, and the number of securities firms declined gradually to the current level. For most companies, it is impossible to operate profitably given the current low trading volume on the MSE.

Listed Companies

As of 2019, there were 200 listed companies on the MSE, but only 8 out of the “Top 100” Mongolian companies are publicly listed. Among the listed companies, 18 companies are state owned, 10 have state participation, and the remaining 170 are private.

One special feature of Mongolian listed companies is that most became publicly listed as a result of privatizations in the early 1990s. The government directly distributed to all citizens vouchers that could be converted to a certain number of common shares in certain formerly state-owned companies. Consequently, right after the privatization, some 470 entities registered as listed public companies on the MSE. The number has gradually decreased as the stock exchange made efforts to delist companies that did not meet the listing rules. Also, some

FIGURE 1. NUMBER OF MARKET PARTICIPANTS, 2019

Stock exchange	Clearing and settlement	Securities depository	Brokerage firm
2	1	1	54
Investment management firm	Securities dealers' association	Custodian bank	Listed company
24	1	3	200

Source: Annual Report 2019, Financial Regulatory Commission.

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companies went bankrupt and some majority shareholders took their companies private.

During the privatization process, a heavy stock concentration occurred for most companies as 50% to 90% of a company's common shares were collected by one individual or members of a family. Over the years, this share concentration and poor corporate governance practice may have had a negative impact on trading activity and on the general lack of public confidence in the stock market.

Mongolian mining companies commonly raise capital on foreign stock exchanges because it is difficult to raise large amounts of capital on the MSE. Among some 30 companies listed abroad, the majority are listed on the Toronto Stock Exchange and the Australian Stock Exchange, with some listed on the Hong Kong Stock Exchange, the US exchanges, and other stock exchanges.

Investors

The investor base on the MSE consists mostly of local retail investors, who generated 96% of the total trading value in 2019. The Mongolian

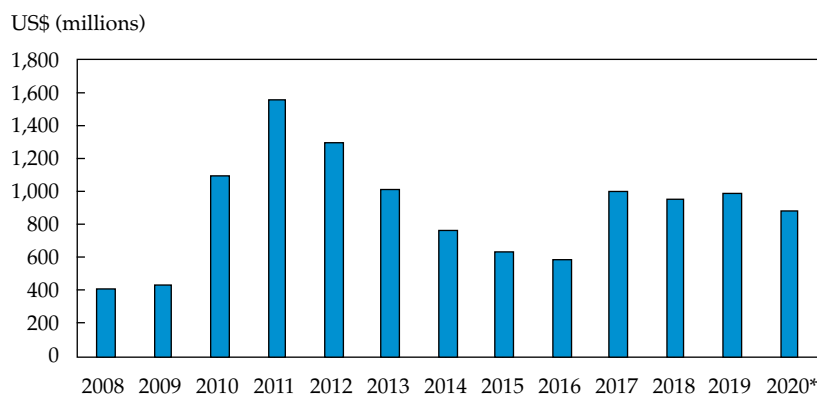
government's recent second attempt to list Erdenes Tavan Tolgoi JSC on the MSE and to distribute dividends to all citizens led most Mongolians to open securities accounts. Although the listing has not yet taken place, most Mongolians now have a securities account. In the first six months of 2020, almost 500,000 new brokerage accounts were opened, which is significant considering the total Mongolian population is 3.3 million. In addition to local citizens, 2,287 foreign individuals, 2,771 local companies, and 196 foreign companies and funds have opened securities accounts in Mongolia.

The institutional investor base is weak in Mongolia. Although the insurance sector is growing and some insurance companies invest in the local capital market, pension funds do not invest in public securities and there are no active mutual funds.

EQUITIES

Total market capitalization of the MSE as a percentage of GDP was only 7.3% in 2019 (see **Figure 2**).

FIGURE 2. TOTAL EQUITY MARKET CAPITALIZATION



*As of June 2020.

Source: Market overview 2019, Mongolian Stock Exchange.

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The main equity index on the MSE is the TOP-20 index, a market capitalization–weighted equity index that consists of 20 leading stocks selected on the basis of market capitalization and trading activity. Lesser-known indexes include MSE ALL, MSE-A, and MSE-B.

The TOP-20 index has fluctuated widely in the past because of the fact that Mongolia is a small economy with high dependency on commodity cycles. The most recent example was in 2017, when the TOP-20 index increased by 62% as the government took drastic measures to improve the economic situation, such as applying for an International Monetary Fund (IMF) program. The high volatility is also linked to the market's low liquidity; average daily volume of the equity market in 2019 was only USD30,000.

Equity trading volume in Mongolia is quite low by world standards and also fluctuates in line with the economic cycle, which in turn is highly correlated with commodity cycles (see **Figure 3**). Trading activity on the MSE increased to USD104 million in 2012 as Mongolia was in the middle of a mining boom,

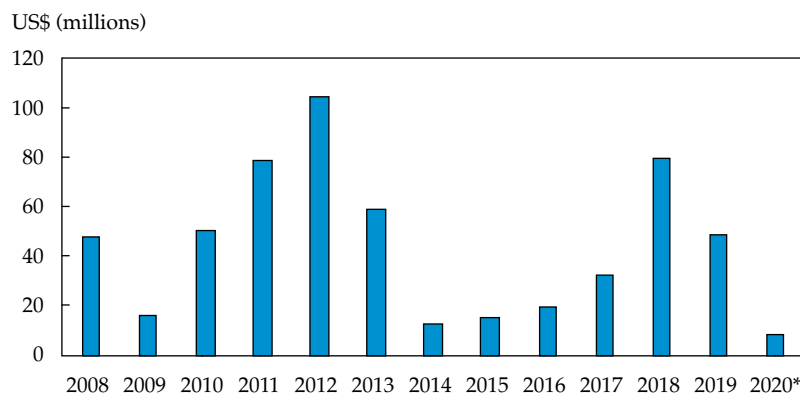
but it has decreased since then as the economic situation worsened from 2014 to 2017.

The market started becoming more active in 2017 as the economic situation improved. Another reason for the recent increase in trading activity is that more start-ups and/or young companies are listing on the MSE to raise capital. This is a positive trend because these companies tend to be more responsible in terms of corporate governance.

BONDS

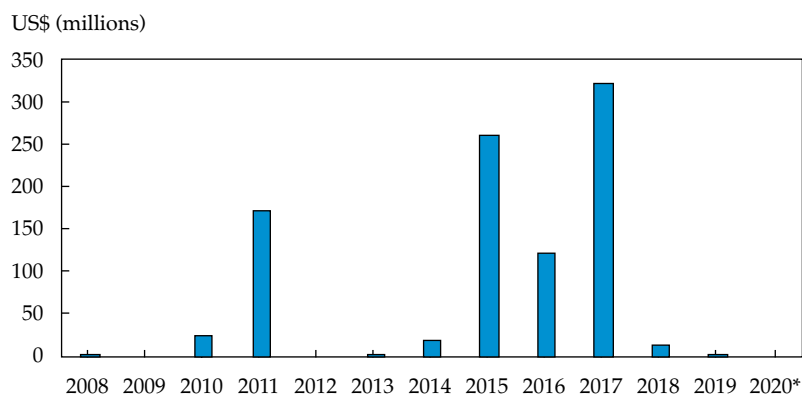
The bond market in Mongolia consists mostly of government bonds (see **Figure 4**). The government of Mongolia issued local currency-denominated bonds regularly until 2017. The latest government bonds had maturities of one to three years and coupon rates of 14%–18%. Given the high yield and the fact that revenue from government bonds is risk-free and tax-exempt, government bonds are attractive investment instruments for all investors, most notably commercial banks and foreign investors. Local banks are the largest investors in government

FIGURE 3. MSE EQUITY TRADING VALUE



*As of June 2020.

Source: Market overview 2019, Mongolian Stock Exchange.

FIGURE 4. GOVERNMENT BOND TRADING VALUE

*As of June 2020.

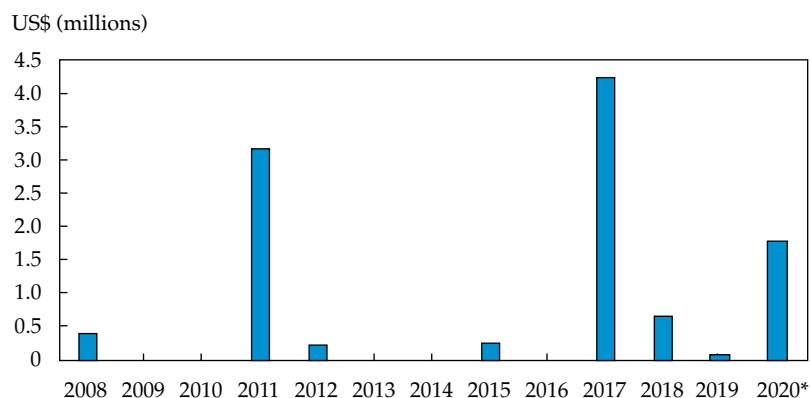
Source: Market overview 2019, Mongolian Stock Exchange.

bonds, which they usually hold until maturity resulting in low trading activity on the secondary market.

Regarding corporate bonds, there have been very few issuances with much smaller amounts (see **Figure 5**). The latest corporate bond was issued by LendMN, a mobile-based

microfinance institution, with a maturity of one year and a coupon rate of 17%.

Demand for alternatives to bank deposits has been increasing in recent years, as evidenced by an increase in the issuance of so-called “private bonds” (in effect, loan agreements between a company and private investors).

FIGURE 5. CORPORATE BOND TRADING VALUE

*As of June 2020.

Source: Market overview 2019, Mongolian Stock Exchange.

THE WAY FORWARD

Multiple factors are behind the current underdeveloped state of the Mongolian capital market, but the most significant is poor corporate governance. Governance practices have improved significantly over the past few years, but minority shareholders need further attention. Poor corporate governance, in turn, negatively affects public interest in the capital market and the overall trading activity. The regulatory authorities have made efforts to improve disclosure and transparency, with some success. The MSE, for example, requires companies to disclose governance self-assessment reports annually. Also, while FRC and the MSE push poorly managed companies to delist, most newly listed companies tend to have much better governance practices, improving the overall credibility of the market.

Future opportunities for developing the Mongolian capital market include the following:

- The downward trend of interest rates in the past years has caused investors to look for opportunities other than term deposits at banks. The sudden increase in activity on the MSE in 2017 is thought to have been caused partially by several years of declining interest rates. Currently, the one-year term-deposit rate is around 10%, which is still high by world standards, despite falling by 6%–7% in the past 10 years. Inflation in 2019 was 5.2%.
- The corporate bond market has the potential to grow to provide long-term capital to businesses. Bank deposits and lending rates have a spread as wide as 4%, which means there is opportunity for companies to borrow directly on the MSE instead of borrowing from banks. Direct and indirect costs associated with issuing bonds should be lowered further in order for companies to feel comfortable issuing bonds.
- Since 2016, a number of successful IPOs and corporate bond issues have demonstrated the opportunity to raise capital on the stock exchange as an alternative to bank financing. Investors, on the other hand, have been learning how to invest in public securities.
- As attempted by the government in the past, if a major state-owned mining company is listed on the MSE, the event is expected to give a significant boost to the local market.
- The government recognizes the need to create an institutional investor base and has been developing the regulatory environment for investment funds.