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CONSERVATIVELY MAKING 5X YOUR MONEY IN A FORGOTTEN MONGOLIAN MINER

Today I'm sharing with you an opportunity that I believe has a favourable risk/reward setup whereby - if I'm correct - we can conservatively make 5x our money. But before I give you the background and thesis, let me explain why you're receiving this.

What follows is the thinking behind a trade I am currently long both personally as we as well as in the Asymmetric Opportunities Fund. I need to make this very clear. I am long at HK$0.12 this stock and I have already provided a very small group of friends and personal clients the information I am about to share with you.

As such please be aware that you are receiving this information nearly two weeks later and things are already moving quite quickly.

I have agonized a bit over whether or not to share this with you for a couple of reasons.

This opportunity is very speculative, as you'll see. And if you do buy, do it carefully and don't, just don't, chase the share price above the level I mention below. I'm mentioning the opportunity to you because:

1. You might be able to make some money, and I want to be completely transparent with you about my own existing positioning and how I'm investing.
2. I wanted to give you a peek into a service I will be launching shortly where I, together with my team, scour the globe looking for asymmetric opportunities sourced from my rolodex of friends, and colleagues and other times originated by myself or one of my

team. This particular opportunity isn't necessarily typical but does highlight the sorts of opportunities that are out there.

Onto the topic for the day...

I have very close contacts throughout the world and one country where my contacts run deep is in ~~Crazystan~~ Mongolia, a country that was both spectacularly successful for me right up until when it was just as spectacularly unsuccessful.

The government which came to power in 2012, through infighting, nepotism, stupidity, and a host of characteristics not uncommon in government everywhere - managed to obliterate foreign capital investment (FDI) putting a halt to the incredible growth Mongolia had experienced for the previous decade.

I won't rehash the story for you here as it's well documented elsewhere.

What follows is the thinking behind the opportunity and why I believe it to be worthy of investment.

If I was to ask you what is the most contrarian thing you can buy today, what might that be?

How about the equity in a bankrupt Mongolian miner?

Mongolian Mining Corp (MMC) 975 in Hong Kong also trading as an ADR in the US under the ticker MOGLF has the makings of a multi-bagger (possibly even 20-bagger). Crazy, right? That's why it's called contrarian investing.

Apologies in advance, but this write-up will be short on numbers and tangible data and long on Mongolian politics. In the end, that's the thesis here. The past no longer matters.

MMC owns the Ukhaa Khudag (UKG) coking coal mine, which makes up a tiny fraction of the massive Tavan Tolgoi (TT) coking coal deposit.

TT is the world's largest coking coal deposit situated about 200 km from the border of China, the largest user of the stuff. Due to the size and seam width of the deposit, it is one of the lowest cost coking coal mines in the world, and its proximity to China should effectively knock Australian seaborne coal out of the market.

In a perfect world, UKG and TT coal should be mined and railroaded directly to Chinese steel plants from the mine-mouth, saving substantially in handling cost when compared to Australian chipping costs.

The Aussies on the other hand railroad it to a port, put it on a ship, unload the ship in China and then ship it by train to the steel mill in China. It's the handling costs that are expensive and Australian coal should not be going to China when compared with Mongolian coal that can be shipped anywhere in China directly from the mine-mouth by rail.

Unfortunately, due to domestic politics (more below), MMC now trucks the coal in huge caravans of trucks nearly 200 km to the border, where it is dumped in large piles to be picked up by Chinese traders who then drive it to railheads in China before finally getting on a railroad.

Due to this dysfunctional supply chain MMC coal is currently uncompetitive. This has led to a near ceasing of production and the default of MMC's approximately US$700 million debt burden. The odds look decent that over the next few months there will be a clear path to resolving the debt and railroad issues, which should lead to a very substantial revaluation of the shares, which have effectively been left for dead.

Let's talk politics

Mongolian politics is notoriously colorful and dysfunctional where personal feuds and interests often overshadow national interests. There are 2 key parties, Democratic Party (DP) and Mongolian People's Party (MPP). When the DP won the election in 2012, they immediately set out to destroy all MPP owned companies and interests. MMC is the largest MPP owned company and it was directly targeted for destruction.

During the past four years, the country changed the tax and royalty rates on coal companies, selectively closed and moved border crossings to inhibit MMC coal from being sold, confiscated MMC's existing paved road to the border, banned MMC from building a railroad to the border and generally succeeded in destroying the company's ability to operate or succeed.

Adding insult to injury, the government owns the TT deposit and has consistently produced and sold coal for less than market prices, effectively undercutting MMC coal—while also creating a glut at the border and largely bankrupting the government's coal company (ETT) in the process. MMC stopped production, but the government's ETT continues to produce at massive losses for no logical reason.

In 2015, MMC was able to put together a consortium of leading Chinese and Japanese firms (including Shenhua Energy and Sumitomo) that would pay to build a railroad to the border, build a power plant and then operate the TT mine so that the government of Mongolia would no longer be in the coal business.

Instead, the government was to earn royalties and taxes. MMC would benefit as project operator, but more importantly, they would get access to the new railroad that would make their coal cheaper than Australian coal and let them once again ramp up production from almost nothing to nearly 10 million tons a year without substantial additional capital investment as all mining is done by a contractor. It was a brilliant deal for all involved, but the DP government was so focused on destroying MMC that they refused a deal that would have improved the government's own finances.

The complete incompetence of the DP became their undoing. When they took over in 2012, the economy under MPP leadership was growing at 17%. Following a war on MPP and foreign businesses, confiscations of assets and arbitrary imprisonment of many foreign business leaders the economy has collapsed.

Today, the GDP is rapidly contracting. The government's deficit is over 20% of GDP, the central bank has a negative balance sheet and the government hasn't paid workers in months. It appears that an IMF bailout is imminent and that the government may default on its sovereign debt.

In June, the MPP won a landslide victory where they secured 65 out of 76 seats in parliament, giving them a clear mandate to fix the disaster created by the DP and much more importantly, to reward key MPP businesses. No Mongolian owned business in Mongolia is larger than MMC and the key MMC shareholders directly funded much of the MPP election campaign. I suspect that those shareholders will now reap the rewards.

It has now been 2 months since the elections, the key ministers have been chosen and I think everyone is ready to get down to business. To start with, the government will stop selling coal for US$25/ton when the price at the border is over US$50. This became clear when the head of ETT, the government's coal company was replaced just recently with an MPP executive. The head of Erdenes Mongol, the state company that owns ETT, resigned last Sunday without a replacement announced.

It seems pretty obvious that the consortium deal is back on the table and will probably become sweeter for MMC than the prior version. In addition, there's also a strong likelihood that MMC's 18 million ton wash plant will be used to wash ETT coal in a toll milling situation.

The new railroad, a toll washing agreement on ETT coal, management of the ETT mine will all create huge value. No one knows the terms yet, but people are throwing around cash flow estimates to MMC in the hundreds of millions (possibly even a billion) annually. There's just one problem with this all playing out, MMC still owes globs of debt that it has defaulted on—the creditors are still in control (sort of).

Let me state the obvious—the creditors have no idea what to do with this debt. It's not like they can seize the crown jewel of one of the most powerful guys in Mongolia and then operate it when he controls the government. In one of the craziest bankruptcies you're likely to ever witness, the creditors have agreed to take a massive haircut on their debt (US$750m becomes US$570m) with the new bonds paying interest in PIK format along with varied payments based on coal prices. In exchange, creditors are getting 10% of the equity.

The only holdup now is BNP Paribas who is fighting for better terms on their US$93 million of debt. Fortunately, the joint provisional liquidator (JPL) seems to be pushing back against them and is likely to force a deal soon.

As you can imagine, MMC wants to look as broke as possible during bankruptcy negotiations and any deal on the consortium is very much on the back-burner and out of sight as well. For this reason, despite an increase in coal prices to a level that is quite profitable, MMC has not increased production—heck, they even took an impairment on their coal stockpile to make their first half loss look worse.

So, that's the roadmap for you.

At some point in the next month or 2, MMC will have settled with creditors and no longer have onerous cash interest costs. At that point, it can start producing coal and selling it into a market that is no longer saturated with underpriced ETT coal. A consortium deal will be announced before year-end and suddenly there will be a roadmap towards a company that can produce hundreds of millions a year in cash flow. Not bad for a company with a market cap today of only a hundred million.

By the way, if you don't believe me, look at the stock trading lately. Since the election, lots of plugged in Mongolians are buying all that they can get and many of these guys are the parliamentarians who will approve the consortium deal this fall.

I apologize in advance if this is the most unorthodox write-up of all time. Any analysis of the past is almost irrelevant. All that matters is that there's an MPP government, an MPP controlled company and a country that is totally broke and in desperate need of good news, jobs, taxes and royalties. A deal was on the table last year, it's still on the table (silently) and MMC is going to clinch it this year.

It's worth noting that when the consortium deal was only talk in the back rooms of parliament, the MPP shareholders did a rights offering at 0.28 and fully subscribed for their shares in order to increase their ownership, even though it was unlikely that the consortium deal could get through a DP government. If they thought the shares were cheap at 0.28, they must think it's a much better deal today at 0.12 with a higher coal price and full control of the government.

The above was written about two weeks ago and today the stock trades at HK$0.16 which is a lot higher than 12 cents but still a long way off the buck I think it gets to.

I'd suggest being patient and I'd buy up to 0.25 if I had to move on it now. I have noticed that the volatility is lower in the stock and I suspect this is due to less sellers coming in and a fairly solid base being set.

Please realize that this is NOT something you want to be betting the farm on as the downside is that liquidity evaporates and this goes straight to zero. It can and does happen. Please trade accordingly.

Disclosure: I, as well as the Asymmetric Opportunities Fund, have an average buy price of HK$0.12 and a conservative position where if this goes South it won't be a killer.

And if it runs as I think it has the very real potential to do, then I could buy myself that Aston Martin DB9… though, I won't.

Sincerely,

Chris

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