

Summary Information

MSE Ticker: SHG



Report Date	Sep 22, 2010
Ticker	MSE: SHG
Closing Price (MNT)	9,000
Closing Price (USD)	\$6.78
Market Cap (MNT bln)	65
Shares Outstanding	7,231,389
Avg Daily Trade Value	\$38,165
YTD Share Performance	375%
52-week High (USD)	\$10.17
52-week Low (USD)	\$1.28
Price / 2009 EPS	8.5x
Price / 2009 BV	2.0x
EV / 2009 EBITDA	6.2x
ROA	4.4%
ROE	6.2%
Dividend Yield	NA
Debt / Equity	270.9%

Share Performance



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Sharyn Gol JSC

Initiating Coverage

MICC initiates coverage on Sharyn Gol JSC, though due to the company's ongoing full-scale restructuring activities, we are hesitant to offer a forecast model at this time. In our opinion, the changes underway and preliminary communication from the new management paint a compelling turnaround story, and we will follow-up with valuation thoughts as material information such as JORC resource numbers, coal quality lab results, offtake agreements, and further details of mine refurbishment and development are disclosed.

Company Background

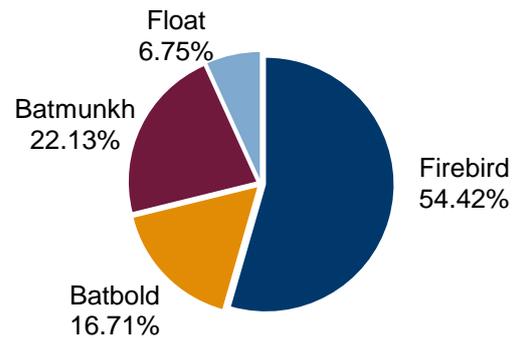
Sharyn Gol was founded in 1965 by the Government of Mongolia to mine thermal coal from an open pit cut outside Darkhan, a city roughly 220 kilometers north of the capital city, Ulaanbaatar (See Figure 1.). The mined thermal coal was used entirely for domestic purposes, including fueling the Darkhan city power plant. By the mid 1980's, the Company was producing in excess of 2.5 million tonnes per annum. After Mongolia's political and economic transition in the early 1990's, the mine has been in decline due to deteriorating mine equipment and lack of capital expenditure.

Figure 1: Sharyn Gol Location



In 2003, the Company was privatized via a listing on the Mongolian Stock Exchange. Around this time production had dropped to 1 million tonnes per annum, and production currently stands at approximately 0.5 million tonnes per annum. Lack of western-style operations and poor management has proven to be a major hindrance for the Company.

Over the last several years, funds affiliated with New York-based Firebird Management LLC, have been acquiring shares in Sharyn Gol in the open market. After reaching the 33% ownership threshold, Firebird launched a tender offer and subsequently secured a 55% stake in the Company. Former owners Batmunkh Batkhuu and Batbold Jiggidsuren together own approximately 38.84% while the remaining 6.75% floats in the open market. As majority shareholder, Firebird is leading the turnaround efforts at Sharyn Gol.

Figure 2: Sharyn Gol Shareholders (as of September 1, 2010)

Source: Sharyn Gol management, Mongolian Stock Exchange.

Current Developments

The Company is currently conducting a full-scale resource drilling program on the Sharyn Gol mining lease. The Company has contracted a leading international coal geological consultancy to oversee the drilling and prepare an internationally recognized JORC (Joint Ore Reserves Committee) resource statement. The Company is in the final stages of completing approximately 15,000 meters of drilling over its lease in preparation for the JORC statement.

Management are conservatively expecting between 100-150 million tonnes in resources, though the final figure estimates will not be available until 3-dimensional modeling of the seams is complete and estimations reported on by late October- early November 2010.

Management have reported some of the new drilling on the eastern side of the existing open cut, in an area named the Satellite Seam Area, intersecting coal seams up to 12 meters thick which were previously not reported by the historical Soviet drilling. It is believed that the Soviet drilling in 1950's and 1980's using outdated drilling techniques may have washed out these softer, friable seams resulting in significant core loss and thus underestimating coal resources in the area.

Management has also reported that the new drilling has intersected completely new seams deeper in the coal basin, which laid undiscovered until now. This could equate to a significant increase in final resource estimates at the project and a sharp upward revision in the company's valuation.

In terms of coal quality, the Management reports the Company is receiving very encouraging coal analyses from the new drilling. Calorific values in excess of 7,000kcal/kg on a dry ash free basis are being consistently reported. This comfortably elevates Sharyn Gol coal into a high-grade thermal coal category.

Having knowledge from the Company's existing customers that the Sharyn Gol coal is suitable for semi coking for domestic smokeless fuel and the local foundries, management have instructed geological consultants to oversee test work looking into the coal's coking characteristics. If any coking fraction were to be identified, this could be a significant upside for the Company, providing new markets as well as being able to set new higher prices for the operations coal.

Figure 3: Photos from the Sharyn Gol drilling program

Source: Sharyn Gol management.

Until the drilling is completed at the end of September 2010 and the resource modeling undertaken in October 2010, it is difficult to know for sure how long the existing open cut has left at Sharyn Gol. What is clear however is the new drilling has confirmed coal mining will continue at Sharyn Gol for many years (most likely several decades). Having intersected several coal seams from the surface in the Satellite Seam Area, located immediately adjacent to the existing open cut, processing and rail load out facilities, there is already clear evidence of the likelihood for another large open cut being developed adjacent to the existing pit. Such a satellite open cut is strategically important as it will provide the existing operation with the choice to simultaneously mine it in conjunction with the existing open cut whilst an underground operation, if required, is developed for the deeper parts of the deposit, thus providing several production centers from which to source coal from. This position provides both a reliable supply of production as well as flexibility for blending and processing for consistent quality products.

Sharyn Gol's production cost is approximately US\$18 per tonne.

Transportation

Sharyn Gol has a highly unusual advantage for a Mongolian mine in that a rail spur connected with the Trans Mongolian railway runs directly to the Sharyn Gol mine site. The railspur was constructed during the socialist period and has a replacement value of approximately US\$100 million. As a result, Sharyn Gol has a distinct transportation cost advantage and does not have the burden of managing trucks, road construction, and maintenance that many other coal mines have.

Buyers

Sharyn Gol is now free from legacy requirements to supply coal to the Mongolian government. Currently, the Company has a moral (but not legal) obligation to supply approximately 150,000 tonnes of coal to the Darkhan power plant at cost or slightly above cost. Beyond this, the Company is free to sell its coal to any interested parties at whatever price can be negotiated. Management has identified three key offtake options:

- 1.) Russian buyers have expressed strong interest and willingness to purchase as much coal as can be produced.
- 2.) Chinese buyers have also expressed strong interest
- 3.) Further expansion into the domestic market particularly in the coal beneficiation arena with companies such as NACO Fuel JSC and Sharyn Gol Energy in Darkhan, where beneficiation technology is now requiring coal for semi coke for smokeless briquettes for local and international foundry markets where such briquettes and semi coke can fetch prices up to US\$300 per tonne.

Financing Activities

The company plans to launch a follow-on offering on the Mongolian Stock Exchange to fund capital expenditures including upgrading of the mining operations equipment. Though rumors of a Hong Kong listing have emerged, the management insists any number of further financing activities is possible in the future.

Corporate Governance and Disclosure

Sharyn Gol's new management team (see Appendix One) now consists of a mix of foreign and Mongolian professionals with relevant experience. The Company recently launched a website in English (www.sharyngol.com) that contains news releases, financial reports, and other material company information presented up to international standards. Of note, the company has engaged Ernst & Young for auditing services and finalized financial statements will be available in one to two months. In terms of disclosure and accessibility in English language, Sharyn Gol is a pioneer among its peer Mongolian Stock Exchange listed companies.

Recent Share Price Performance

Sharyn Gol has been a top performer on the Mongolian Stock Exchange, especially over the last several months. With limited shares floating, small changes in demand can result in dramatic share price fluctuations. In our opinion, marketing by the management team and others concerning the turnaround story coupled with increasing foreign investor interest in Mongolia on the heels of press coverage is resulting in the impressive share price appreciation.

Figure 4: Sharyn Gol Stock Price Fluctuation



Source: MSE

Appendix One: BOD and Management Profiles

Figure 5: Board of Directors Profiles

Batmunkh Batkhuu <i>Chairman</i>	<ul style="list-style-type: none"> • Co-founder and manages B&G Group of Mongolia and its subsidiary companies. • Began career in 1996 at Bank of Mongolia and has worked as CEO for several Mongolian companies, including Bodi Leasing Financing Ltd, Orix Consulting Ltd and B&G Equipment Ltd. • Joined Sharyn Gol JSC in 2003 serving as a Board member and Chairman of the Board. • Holds a B.A in Financial Management from the School of Economic Sciences, National University of Mongolia and studied in the MBA program at University of California, Berkeley Walter Haas School of Business. • Speaks English and Russian.
Anthony Milewski <i>Vice Chairman</i>	<ul style="list-style-type: none"> • Emerging Markets Professional at Firebird Management LLC • Previously was an associate in the Moscow office of Skadden, Arps where he worked closely with Russian and Kazakh companies. • Started career at Renaissance Capital in Moscow. • Holds a B.A. in Russian history from Brigham Young University, an M.A. in Russian studies from the University of Washington, and a J.D. from the University of Washington. • He speaks Russian and is a member of the New York State Bar. Anthony currently serves as a board member for several publicly listed and private Mongolian companies.
Bailikhuu Dambachultem <i>Director</i>	<ul style="list-style-type: none"> • Worked in the Ministry of Food & Light Industry from 1982, as Deputy Director, as well as Adviser to the State Property Privatization Commission and Secretary at State Property Privatization Commission. • Graduated from the School of Economics Sciences, National University of Mongolia where he majored in economics and received his MBA. • Holds title of state honored economist and speaks Russian • Current position is Adviser to the State Property Committee. • Has been a member of the Board since 1996.
Dayanbilguun Danzan <i>Director</i>	<ul style="list-style-type: none"> • Member of the Board since 2008. • Graduated from the University of European Linguistics and holds an MBA from the Institute of Finance and Economics. • Executive Director of BDSec brokerage and dealing company.
Batbold Jigjidsuren <i>Director</i>	<ul style="list-style-type: none"> • Joined Sharyn Gol JSC in 1996 as Executive Director and Chairman of the Board. • Has working experience of private and public entities including technical college of Darkhan province of Mongolia, Darkhan Eleksim LLC and Sharyn Gol Energo Ltd. • Graduated from Federal State Polytechnic Institution in Sverdlovsk of Russia as Mining Electro Mechanical Engineer. • Administration Methodologist and holds an MBA. • Speaks Russian.
James Passin <i>Director</i>	<ul style="list-style-type: none"> • Co-founded and manages Firebird Global Fund, Firebird Global Fund II, and Firebird Mongolia Fund. • Former editor at investment newsletter Taipan. • Graduate of St. John's College, where he majored in philosophy and classical literature. • Serves on the board of directors of several Mongolian and Canadian public companies, including BDSec JSC, Vanoil Energy Ltd., Vangold Resources Ltd., as well as Maghreb Minerals PLC, a mineral exploration company listed on AIM.

Ganbat Tsogzol <i>Director</i>	<ul style="list-style-type: none"> • Co-founder of the B&G Group and member of the Board since 2003. • Executive Director of B&G International Ltd and Sharyn Gol Trading Ltd. • Graduated from Mongolian University of Sciences and Technology as a Communication Line System Engineer.
Joseph Naemi <i>Independent Director</i>	<ul style="list-style-type: none"> • Founder or co-founder of numerous commercial entities that were or are engaged in the energy sector internationally. • Significant exposure across the energy sector value chain throughout Central Asia, Latin America, and Africa. • Serves on the board of several companies, including Australian and Canadian publicly listed entities until 2007, and is a member of: The Energy Institute in London, UK; International Association for Energy Economics in Cleveland, Ohio, USA; Australian Institute of Management (NSW & ACT Branch) in Sydney, Australia; and The Australian Institute of International Affairs.
Ian Spence <i>Independent Technical Director</i>	<ul style="list-style-type: none"> • Over 15 years of experience within the Mining and Mining Finance related industries. • For a period of approximately 10 years Ian gained significant experience in both open cut and underground mining environments in numerous technical management and supervisory roles. • Following the attaining of an MBA in 2002 Ian moved into the Mining Finance arena as a Resources Analyst and Consultant. During the 6 years in that role he was involved with the establishment of a number of successful resource companies as well as numerous capital raisings and extensive project evaluations on an international level over a wide range of commodities including coal. • Currently Managing Director of Triton Coal Pte Ltd. • MBA from the University of Western Australia, an MSc in Mineral Exploration & Mining Geology from Leicester University (UK) and a BSc Hons degree in Geology & Petroleum Geology from Aberdeen (UK).
David Dring <i>Chief Financial Officer</i>	<ul style="list-style-type: none"> • 10-year background in the accounting and stock broking industries • In 2007, attained the role of Responsible Manager at Perth-based resource specialist Montagu Stockbrokers • Following the takeover of Montagu by Patersons Securities, worked as a consultant for Triton Resources, before being appointed Executive Director of Triton Coal Pte Ltd in late 2009 • BSc(Hons) Mathematical Sciences from University of Teesside, United Kingdom • Association of Accounting Technicians, United Kingdom

About MICC

Mongolia International Capital Corporation (MICC) was established in 2005 as the first investment banking firm in Mongolia. Mongolia's rapid economic development and favorable financial environment present unique prospects for investment opportunities and growth potential for companies. In order to enable our clients and investors take full advantage of these opportunities, MICC offers investment banking, asset management, securities underwriting and brokerage services. In addition, we conduct periodic macroeconomic research, analyses of domestic industries and review of equities listed on the Mongolian Stock Exchange.

MICC continues to make history in the Mongolian financial sector. We serve leading companies in the metals and mining, manufacturing, financial, retail trade, agribusiness, airline and construction sectors, and prize our close and long-standing working relationships with our clients. Our goal is to assist both local and international companies realize their strategic goals by offering innovative and efficient financing solutions

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Disclosure

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