SouthGobi Resources Ltd.
Management's Discussion and Analysis of Financial Condition and Results of Operations

December 31, 2013
(Expressed in U.S. Dollars)

FORWARD-LOOKING STATEMENTS

Except for statements of fact relating to the Company, certain information contained herein constitutes forward-looking statements. Forward-looking statements are frequently characterized by words such as "plan", "expect", "project", "intend", "believe", "anticipate" and other similar words, or statements that certain events or conditions "may" or "will" occur. Forward-looking statements are based on the opinions and estimates of management at the dates the statements are made, and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements. These factors include the Company's expectations of sufficient liquidity and capital resources to meets its ongoing obligations and future contractual commitments; including the Company's ability to secure additional funding, the estimates and assumptions included in the Company's impairment analysis; the ability of the Company to increase its market penetration in the People's Republic of China ("China"); the ability for higher-ash product to be sold as a thermal coal product; the ability to preserve liquidity and continue on a sustainable basis; the ability of the Company to continue dialogue with the Government of Mongolia regarding a more equitable process of setting reference prices; the ability of the Company to meet the targeted annual capacity of run-of-mine production; the ability of the Company to successfully review the utilization of the wet washing facility and enhance the quality of its coal products through wet washing; the possibility of the China Investment Corporation ("CIC") convertible debenture and all accrued and unpaid interest becoming immediately due; whether the Company will be required to obtain a permit from Mongolia's Ministry of Economic Development with regards to a share interest payment to CIC, under the CIC convertible debenture; the application and effect of uncertainties in Mongolian laws as they relate to the Company, or the effects of any subsequent amendments to those laws; the impact of future political and economic conditions in Mongolia; whether the Company's exploration projects will be converted to commercially viable mines, and the effect of any project delays, cost overruns, or changes in market conditions; the continued pressure on the coal prices in China, and the related impact on the Company's margins and liquidity; the outcome of the issues described in the section "Regulatory Issues and Contingencies"; statements regarding the outlook for 2014; statements regarding the Company's objectives for 2014 and beyond; the statement that completion of the paved highway is expected by the end of the first half of 2014; the statement that the capacity of the paved highway is in excess of 20 million tonnes of coal per year; and other statements that are not historical facts. Except as required by law, the Company undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change. The reader is cautioned not to place undue reliance on forward-looking statements.

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INTRODUCTION

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") of SouthGobi Resources Ltd. (which, together with its subsidiaries, is collectively referred to as the "Company") should be read in conjunction with the consolidated financial statements of the Company and the notes thereto for the year ended December 31, 2013. The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the IFRS Interpretations Committee ("IFRIC").

The functional currency of all of the Company's operations is the U.S. Dollar. All figures in this MD&A are presented in U.S. Dollars unless otherwise stated.

Disclosure of a scientific or technical nature in this MD&A, as derived from the Ovoot Tolgoi, Soumber, and Zag Suuj Technical Reports, in respect of each of the Company's material mineral projects was prepared by or under the supervision of the Qualified Persons listed below. Copies of the Ovoot Tolgoi Technical Report (dated March 19, 2012), the Soumber Technical Report (dated March 25, 2013) and the Zag Suuj Technical Report (dated March 25, 2013) are available on SEDAR at www.sedar.com. :

Property	Qualified Persons	Field of Expertise	Relationship to Company
Ovoot Tolgoi	Merryl Peterson	Resources	Independent Consultant
Ovoot Tolgoi	Robert Mackenzie	Reserves	Independent Consultant
Ovoot Tolgoi	Ross Seedsman	Geotechnical	Independent Consultant
Ovoot Tolgoi	David Morris	Dry Coal Processing	Independent Consultant
Ovoot Tolgoi	Michael Evans	Wet Coal Processing	Independent Consultant
Soumber	Merryl Peterson	Resources	Independent Consultant
Zag Suuj	Merryl Peterson	Resources	Independent Consultant

Other disclosures of a scientific or technical nature in this MD&A (other than such information relating to Aspire Mining Limited ("Aspire"), which information was taken from Aspire's public disclosure record) in respect of the Ovoot Tolgoi mine and the Soumber project were prepared by employees of the Company and reviewed by Robert Mackenzie, an employee of RungePincockMinarco, a registered member and Chartered Professional (Mining) of the Australasian Institute of Mining and Metallurgy (Member No 103878) and a Qualified Person, as that term is defined in National Instrument 43-101 of the Canadian Securities Administrators ("NI 43-101"). Robert Mackenzie was the Qualified Person responsible for overall preparation of and the Coal Reserve estimates in the March 2012 Technical Report for Ovoot Tolgoi.

1. OVERVIEW

The Company is an integrated coal mining, development and exploration company. The Company's common shares trade on the Toronto Stock Exchange ("TSX") under the symbol SGQ and on the Hong Kong Stock Exchange ("HKEX") under the stock code symbol 1878. The Company's immediate parent company is Turquoise Hill Resources Ltd. ("Turquoise Hill") and at December 31, 2013, Turquoise Hill owned approximately 56% of the outstanding common shares of the Company. Turquoise Hill is controlled by Rio Tinto plc ("Rio Tinto").

The Company owns the following significant coal projects in Mongolia: the Ovoot Tolgoi open pit coal mine (the "Ovoot Tolgoi Mine") and the following significant development projects, the Ovoot Tolgoi Underground Deposit, the Soumber Deposit and the Zag Suuj Deposit. These projects are located in the Umnugobi Aimag (South Gobi Province) of Mongolia, within 150 kilometers ("km") of each other and in close proximity to the Mongolia-China border. The Ovoot Tolgoi Mine, together with the Ovoot Tolgoi Underground Deposit, forms the Ovoot Tolgoi Complex. The Company owns a 100% interest in these coal projects.

The Ovoot Tolgoi Mine, strategically located approximately 40km from the Shivee Khuren-Ceke crossing at the Mongolia-China border ("Shivee Khuren Border Crossing"), is the Company's flagship asset. The Company commenced mining at the Ovoot Tolgoi Mine in 2008 and the Company sells coal at the mine-gate to Chinese customers. Ceke, at the Chinese side of the Shivee Khuren Border Crossing, is a major Chinese coal distribution terminal with rail connections to key coal markets in China.

Saleable products from the Ovoot Tolgoi Mine primarily include the SouthGobi standard ("Standard") and SouthGobi premium ("Premium") semi-soft coking coal products. Some higher-ash product is sold as a thermal coal product as and when the market allows.

COAL RESERVES *(millions of tonnes)* *(i)*

Property	Proven	Probable	Total
Ovoot Tolgoi Mine	**119**	**57**	**176**

COAL RESOURCES *(millions of tonnes)* *(i)*

Property	Measured	Indicated	Measured & Indicated	Inferred
Ovoot Tolgoi Mine	133	60	193	24
Ovoot Tolgoi Underground	66	43	109	62
Soumber Deposit	63	110	173	123
Zag Suuj Deposit	-	22	22	84
Tsagaan Tolgoi Deposit	23	13	36	9
Total coal resources	**285**	**248**	**533**	**302**

(i) Reserves and resources estimates have been prepared in compliance with NI 43-101. Coal resources are inclusive of coal reserves. Details of the assumptions and parameters used to estimate the reserves and resources and information on data verification are set out in the Annual Information Form dated March 24, 2014, and available at www.sedar.com.

As at December 31, 2013, the Company owned 18.8%[1] of the outstanding common shares of Aspire, a company listed on the Australian Securities Exchange under the symbol AKM. Aspire's primary focus is its Mongolian coal assets, particularly those pertaining to its Ovoot Coking Coal Project.

[1] Calculation based on number of Aspire common shares outstanding according to their public announcements available at http://www.aspiremininglimited.com/.

Significant Events and Highlights

The Company's significant events and highlights for the year ended December 31, 2013 and subsequent period to March 24, 2014 are as follows:

- Resumed operations at the Ovoot Tolgoi Mine on March 22, 2013 after having been fully curtailed since the end of the second quarter of 2012. The Company completed the fourth quarter of 2013 in line with the coal sales and production guidance provided in November 2013.

- Production increased to 3.06 million tonnes of raw coal in 2013 compared to production of 1.33 million tonnes of raw coal in 2012. The increase in production from 2012 to 2013 primarily related to the operations at the Ovoot Tolgoi Mine being fully curtailed in the second half of 2012.

- Sales volumes increased to 3.26 million tonnes in 2013 compared to 1.98 million tonnes in 2012, whereas revenue decreased to $58.6 million in 2013 compared to $78.1 million in 2012 primarily due to lower average selling prices for the Company's coal products.

- On August 22, 2013, announced the withdrawal of the Notice of Investment Dispute on the Government of Mongolia in recognition of the fact that the dispute was resolved following the grant of three pre-mining agreements ("PMAs") on August 14, 2013 relating to the Zag Suuj Deposit and certain areas associated with the Soumber Deposit, and the earlier grant of a PMA on January 18, 2013 pertaining to the Soumber Deposit.

- Announced the appointment of Bertrand Troiano as its Chief Financial Officer, Brett Salt as its Chief Commercial Officer and Enkh-Amgalan Sengee as President and Executive Director of SouthGobi Sands LLC, the Company's wholly-owned Mongolian operating subsidiary. Brett Salt resigned as a Non-Executive Director of the Company following his appointment as Chief Commercial Officer. Bold Baatar was appointed as a Non-Executive Director of the Company in 2013.

- Following an extensive review of the dry coal handling facility ("DCHF") at the Ovoot Tolgoi Mine and its contribution to the Company's product strategy, recorded a $66.9 million non-cash impairment charge in the fourth quarter of 2013 related to the DCHF. Refer to section 5 "Processing Infrastructure – Dry Coal Handling Facility" for further analysis.

- Recorded a $30.2 million impairment loss in the fourth quarter of 2013 related to the $33.6 million of prepaid toll washing fees to Ejinaqi Jinda Coal Industry Co. Ltd. ("Ejin Jinda"). The impairment followed the results of a trial sample from the wet washing facility and the delay in starting the commercial operations at the facility. The Company is cooperating with Ejin Jinda in reviewing the utilization of the facility. Refer to section 5 "Processing Infrastructure – Wet Washing Facility" for further analysis.

2. SELECTED ANNUAL INFORMATION

$ in thousands, except per share and per tonne information	Year ended December 31, 2013	2012	2011
Revenue [(i)]	**$ 58,636**	$ 78,061	$ 130,756
Loss from operations	**(196,829)**	(124,226)	(50,257)
Net income/(loss)	**(237,464)**	(97,502)	48,552
Basic income/(loss) per share	**$ (1.30)**	$ (0.54)	$ 0.27
Diluted loss per share	**$ (1.30)**	$ (0.60)	$ (0.24)
Cash from/(used in) operating activities	**7,559**	(26,283)	(70,023)
Cash used in investing activities	**(4,892)**	(77,737)	(270,432)
Cash from/(used in) financing activities	**129**	(51)	(27,574)
Coal sales volumes *(millions of tonnes)* [(ii)]	**3.26**	1.98	3.09
Average realized selling price *(per tonne)* [(iii)]	**$ 24.25**	$ 47.49	$ 50.64

$ in thousands	As at December 31, 2013	2012	2011
Cash and cash equivalents	**$ 21,837**	$ 19,674	$ 123,567
Short term money market investments	**-**	15,000	-
Long term money market investments	**-**	-	44,967
Total cash and cash equivalents and money market investments	**21,837**	34,674	168,534
Total working capital	**41,670**	120,435	221,916
Total assets	**506,206**	732,452	918,680
Total non-current liabilities	**96,610**	103,771	145,607

(i) Revenue is presented net of royalties and selling fees.
(ii) Coal sales volumes are from the Ovoot Tolgoi Mine.
(iii) Average realized selling price excludes royalties and selling fees.

The Company's activities in 2011 were focused on the ramp-up of production at the Ovoot Tolgoi Mine and evaluation and exploration of the Company's significant development projects. The ramp-up activities included making significant investments in the Company's mining fleet together with ancillary equipment and infrastructure.

In 2012, the Company's operations were impacted by transportation infrastructure constraints in Mongolia, the significant uncertainty resulting from certain regulatory issues facing the Company and the softening of Chinese coal markets. Mining activities at the Ovoot Tolgoi Mine were curtailed to varying degrees in the second quarter of 2012, with mining activities being fully curtailed at the end of the second quarter of 2012, to manage coal inventories and to maintain efficient working capital levels. Mining activities remained fully curtailed for the remainder of 2012. From 2012 to date, the Company has focused on minimizing uncommitted capital expenditures and exploration expenditures in order to preserve the Company's financial resources.

In the second half of 2012, the Company announced key changes to its Board of Directors and senior management. Additional Board of Directors and senior management appointments were made in 2013.

The Company resumed operations at the Ovoot Tolgoi Mine on March 22, 2013. The coal markets in China continued to be challenging in 2013 with certain coal price indices in China reaching four year lows during the year. In 2013, the Company generated $7.6 million of cash from operating activities following the resumption of mining activities at the Ovoot Tolgoi Mine.

3. OVERVIEW OF OPERATIONAL DATA AND FINANCIAL RESULTS

Summary of Annual Operational Data

	Year ended December 31,	
	2013	**2012**
Sales Volumes, Prices and Costs		
Premium semi-soft coking coal		
Coal sales *(millions of tonnes)*	**0.54**	0.78
Average realized selling price *(per tonne)* (i)	**$ 36.61**	$ 66.87
Standard semi-soft coking coal		
Coal sales *(millions of tonnes)*	**2.27**	0.47
Average realized selling price *(per tonne)* (i)	**$ 23.41**	$ 49.68
Thermal coal		
Coal sales *(millions of tonnes)*	**0.45**	0.73
Average realized selling price *(per tonne)* (i)	**$ 13.43**	$ 25.65
Total		
Coal sales *(millions of tonnes)*	**3.26**	1.98
Average realized selling price *(per tonne)* (i)	**$ 24.25**	$ 47.49
Raw coal production *(millions of tonnes)*	**3.06**	1.33
Direct cash costs of product sold *(per tonne)* (ii)	**$ 10.58**	$ 16.86
Mine administration cash costs of product sold *(per tonne)* (ii)	**$ 2.23**	$ 3.15
Total cash costs of product sold *(per tonne)* (ii)	**$ 12.81**	$ 20.01
Other Operational Data		
Production waste material moved *(millions of bank cubic meters)*	**8.45**	3.36
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**2.76**	2.52
Lost time injury frequency rate (iii)	**-**	-

(i) Average realized selling price excludes royalties and selling fees.
(ii) A non-IFRS financial measure, see section 4. Cash costs of product sold exclude idled mine asset cash costs.
(iii) Per 200,000 man hours.

Overview of Annual Operational Data

The Company resumed operations at the Ovoot Tolgoi Mine on March 22, 2013 after having been fully curtailed since the end of the second quarter of 2012. The 2013 mining activities reflected a safe and cost effective resumption of operations, designed to preserve liquidity and allow operations to continue on a sustainable basis. The Company ended 2013 without a lost time injury.

Raw coal production was 3.06 million tonnes in 2013 with a strip ratio of 2.76 compared to 1.33 million tonnes in 2012 with a strip ratio of 2.52. The rate of production in 2013 was paced to meet contracted sales volumes and adjust to market conditions. The strip ratios in both 2012 and 2013 were below the average life-of-mine trend.

Summary of Annual Financial Results

$ in thousands, except per share information	Year ended December 31, 2013	2012
Revenue [(i),(ii)]	**$ 58,636**	$ 78,061
Cost of sales [(ii)]	**(112,627)**	(127,407)
Gross profit/(loss) excluding idled mine asset costs	**(23,552)**	3,612
Gross loss including idled mine asset costs	**(53,991)**	(49,346)
Other operating expenses	**(126,040)**	(41,645)
Administration expenses	**(15,629)**	(24,637)
Evaluation and exploration expenses	**(1,169)**	(8,598)
Loss from operations	**(196,829)**	(124,226)
Finance costs	**(21,162)**	(15,385)
Finance income	**5,566**	39,942
Income tax recovery/(expense)	**(24,986)**	1,532
Net loss	**(237,464)**	(97,502)
Basic loss per share	**$ (1.30)**	$ (0.54)
Diluted loss per share	**$ (1.30)**	$ (0.60)

(i) Revenue is presented net of royalties and selling fees.
(ii) Revenue and cost of sales relate to the Company's Ovoot Tolgoi Mine within the Mongolian Coal Division operating segment. Refer to note 5 of the consolidated financial statements for further analysis regarding the Company's reportable operating segments.

Overview of Annual Financial Results

The Company recorded a $196.8 million loss from operations in 2013 compared to a $124.2 million loss from operations in 2012 and a $237.5 million net loss in 2013 compared to a $97.5 million net loss in 2012. The 2013 loss from operations was negatively impacted by $20.7 million of coal stockpile impairments (2012: $20.5 million), $30.4 million of idled mine asset costs (2012: $53.0 million) and $121.1 million of impairment losses recorded in other operating expenses (2012: $35.5 million). The Company's loss from operations was $24.6 million in 2013 excluding the impact of the above noted items (2012: $15.2 million).

Revenue was $58.6 million in 2013 compared to $78.1 million in 2012. The Company sold 3.26 million tonnes of coal in 2013 at an average realized selling price of $24.25 per tonne compared to sales of 1.98 million tonnes in 2012 at an average realized selling price of $47.49 per tonne. Revenue decreased due to lower average realized selling prices for the Company's coal products. Following the softening of coal markets in mid-2012, the coal markets in China continued to be challenging in 2013 with certain coal price indices in China reaching four year lows during the year. The decrease in average realized selling prices for the Company's coal products was partially offset by higher sales volumes in 2013 compared to 2012.

The Company's revenue is presented net of royalties and selling fees. The Company is subject to a base royalty in Mongolia of 5% on all export coal sales. In addition, effective January 1, 2011, the Company is subject to an additional sliding scale royalty of up to 5%. The royalty is calculated using a set reference price per tonne published monthly by the Government of Mongolia.

Based on the reference prices for 2013, the Company was subject to an average 7% royalty based on a weighted average reference price of $65.81 per tonne. The Company's effective royalty rate for 2013, based on the Company's average realized selling price of $24.25 per tonne, was 19% or $4.53 per tonne compared to 15% or $7.12 per tonne in 2012.

During a trial period from October 1, 2012 to March 31, 2013, the royalty was determined using the actual contracted sales price per tonne, not the reference price. However, effective April 1, 2013, the royalty regime returned to the set reference price per tonne published monthly by the Government of Mongolia. The Company, together with other Mongolian mining companies, continues the dialogue with the appropriate Government of Mongolia authorities with the goal of moving to a more equitable process for setting reference prices.

Cost of sales was $112.6 million in 2013 compared to $127.4 million in 2012. Cost of sales comprises operating expenses, share-based compensation expense, equipment depreciation, depletion of mineral properties, coal stockpile inventory impairments and idled mine asset costs. Operating expenses in cost of sales reflect the total cash costs of product sold (a non-IFRS financial measure, see section 4 for further analysis) during the period.

	Year ended December 31,	
$ in thousands	**2013**	**2012**
Operating expenses	**$ 41,746**	$ 39,671
Share-based compensation expense	**(293)**	1,205
Depreciation and depletion	**20,000**	13,042
Impairment of coal stockpile inventories	**20,735**	20,531
Cost of sales from mine operations	**82,188**	74,449
Cost of sales related to idled mine assets	**30,439**	52,958
Cost of sales	**$ 112,627**	$ 127,407

Operating expenses in cost of sales were $41.7 million in 2013 compared to $39.7 million in 2012. Operating expenses were largely consistent from 2012 to 2013 as the impact from higher sales volumes was partially offset by lower total cash costs of product sold in 2013 compared to 2012.

Cost of sales in 2013 and 2012 included coal stockpile impairments of $20.7 million and $20.5 million, respectively, to reduce the carrying value of the Company's coal stockpiles to their net realizable value. The coal stockpile impairments recorded in both 2013 and 2012 reflect the challenging coal market conditions and primarily related to the Company's higher-ash products.

Cost of sales related to idled mine asset costs primarily consisted of period costs, which were expensed as incurred and primarily included depreciation expense. Cost of sales related to idled mine assets in 2013 included $25.1 million related to depreciation expenses for idled equipment (2012: $33.2 million). Idled mine asset costs decreased in 2013 compared to 2012 as a result of the recommencement of mining operations at the Ovoot Tolgoi Mine on March 22, 2013. However, the 2013 production plan did not fully utilize the Company's existing mining fleet, therefore, idled mine asset costs continued to be incurred throughout 2013.

Other operating expenses were $126.0 million in 2013 compared to $41.6 million in 2012.

$ in thousands	Year ended December 31, 2013	2012
Public infrastructure	**$ 7**	$ 1,273
Sustainability and community relations	**235**	894
Foreign exchange loss	**1,659**	3,226
Provision for doubtful trade and other receivables	**200**	1,032
Impairment loss on available-for-sale financial asset	**3,067**	19,184
Loss on disposal of property, plant and equipment	**895**	720
Impairment of property, plant and equipment	**72,669**	15,245
Impairment of prepaid expenses and deposits	**30,152**	-
Impairment of materials and supplies inventories	**14,962**	-
Other	**2,194**	71
Other operating expenses	**$ 126,040**	$ 41,645

The Company recognized an impairment loss of $3.1 million in 2013 related to its investment in Aspire compared to an impairment loss of $19.2 million in 2012. The Company's investment in Aspire is accounted for as an available-for-sale financial asset. In 2012, the Company determined that objective evidence of impairment in the Company's investment in Aspire existed. Therefore, the Company recorded impairment losses in 2013 and 2012 as a result of declines in the fair value of the Company's investment in Aspire.

The Company recorded $72.7 million of impairment charges in 2013 to reduce various items of property, plant and equipment ("PP&E") to their recoverable amounts compared to $15.2 million in 2012. The impairment charges in 2013 included $66.4 million related to the DCHF at the Ovoot Tolgoi Mine. The impairment charge followed an extensive review of the DCHF and its contribution to the Company's product strategy. Refer to section 5 "Processing Infrastructure – Dry Coal Handling Facility" for further analysis of the impairment charge related to the DCHF. The impairment charges also included $6.3 million related to surplus capital spares not expected to be utilized with the Company's existing mining fleet.

An impairment of prepaid expenses and deposit of $30.2 million was included in other operating expenses in 2013 related to prepaid toll washing fees under the Ejin Jinda contract. The impairment charge followed a trial sample from the wet washing facility and also related to the delay in starting the commercial operations at the wet washing facility. Refer to section 5 "Processing Infrastructure – Wet Washing Facility" for further analysis of the impairment charge.

Other operating expenses in 2013 included a $15.0 million impairment of materials and supplies inventories compared to $nil in 2012. Following an extensive review of the Company's mining fleet in 2013, $14.5 million of surplus materials and supplies inventories were identified. These items are not expected to be utilized with the Company's existing mining fleet and, therefore, were adjusted to their net realizable value in 2013. In addition, the Company has implemented further controls related to procurement and inventory warehousing to prevent future overstocking. The impairment of materials and supplies inventories in 2013 also included $0.5 million of materials and supplies related to the DCHF.

Administration expenses were $15.6 million in 2013 compared to $24.6 million in 2012.

$ in thousands	Year ended December 31, 2013	2012
Corporate administration	**$ 3,269**	$ 5,525
Legal and professional fees	**8,252**	7,293
Salaries and benefits	**3,748**	5,556
Share-based compensation expense	**167**	6,048
Depreciation	**193**	215
Administration expenses	**$ 15,629**	$ 24,637

Legal and professional fees remained high in 2013 as a result of ongoing regulatory issues. In particular, the internal and tripartite committees referred to in section 7 "Regulatory Issues and Contingencies" resulted in $4.3 million of legal and professional fees in 2013 compared to $1.9 million of legal and professional fees in 2012. Corporate administration and salaries and benefits were lower in 2013 as the Company focused on cost-cutting initiatives and reduced headcount. Share-based compensation expense decreased in 2013 as certain employee stock options terminated in late 2012 and early 2013 with the change in senior management.

Evaluation and exploration expenses were $1.2 million in 2013 compared to $8.6 million in 2012. The Company continued to minimize evaluation and exploration expenditures in 2013 in order to preserve the Company's financial resources. The 2013 exploration program focused on further defining the Soumber Deposit. Other exploration activities and expenditures were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining and exploration licenses.

Finance costs were $21.2 million in 2013 compared to $15.4 million in 2012. Finance costs in 2013 primarily consisted of $20.3 million of interest expense on the $250.0 million China Investment Corporation ("CIC") convertible debenture compared to $10.5 million in 2012. The increase in the interest expense is the result of $nil interest capitalized to PP&E in 2013, compared to $9.6 million capitalized in 2012, as the Company minimized uncommitted capital expenditures, including expenditures on construction projects. In addition, finance costs in 2012 included a $4.5 million unrealized loss on the Company's investment in Kangaroo Resources Limited ("Kangaroo"). The Company's investment in Kangaroo is classified as fair value through profit or loss ("FVTPL").

Finance income was $5.6 million in 2013 compared to $39.9 million in 2012. Finance income for 2013 and 2012 primarily consisted of a $5.5 million and $39.5 million unrealized gain on the fair value change of the embedded derivatives in the CIC convertible debenture, respectively. The fair value of the embedded derivatives in the CIC convertible debenture is driven by many factors including: the Company's common share price, U.S. Dollar and Canadian Dollar exchange rates and share price volatility.

Income tax expense was $25.0 million in 2013 (primarily deferred income taxes) compared to a recovery of $1.5 million in 2012. As at December 31, 2013, the Company's deferred income tax asset was reduced to $nil (2012: $25.0 million). Deferred income tax expense in 2013 included $17.5 million related to the derecognition of deferred tax assets related to the Company's Mongolian tax loss carry forwards and deductible temporary differences.

Summary of Quarterly Operational Data

	2013				2012			
Quarter Ended	**31-Dec**	**30-Sep**	**30-Jun**	**31-Mar**	31-Dec	30-Sep	30-Jun	31-Mar
Sales Volumes, Prices and Costs								
Premium semi-soft coking coal								
Coal sales *(millions of tonnes)*	**0.21**	**0.04**	**0.21**	**0.08**	0.03	-	0.42	0.33
Average realized selling price *(per tonne)* (i)	**$ 37.54**	**$ 37.50**	**$ 32.46**	**$ 45.81**	$ 47.86	$ -	$ 67.46	$ 67.58
Standard semi-soft coking coal								
Coal sales *(millions of tonnes)*	**1.40**	**0.87**	**-**	**-**	-	0.01	0.36	0.10
Average realized selling price *(per tonne)* (i)	**$ 24.49**	**$ 21.67**	**$ -**	**$ -**	$ -	$ 49.91	$ 49.74	$ 49.43
Thermal coal								
Coal sales *(millions of tonnes)*	**0.11**	**0.03**	**0.11**	**0.20**	-	0.31	0.28	0.15
Average realized selling price *(per tonne)* (i)	**$ 12.60**	**$ 13.07**	**$ 13.98**	**$ 13.67**	$ -	$ 15.87	$ 34.10	$ 30.29
Total								
Coal sales *(millions of tonnes)*	**1.72**	**0.94**	**0.32**	**0.28**	0.03	0.32	1.06	0.58
Average realized selling price *(per tonne)* (i)	**$ 25.30**	**$ 22.05**	**$ 26.26**	**$ 22.75**	$ 47.86	$ 16.98	$ 52.86	$ 54.60
Raw coal production *(millions of tonnes)*	**1.73**	**1.13**	**0.17**	**0.02**	-	-	0.27	1.07
Direct cash costs of product *(per tonne)* (ii)	**$ 11.13**	**$ 9.41**	**$ 11.49**	**$ 10.22**	$ 11.67	$ 9.56	$ 16.52	$ 22.09
Mine administration cash costs of product sold *(per tonne)* (ii)	**$ 1.39**	**$ 2.20**	**$ 7.14**	**$ 1.46**	$ 5.08	$ 3.75	$ 1.33	$ 6.16
Total cash costs of product sold *(per tonne)* (ii)	**$ 12.52**	**$ 11.61**	**$ 18.63**	**$ 11.68**	$ 16.75	$ 13.31	$ 17.85	$ 28.25
Other Operational Data								
Production waste material moved *(millions of bank cubic meters)*	**3.77**	**1.57**	**2.71**	**0.40**	-	-	1.16	2.20
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**2.18**	**1.39**	**15.55**	**26.21**	-	-	4.31	2.07
Lost time injury frequency rate (iii)	**-**	**-**	**-**	**-**	0.1	0.2	0.2	0.3

(i) *Average realized selling price excludes royalties and selling fees.*
(ii) *A non-IFRS financial measure, see section 4. Cash costs of product sold exclude idled mine asset cash costs.*
(iii) *Per 200,000 man hours.*

Overview of Quarterly Operational Data

Raw coal production was 1.73 million tonnes in the fourth quarter of 2013 with a strip ratio of 2.18. The Ovoot Tolgoi Mine had been fully curtailed since the end of the second quarter of 2012, and therefore there was no production in the fourth quarter of 2012. Raw coal production in the fourth quarter of 2013 was paced to meet contracted sales tonnages.

Summary of Quarterly Financial Results

$ in thousands, except per share information	2013				2012			
Quarter Ended	**31-Dec**	**30-Sep**	**30-Jun**	**31-Mar**	31-Dec	30-Sep	30-Jun	31-Mar
Financial Results								
Revenue (i), (ii)	**$ 32,457**	**$ 15,652**	**$ 6,129**	**$ 4,398**	$ 1,186	$ 3,804	$ 46,575	$ 26,497
Cost of sales (ii)	**(40,359)**	**(33,486)**	**(17,477)**	**(21,305)**	(32,229)	(31,454)	(41,884)	(21,839)
Gross profit/(loss) excluding idled mine asset costs	**(4,141)**	**(13,323)**	**(5,593)**	**(494)**	(12,601)	(8,719)	20,277	4,657
Gross profit/(loss) including idled mine asset costs	**(7,900)**	**(17,834)**	**(11,348)**	**(16,908)**	(31,043)	(27,650)	4,690	4,657
Other operating expenses	**(109,682)**	**(1,003)**	**(14,925)**	**(431)**	(19,282)	(18,315)	(1,344)	(2,702)
Administration expenses	**(3,668)**	**(4,204)**	**(4,024)**	**(3,733)**	(6,080)	(5,178)	(7,497)	(5,882)
Evaluation and exploration expenses	**(489)**	**(186)**	**(221)**	**(273)**	(508)	(958)	(2,099)	(5,033)
Loss from operations	**(121,740)**	**(23,227)**	**(30,518)**	**(21,344)**	(56,913)	(52,101)	(6,250)	(8,961)
Finance costs	**(5,167)**	**(5,382)**	**(5,617)**	**(4,996)**	(4,718)	(5,164)	(4,006)	(1,497)
Finance income	**1,301**	**124**	**3,366**	**775**	(116)	12,947	26,875	236
Income tax recovery/(expense)	**(13,109)**	**(13,377)**	**(415)**	**1,915**	5,040	(2,383)	(867)	(258)
Net income/(loss)	**(138,730)**	**(41,928)**	**(33,140)**	**(23,666)**	(56,564)	(46,413)	15,955	(10,480)
Basic income/(loss) per share	**$ (0.75)**	**$ (0.23)**	**$ (0.18)**	**$ (0.13)**	$ (0.31)	$ (0.26)	$ 0.09	$ (0.06)
Diluted loss per share	**$ (0.75)**	**$ (0.23)**	**$ (0.18)**	**$ (0.13)**	$ (0.31)	$ (0.26)	$ (0.04)	$ (0.06)

(i) *Revenue is presented net of royalties and selling fees.*
(ii) *Revenue and cost of sales relate to the Company's Ovoot Tolgoi Mine within the Mongolian Coal Division operating segment. Refer to note 5 of the consolidated financial statements for further analysis regarding the Company's reportable operating segments.*

Overview of Quarterly Financial Results

The Company recorded a $121.7 million loss from operations in the fourth quarter of 2013 compared to a $56.9 million loss from operations in the fourth quarter of 2012 and a $138.7 million net loss in the fourth quarter of 2013 compared to a $56.6 million net loss in the fourth quarter of 2012. The fourth quarter 2013 loss from operations was negatively impacted by $4.9 million of coal stockpile impairments (2012: $13.3 million), $3.8 million of idled mine asset costs (2012: $18.4 million) and $106.8 million of impairment losses recorded in other operating expenses (2012: $17.1 million). The Company's loss from operations was $6.2 million in the fourth quarter of 2013 excluding the impact of the above noted items (2012: $8.1 million).

Revenue was $32.5 million in the fourth quarter of 2013 compared to $1.2 million in the fourth quarter of 2012. The Company sold 1.72 million tonnes of coal in the fourth quarter of 2013 at an average realized selling price of $25.30 per tonne compared to sales of 0.03 million tonnes from stockpile in the fourth quarter of 2012 at an average realized selling price of $47.86. The average realized selling price decreased as a result of the product mix in the fourth quarter of 2013. The fourth quarter of 2013 product mix primarily included Standard semi-soft coking coal compared to entirely Premium semi-soft coking coal in the fourth quarter of 2012. While certain coal price indices in China reached four year lows during 2013, Chinese coal price indices recovered slightly in the fourth quarter of 2013 compared to the third quarter of 2013. This resulted in an increase in the average realized selling price from $22.05 in the third quarter of 2013 to $25.30 in the fourth quarter of 2013.

Based on the royalty reference prices for the fourth quarter of 2013, the Company was subject to an average 7% royalty based on a weighted average reference price of $69.17 per tonne. The Company's effective royalty rate for the fourth quarter of 2013, based on the Company's average realized selling price of $25.30 per tonne, was 19% or $4.84 per tonne compared to 6% or $2.87 per tonne in the fourth quarter of 2012. The fourth quarter 2012 royalty per tonne benefitted from the trial royalty period from October 1, 2012 to March 31, 2013 whereby the royalty was determined using the actual contracted sales price per tonne, not the reference price.

Cost of sales was $40.4 million in the fourth quarter of 2013 compared to $32.2 million in the fourth quarter of 2012.

	Three months ended December 31,	
$ in thousands	**2013**	**2012**
Operating expenses	**$ 21,537**	$ 199
Share-based compensation expense	**28**	-
Depreciation and depletion	**10,096**	279
Impairment of coal stockpile inventories	**4,938**	13,310
Cost of sales from mine operations	**36,599**	13,788
Cost of sales related to idled mine assets	**3,760**	18,441
Cost of sales	**$ 40,359**	$ 32,229

Operating expenses in cost of sales were $21.5 million in 2013 compared to $0.2 million in the fourth quarter of 2012. The increase in operating expenses was due to the increase in coal sales in the fourth quarter of 2013 compared to the fourth quarter of 2012.

The coal stockpile impairments recorded in both the fourth quarter of 2013 and fourth quarter of 2012 of $4.9 million and $13.3 million, respectively, related to the Company's higher-ash products. Cost of sales related to idled mine assets in the fourth quarter of 2013 included $3.7 million related to depreciation expenses for idled equipment compared to $12.1 million in the fourth quarter of 2012.

Other operating expenses were $109.7 million in the fourth quarter of 2013 compared to $19.3 million in the fourth quarter of 2012.

$ in thousands	Three months ended December 31, 2013	2012
Public infrastructure	**$ 1**	$ 50
Sustainability and community relations	**117**	213
Foreign exchange loss	**631**	1,128
Provision for doubtful trade and other receivables	**200**	1,032
Impairment loss on available-for-sale financial asset	**-**	3,075
Impairment of property, plant and equipment	**68,370**	12,957
Impairment of prepaid expenses and deposits	**30,152**	-
Impairment of materials and supplies inventories	**8,032**	-
Other	**2,179**	827
Other operating expenses	**$ 109,682**	$ 19,282

The Company recorded $68.4 million of impairment charges in the fourth quarter of 2013 to reduce various items of PP&E to their recoverable amounts (2012: $13.0 million). The impairment charges included $66.4 million related to the DCHF (refer to section 5 "Processing Infrastructure – Dry Coal Handling Facility" for further analysis).

An impairment of prepaid expenses and deposit of $30.2 million was included in other operating expenses in the fourth quarter of 2013 related to prepaid toll washing fees under the Ejin Jinda contract (refer to section 5 "Processing Infrastructure – Wet Washing Facility" for further analysis of the impairment charge).

Other operating expenses included an $8.0 million impairment of materials and supplies inventories. Following a review of the Company's mining fleet that continued in the fourth quarter of 2013, $7.5 million of additional surplus materials and supplies inventories were identified. These items are not expected to be utilized with the Company's existing mining fleet and, therefore, were adjusted to their net realizable value in the fourth quarter of 2013. The impairment of materials and supplies inventories in the fourth quarter of 2013 also included $0.5 million of materials and supplies related to the DCHF.

Administration expenses were $3.7 million in the fourth quarter of 2013 compared to $6.1 million in the fourth quarter of 2012.

$ in thousands	Three months ended December 31, 2013	2012
Corporate administration	**$ 1,052**	$ 1,504
Legal and professional fees	**2,075**	3,082
Salaries and benefits	**780**	1,626
Share-based compensation recovery	**(275)**	(184)
Depreciation	**36**	52
Administration expenses	**$ 3,668**	$ 6,080

Legal and professional fees remained high in the fourth quarter of 2013. In particular, the internal and tripartite committees referred to in section 7 "Regulatory Issues and Contingencies" resulted in $1.8 million of legal and professional fees in the fourth quarter of 2013 (2012: $1.9 million). Meanwhile, corporate administration and salaries and benefits were lower in the fourth quarter of 2013 as a result of the Company's cost-cutting initiatives throughout 2013.

Evaluation and exploration expenses were $0.5 million in the fourth quarters of 2013 and 2012 as the Company continued to minimize evaluation and exploration expenditures in these periods.

Finance costs were $5.2 million in the fourth quarter of 2013 compared to $4.7 million in the fourth quarter of 2012. Finance costs in the fourth quarters of 2013 and 2012 primarily consisted of interest expense on the CIC convertible debenture. Finance income was $1.3 million in the fourth quarter of 2013 compared to $0.1 million in the fourth quarter of 2012. Finance income in both the fourth quarters of 2013 and 2012 primarily consisted of unrealized gains on the fair value change of the embedded derivatives in the CIC convertible debenture.

The Company recorded an income tax expense of $13.1 million in the fourth quarter of 2013 (primarily deferred income taxes) compared to an income tax recovery of $5.0 million in the fourth quarter of 2012 (primarily related to deferred income taxes). Deferred income tax expense in the fourth quarter of 2013 included $17.5 million related to the derecognition of deferred tax assets related to the Company's Mongolian tax loss carry forwards and deductible temporary differences.

4. NON-IFRS FINANCIAL MEASURES

The Company has included the non-IFRS financial measure "cash costs" in this MD&A to supplement its consolidated financial statements, which have been prepared in accordance with IFRS.

The Company believes that this measure, together with measures determined in accordance with IFRS, provide investors with useful information to evaluate the underlying performance of the Company. Non-IFRS financial measures do not have a standardized meaning prescribed under IFRS and therefore may not be comparable to similar measures employed by other companies. The non-IFRS financial measure is intended to provide additional information and should not be considered in isolation or as substitute for measures of performances prepared in accordance with IFRS.

Cash Costs

The Company uses cash costs to describe its cash production costs. Cash costs incorporate all production costs, which include direct and indirect costs of production, with the exception of idled mine asset costs and non-cash expenses which are excluded. Non-cash expenses include share-based compensation expense, impairments of coal stockpile inventories, depreciation and depletion of mineral properties.

The Company uses this performance measure to monitor its operating cash costs internally and believes this measure provides investors and analysts with useful information about the Company's underlying cash costs of operations. The Company believes that conventional measures of performance prepared in accordance with IFRS do not fully illustrate the ability of its mining operations to generate cash flows. The Company reports cash costs on a sales basis. This performance measure is commonly utilized in the mining industry.

The cash costs of product sold presented below may differ from cash costs of product produced depending on the timing of stockpile inventory turnover.

	Three months ended December 31,		Year ended December 31,	
$ in thousands, except per tonne information	**2013**	**2012**	**2013**	**2012**
Cash costs				
Cost of sales determined in accordance with IFRS	**$ 40,359**	$ 32,229	**$ 112,627**	$ 127,407
Less non-cash expenses	**(15,062)**	(13,367)	**(40,442)**	(34,778)
Less non-cash idled mine asset costs	**(3,721)**	(11,211)	**(25,053)**	(34,300)
Total cash costs	**21,576**	7,650	**47,132**	58,329
Less idled mine asset cash costs	**(39)**	(7,230)	**(5,386)**	(18,658)
Total cash costs excluding idled mine asset cash costs	**21,537**	420	**41,746**	39,671
Coal sales *(millions of tonnes)*	**1.72**	0.03	**3.26**	1.98
Total cash costs of product sold *(per tonne)*	**$ 12.52**	$ 16.75	**$ 12.81**	$ 20.01

	Three months ended December 31,		Year ended December 31,	
$ in thousands, except per tonne information	**2013**	**2012**	**2013**	**2012**
Cash costs				
Direct cash costs of product sold *(per tonne)*	**$ 11.13**	$ 11.67	**$ 10.58**	$ 16.86
Mine administration cash costs of product sold *(per tonne)*	**1.39**	5.08	**2.23**	3.15
Total cash costs of product sold *(per tonne)*	**$ 12.52**	$ 16.75	**$ 12.81**	$ 20.01

Adjusted Net Income/(loss)

Effective December 31, 2013, the Company discontinued the reporting of adjusted net income/(loss). The Company has determined that this non-IFRS measure no longer provides investors with useful information to evaluate the underlying performance of the Company.

5. PROPERTIES

The Company currently holds three mining licenses and four exploration licenses in Mongolia, which in total cover an area of approximately 234,000 hectares ("ha"). The mining licenses pertain to the Ovoot Tolgoi Complex (12726A), the Soumber Deposit (MV-016869) and the Tsagaan Tolgoi Deposit (15041A).

In addition to the existing mining license, the Company also holds two exploration licenses (9443X and 9449X) pertaining to certain areas associated with the Soumber Deposit for which PMAs have been issued. The Company holds two exploration licenses (13779X and 5267X) pertaining to the Zag Suuj Deposit for which PMAs have been issued.

Operating Mines

Ovoot Tolgoi Mine

The Ovoot Tolgoi Mine is located in the southwest corner of the Umnugobi Aimag (South Gobi Province) of Mongolia. The deposit is within the administrative unit of Gurvantes Soum, 320km southwest of the provincial capital of Dalanzadgad and 950km southwest of the nation's capital of Ulaanbaatar. To date, mining operations at the Ovoot Tolgoi Mine have been carried out in two distinct areas, the Sunset Pit to the west and the Sunrise Pit to the east.

Saleable products from the Ovoot Tolgoi Mine primarily include the Standard and Premium semi-soft coking coal products. The Company's raw semi-soft products together with raw higher-ash coals are suitable for washing and blending in order to be sold as a 1/3 coking coal in the Chinese market. Some higher-ash product is sold as a thermal coal product as and when the market allows. The Company intends to continue to develop markets for both its Premium and Standard semi-soft coking coal brands and to pursue long-term supply offtake with end users in China to complement its existing customer base and to gain best value of the Company's coal in the Chinese market. The Company is committed to further enhance the quality of its coal products through wet washing and increase its market penetration in China, and as part of this strategy is cooperating with Ejin Jinda to study the utilization of the Ejin Jinda wet washing facility (refer to "Processing Infrastructure – Wet Washing Facility" section below).

Reserves and Resources

On March 19, 2012, the Company announced an updated NI 43-101 compliant independent resource estimate prepared by RungePincockMinarco ("RPM"). RPM estimated that the Ovoot Tolgoi Mine contains 175.7 million tonnes of proven and probable surface coal reserves, 133.3 million tonnes of measured coal resources, 59.9 million tonnes of indicated coal resources and 24.0 million tonnes of inferred coal resources as at October 31, 2011. All of these resources are located above 300m and are amenable to surface mining. The Measured and Indicated Mineral Resources are inclusive of those Mineral Resources modified to produce the Mineral Reserves. Details of the assumptions and parameters used to calculate the reserves, resources and coal quality estimates and information on data verification are set out in the Annual Information Form dated March 24, 2014, and available at www.sedar.com.

The coal rank at the Ovoot Tolgoi Mine is high volatile B to A bituminous based on the ASTM D388 standard. High volatile B produces between 7,212 to 7,785 kcal/kg and high volatile A produces greater than 7,785 kcal/kg heat output.

Operational Data and Financial Results

Refer to section 3 for an overview of the operational data and financial results of the Ovoot Tolgoi Mine.

Processing Infrastructure

Dry Coal Handling Facility

Following an extensive review that commenced in the fourth quarter of 2013, the Company concluded that it does not plan to either complete or use the DCHF at the Ovoot Tolgoi Mine in the foreseeable future. This conclusion constituted an indicator of impairment and the Company performed an impairment assessment over the DCHF. As a result of the impairment assessment, the Company recorded a $66.9 million non-cash impairment in other operating expenses to reduce the carrying value of the DCHF to its recoverable amount. The Company used a value in use cash flow model, with a discount rate of 10.4%, to estimate the recoverable amount. The total construction capital investment to date on the DCHF is $85.0 million and the DCHF had a carrying value of $78.1 million prior to the impairment assessment. Subsequent to the impairment charge, the DCHF has a carrying value of $11.2 million at December 31, 2013.

The first phase of the DCHF project comprised a coal rotary breaker intended to reduce screening costs and improve yield recoveries. On February 13, 2012, the Company announced the successful commissioning of the coal rotary breaker. The Ovoot Tolgoi Mine operations were curtailed during the second half of 2012 and resumed on March 22, 2013. The Company has not operated the coal rotary breaker since its announced commissioning. The second phase of the DCHF project included the installation of dry air separation modules and covered load out conveyors with fan stackers to take processed coals to stockpiles and enable more efficient blending. In 2012, the Company announced the suspension of the completion of the DCHF project to minimize uncommitted capital expenditures and preserve the Company's financial resources. On November 14, 2013, the Company announced that it was conducting a review of the DCHF project and its contribution to the Company's product strategy.

The review of the DCHF project was completed in the first quarter of 2014. The Company continues to focus on preserving its financial resources and has assessed, using updated operating cost assumptions and estimates, that it currently has the adequate equipment and capacity to efficiently meet its commercial objectives and execute its product strategy without the use of the DCHF. The use of mobile screens at stockpile areas closer to the pits has enabled the Company to realize a cost benefit compared to hauling the coal to the central DCHF and operating the rotary breaker. This provides a lower cost solution without adversely impacting the coal quality of the coal planned to be mined over the next year. As coal markets improve and production from the Ovoot Tolgoi Mine increases in line with its anticipated annual capacity of 9 million tonnes run-of-mine production, the Company will review the use of the DCHF as part of its existing assets and continue developing beneficiation capabilities to maximize value from its product.

Wet Washing Facility

In 2011, the Company entered into an agreement with Ejin Jinda, a subsidiary of China Mongolia Coal Co. Ltd. to toll-wash coals from the Ovoot Tolgoi Mine. The agreement has a duration of five years from commencement of the contract and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input coal. The facility is located approximately 10km inside China from the Shivee Khuren Border Crossing, approximately 50km from the Ovoot Tolgoi Mine. Ejin Jinda will charge the Company a single toll washing fee which will cover their expenses, capital recovery and profit. Ejin Jinda will also transport coal from the Ovoot Tolgoi Mine to the wet washing facility under a separate transportation agreement. Pursuant to the terms of the agreement, the Company prepaid $33.6 million of toll washing fees in 2011.

To date, commercial operations at the wet washing facility have not commenced. The Company identified the results of a trial sample from the wet washing facility and the delay in starting the commercial operations at the wet washing facility as indicators of impairment for the prepaid toll washing fees which are part of the contract with Ejin Jinda. Based on updated estimates and assumptions related to wash yields from the facility, a $30.2 million impairment loss on the $33.6 million of prepaid toll washing fees was recorded in the fourth quarter of 2013.

The Company's objective continues to be the implementation of an effective and profitable wet washing solution, and the Company is cooperating with Ejin Jinda in reviewing the utilization of the wet washing facility.

Transportation Infrastructure

On August 2, 2011, the State Property Committee of Mongolia awarded the tender to construct a paved highway from the Ovoot Tolgoi Complex to the Shivee Khuren Border Crossing to consortium partners NTB LLC and SouthGobi Sands LLC (together referred to as "RDCC LLC"). SouthGobi Sands LLC holds a 40% interest in RDCC LLC.

On October 26, 2011, RDCC LLC signed a concession agreement with the State Property Committee of Mongolia. RDCC LLC has the right to conclude a 17 year build, operate and transfer agreement under the Mongolian Law on Concessions. Construction of the paved highway was substantially complete by the end of 2013. Subject to the Company having available financial resources to fund its portion of the remaining construction costs, the remaining construction work and commissioning of the paved highway is expected to be completed by the end of the first half of 2014.

During the third quarter of 2013, a sub-contractor employee was fatally injured by a vehicle at the construction site. Following the fatality, additional safety training was carried out by RDCC LLC and its sub-contractors in order to reinforce compliance with safety protocols.

The paved highway will have an intended carrying capacity upon completion in excess of 20 million tonnes of coal per year.

Mining Equipment

The key elements of the currently commissioned mining fleet includes: two Liebherr 996 ($34m^3$) hydraulic excavators, three Liebherr R9250 ($15m^3$) hydraulic excavators, 22 Terex MT4400 (218 tonne capacity) haul trucks and two Terex TR100 (91 tonne capacity) haul trucks, together with various pieces of ancillary equipment. The 2013 production plan did not fully utilize the Company's existing mining fleet.

Workforce

As at December 31, 2013, SouthGobi Sands LLC employed 431 employees in Mongolia. Of the 431 employees, 64 are employed in the Ulaanbaatar office, 2 in outlying offices and 365 at the Ovoot Tolgoi Mine site. Of the 431 employees based in Mongolia, 423 (98%) are Mongolian nationals and of those, 204 (48%) are residents of the local Gurvantes, Dalanzadgad, Sevrei and Noyon Soums.

Development Projects and Exploration Program

Soumber Deposit

The Soumber Deposit, comprising the Central Soumber, East Soumber, Biluut, South Biluut and Jargalant Fields, is located approximately 20km east of the Ovoot Tolgoi Mine. It lies within the administrative units of Gurvantes and Noyon Soums in the Umnugobi Aimag (South Gobi Province), approximately 50km northeast of the Shivee Khuren Border Crossing. The proximity of the Soumber Deposit to the Ovoot Tolgoi Mine will allow any future mining operation at the Soumber Deposit to share existing infrastructure with the Ovoot Tolgoi Mine.

The Central and East Soumber Fields include six major seam groups. Approximately 40% of the resources are contained in one seam, averaging 5.9m in thickness. All seam groups consist of a number of coal plies of highly variable thickness, separated by stone partings. Interburden between the seam groups is mainly sandstone and conglomerate, whilst partings within the seam groups tend to be dominated by mudstone and carbonaceous mudstone.

Three major seams have been identified at the Biluut, South Biluut and Jargalant Fields. Correlation of these seams with the Central and East Soumber Fields has not been undertaken. Approximately 60% of the resources are contained in one seam, averaging 5.5m in thickness.

On March 25, 2013, the Company reported an updated NI 43-101 compliant independent resource estimate prepared by RPM. RPM estimated that the Soumber Deposit contains measured coal resources of 62.4 million tonnes, indicated coal resources of 110.3 million tonnes and inferred coal resources of 123.0 million tonnes as at January 10, 2013. Approximately 76% of the Soumber Deposit resource is located above 300m and is amenable to surface mining. Details of the assumptions and parameters used to calculate the resources and coal quality estimates and information on data verification are set out in the Annual Information Form dated March 24, 2014, and available at www.sedar.com.

The coal rank at the Soumber Deposit is low to medium volatile bituminous based on the ASTM D388 standard producing between 5,000 to 7,800 kcal/kg of heat output. Laboratory data demonstrated that some of the coal benches exhibit potential coking coal characteristics.

On July 6, 2011, the Company announced that the Mineral Resources Authority of Mongolia ("MRAM") issued the Company a mining license pertaining to the Soumber Deposit. The 10,993ha mining license was granted for an initial term of 30 years with an option for two 20 year extensions. In addition to the existing mining license, the Company also holds two exploration licenses pertaining to certain areas associated with the Soumber Deposit for which PMAs have been issued. The Company has applied for a mining license on the area covered by the PMA issued on January 18, 2013. The Company plans to progress to the mining license application process for the PMA issued on August 14, 2013 (refer to section 7 "Regulatory Issues - Withdrawal of Notice of Investment Dispute" for further analysis).

Environmental baseline studies have been completed and general environmental impact assessments have been approved. The Company has delayed plans for a pre-feasibility study for the Soumber Deposit and intends to manage the feasibility planning and physical preparation of the Soumber Deposit with respect to ongoing market conditions, government requirements and the Company's available financial resources.

Zag Suuj Deposit

The Zag Suuj Deposit, located approximately 150km east of the Ovoot Tolgoi Mine and approximately 45km north of the Mongolia-China border, lies within the administrative units of Noyon and Bayandalai Soums in the Umnugobi Aimag (South Gobi Province).

Based on the exploration results to date, the coal occurrence at the Zag Suuj Deposit can be divided into four major seam groups. Each of the seam groups split into a number of coal plies of highly variable thickness, separated by stone partings. Interburden between the seams is mainly sandstone and conglomerate, whilst partings within the seams tend to be dominated by mudstone and carbonaceous mudstone. Correlation of the coal seams at the Zag Suuj Deposit with the Ovoot Tolgoi Complex and the Soumber Deposit has not been undertaken.

Several of the seams at the Zag Suuj Deposit have an average free swell index greater than 5, indicating metallurgical properties; however, limited metallurgical testing has been undertaken to date.

On March 25, 2013, the Company reported an updated NI 43-101 compliant independent resource estimate for the Zag Suuj Deposit prepared by RPM. RPM estimated that the Zag Suuj Deposit contains indicated coal resources of 21.5 million tonnes and inferred coal resources of 84.0 million tonnes as at January 10, 2013. The entire Zag Suuj Deposit resource is located above 300m and is amenable to surface mining. Details of the assumptions and parameters used to calculate the resources and coal quality estimates and information on data verification are set out in the Annual Information Form dated March 24, 2014, and available at www.sedar.com.

The coal rank at the Zag Suuj Deposit ranges between low to medium volatile bituminous coal based on the ASTM D388 standard. The average calorific value for individual coal seams ranges between 5,600 and 6,100 kcal/kg (ad).

The Company holds two exploration licenses pertaining to the Zag Suuj Deposit for which PMAs were issued on August 14, 2013 by MRAM. The Company plans to progress to the mining license application process for the PMAs (refer to section 7 "Regulatory Issues - Withdrawal of Notice of Investment Dispute" for further analysis).

It is anticipated that coals from the Zag Suuj Deposit can be washed to produce a coking coal product or a coking coal blend product. Limited exploration activities are planned for the Zag Suuj Deposit in 2014. Exploration activities in 2014 will ensure to meet the requisite requirements under the Mongolian Minerals Law.

Ovoot Tolgoi Underground Deposit

The Ovoot Tolgoi Underground Deposit is contiguous to, and located directly below, the Ovoot Tolgoi Mine. The entire extension of the coal at depth from 300m to 600m that is designated for potential underground development is located inside the existing Ovoot Tolgoi mining license.

On March 19, 2012, the Company announced an updated NI 43-101 compliant independent resource estimate prepared by RPM. RPM estimated that the Ovoot Tolgoi Underground Deposit contains measured coal resources of 65.8 million tonnes, indicated coal resources of 43.3 million tonnes and inferred coal resources of 62.0 million tonnes as at October 31, 2011. Details of the assumptions and parameters used to calculate the resources and coal quality estimates and information on data verification are set out in the Annual Information Form dated March 24, 2014, and available at www.sedar.com.

The coal rank at the Ovoot Tolgoi Underground Deposit is high volatile B to A bituminous based on the ASTM D388 standard. High volatile B produces between 7,212 to 7,785 kcal/kg and high volatile A produces greater than 7,785 kcal/kg heat output.

The Company has indefinitely delayed studies to determine the feasibility and economics of conducting an underground mining operation at the Ovoot Tolgoi Underground Deposit.

Tsagaan Tolgoi Deposit

The Tsagaan Tolgoi Deposit is located in south-central Mongolia. The property is located in the Umnugobi Aimag (South Gobi Province) approximately 570km south of Ulaanbaatar and 113km southeast of the provincial capital of Dalanzadgad, and approximately 115km west of Oyu Tolgoi.

In February 2008, Norwest estimated 23.4 million tonnes of measured coal resources, 13.0 million tonnes of indicated coal resources and 9.0 million tonnes of inferred coal resources. The coal is of volatile B to C bituminous rank based on ASTM D388 standards and is suitable for use as a thermal coal. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are set out in the Technical Report entitled, "Coal Geology and Resources – Tsagaan Tolgoi Property" dated March 25, 2008, and available at www.sedar.com.

Effective August 12, 2009, the Government of Mongolia issued a mining license for the Tsagaan Tolgoi Deposit. The Technical and Economic Study has been completed and was approved by the Government of Mongolia on March 4, 2010. The Detailed Environmental Impact Assessment was approved on April 9, 2010. The Company is evaluating its strategic options with respect to the Tsagaan Tolgoi Deposit.

Aspire (18.8% owned)

As at December 31, 2013, the Company owned 18.8% of Aspire, a company listed on the Australian Stock Exchange under the symbol AKM. Aspire's primary focus is its Mongolian coal assets, particularly those pertaining to the Ovoot Coking Coal Project. On July 31, 2013, Aspire announced an upgraded Australian JORC code reserve and resource estimate of 255.0 million tonnes of probable coal reserves, 197.0 million tonnes of measured coal resources, 72.3 million tonnes of indicated coal resources and 11.8 million tonnes of inferred coal resources. Reported coal resources are inclusive of coal reserves[2]. As at March 24, 2014, SouthGobi had invested a total of $27.9 million in Aspire and its interest in Aspire has a market value of $3.7 million.

Exploration Program

The Company continued to minimize evaluation and exploration expenditures in 2013 in order to preserve the Company's financial resources. The 2013 exploration program focused on further defining the Soumber Deposit. Other exploration activities and expenditures were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining and exploration licenses.

6. LIQUIDITY AND CAPITAL RESOURCES

Liquidity and Capital Management

The Company has in place a planning, budgeting and forecasting process to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans.

The Company anticipates that coal prices in China will remain under pressure in 2014, which will continue to impact the Company's margins and liquidity. Based on the Company's forecasts for the year ended December 31, 2014, the Company is unlikely to have sufficient capital resources and does not expect to generate sufficient cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC convertible debenture. Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives.

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2014 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. While the Company is actively seeking additional sources of financing to continue operating and meet its objectives, there can be no assurance that such financing will be available on terms acceptable to the Company. If for any reason, the Company is unable to secure the additional sources of financing and continue as a going concern, then this could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

While the Company intends to secure additional sources of financing as soon as possible, a continued delay in securing additional financing could ultimately result in an event of default of the $250.0 million CIC convertible debenture, which if not cured within applicable cure periods in accordance with the terms of such debenture, may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

[2] For more information on the Aspire resource and reserve estimates, refer to Aspire's press release dated July 31, 2013 and available at http://www.aspireminingl imited.com/.

The Company is focused on securing additional sources of financing and continues to minimize uncommitted capital expenditures while preserving the Company's growth options. Factors that impact the Company's liquidity are being closely monitored and include, but are not limited to, Chinese economic growth, market prices of coal, production levels, operating cash costs, capital costs, exchange rates of currencies of countries where the Company operates and exploration and discretionary expenditures.

As at December 31, 2013, the Company had cash of $21.8 million compared to cash of $19.7 million and short term money market investments of $15.0 million for a total of $34.7 million in cash and money market investments as at December 31, 2012. Working capital (excess current assets over current liabilities) was $41.7 million as at December 31, 2013 compared to $120.4 million as at December 31, 2012. As at March 24, 2014, the Company had cash of $10.0 million.

As at December 31, 2013, the Company's gearing ratio was 0.19 (December 31, 2012: 0.14), which was calculated based on the Company's long term liabilities to total assets. As at December 31, 2013, the Company is not subject to any externally imposed capital requirements.

CIC Convertible Debenture

In November 2009, the Company entered into a financing agreement with a wholly owned subsidiary of the CIC for $500 million in the form of a secured, convertible debenture bearing interest at 8.0% (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's shares) with a maximum term of 30 years. The CIC convertible debenture is secured by a charge over the Company's assets and certain subsidiaries. The financing was required primarily to support the accelerated investment program in Mongolia and up to $120 million of the financing could also be used for working capital, repayment of debt due on funding, general and administrative expenses and other general corporate purposes. The Company's actual use of financing has been in accordance with the above.

On March 29, 2010, the Company exercised its right to call for the conversion of up to $250.0 million of the CIC convertible debenture into approximately 21.5 million shares at a conversion price of $11.64 (Cdn$11.88). As at December 31, 2013, the CIC owned, through its indirect wholly owned subsidiary, approximately 16% of the issued and outstanding common shares of the Company.

Foreign Strategic Sectors Law

The terms of the CIC convertible debenture provide for the 1.6% share interest payment of $4.0 million to be paid annually in common shares of the Company. On May 17, 2012, the Parliament of Mongolia approved a Law on Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance ("Foreign Strategic Sectors Law") that regulated foreign direct investment into a number of key sectors of strategic importance, which includes mineral resources.

As a result of the Foreign Strategic Sectors Law, the Company expected that it would require parliamentary approval for the shares to be issued for the November 19, 2012 share interest payment to the CIC. As a result, in the first quarter of 2013, the Company settled the 1.6% share interest payment of $4.0 million in cash.

Following amendments to the Foreign Strategic Sectors Law, passed in the second quarter of 2013, the requirement for parliamentary approval was limited to circumstances where a state owned entity is to exceed 49% share ownership of a strategic asset, irrespective of the amount of investment. As a result, the Company is only required to give notice, rather than obtaining parliamentary or other approval, under the Foreign Strategic Sectors Law for the 1.6% share interest payment to the CIC.

On October 3, 2013 Mongolia's foreign investment environment changed again when the Parliament of Mongolia passed the Investment Law to repeal and replace the Foreign Strategic Sectors Law. The Investment Law regulates, amongst other things, investment by Foreign State Owned Entities ("FSOEs") in sectors of strategic importance, which includes mineral resources, by requiring that FSOEs obtain a permit from Mongolia's Ministry of Economic Development if they are to acquire 33% or more of the shareholding of a Mongolian entity operating in a sector of strategic importance. The Company understands that it will not be required to obtain a permit from the Ministry of Economic Development in connection with the 1.6% share interest payment to CIC, unless such share interest payment will result in CIC acquiring 33% or more of the shareholding in the Company. The Company will fully comply with the requirements of the Investment Law in connection with share interest payments.

Share interest payments were made to the CIC on September 19, 2013 and November 21, 2013.

Interest Payment Deferral

During the second quarter of 2013, the Company and the CIC mutually agreed upon a three month deferral of the convertible debenture semi-annual $7.9 million cash interest payment due on May 19, 2013. The Company and the CIC subsequently agreed to an additional deferral of one month, and the cash interest payment became due on September 19, 2013.

On September 19, 2013, the Company settled the $7.9 million amount, plus additional accrued interest of $0.2 million, as follows:

- The Company issued 1.8 million shares to the CIC for the November 19, 2012 1.6% share interest payment, where the number of common shares was based on the 50-day volume-weighted average share price on November 19, 2012 of Cdn$2.16;
- In consideration of the common share issue, the CIC applied the $4.0 million in cash already paid by the Company in the first quarter of 2013 for the November 19, 2012 share interest payment against the amount due on September 19, 2013; and
- The Company paid the remaining $4.1 million balance in cash.

The mutually agreed upon deferral of the cash interest payment, and subsequent settlement in cash and common shares of the Company, did not trigger an event of default and all other terms of the convertible debenture remain unchanged.

Mongolian IAAC Investigation

In the first quarter of 2013, the Company was subject to orders imposed by Mongolia's Independent Authority against Corruption (the "IAAC") which placed restrictions on certain of the Company's Mongolian assets. The orders were imposed on the Company in connection with the IAAC's investigation of the Company. The Mongolian State Investigation Office (the "SIA") also continues to enforce the orders on the Company.

The orders placing restrictions on certain of the Company's Mongolian assets could ultimately result in an event of default of the Company's CIC convertible debenture. Following a review by the Company and its advisers, it is the Company's view that this does not result in an event of default as defined under the CIC convertible debenture terms. However, if an event of default of the CIC convertible debenture occurs that remains uncured for ten business days, the principal amount owing and all accrued and unpaid interest will become immediately due and payable upon notice to the Company by CIC.

The orders relate to certain items of operating equipment and infrastructure and the Company's Mongolian bank accounts. The orders related to the operating equipment and infrastructure restricts the sale of these items; however, the orders do not restrict the use of these items in the Company's mining activities. The orders related to the Company's Mongolian bank accounts restrict the use of in-country funds. While the orders restrict the use of in-country funds pending outcome of the investigation, they are not expected to have any material impact on the Company's activities.

Cash Flow Highlights

	Year ended December 31,	
$ in thousands	**2013**	**2012**
Cash from/(used in) operating activities	**$ 7,559**	$ (26,283)
Cash used in investing activities	**(4,892)**	(77,737)
Cash from/(used in) financing activities	**129**	(51)
Effect of foreign exchange rate changes on cash	**(633)**	178
Increase/(decrease) in cash for the year	**2,163**	(103,893)
Cash balance, beginning of year	**19,674**	123,567
Cash balance, end of year	**$ 21,837**	$ 19,674

Cash from/(used in) Operating Activities

The Company generated $7.6 million of cash from operating activities in 2013 following the resumption of mining activities at the Ovoot Tolgoi Mine compared to cash used in operating activities of $26.3 million in 2012. Cash generated from operating activities was primarily the result of the reduction of non-cash working capital items in 2013.

Cash used in Investing Activities

The Company used $4.9 million of cash in investing activities in 2013 compared to $77.7 million in 2012. Cash used in investing activities primarily related to expenditures on PP&E of $11.8 million (2012: $97.4 million) and investments in the RDCC LLC joint venture of $10.4 million (2012: $13.3 million), partially offset by the proceeds from the maturity of money market investments of $15.0 million (2012: $30.0 million). The decrease in cash used for investing activities in 2013 compared to 2012 reflects the Company's efforts to minimize uncommitted capital expenditures.

Cash from/(used in) Financing activities

The Company generated $0.1 million of cash from financing activities in 2013 compared to a use of $0.1 million in 2012. The cash generated in 2013 related to the issuance of common shares under the Company's employee share purchase plan. Cash used in financing activities in 2012 was $0.1 million, primarily related to net repayments on the line of credit facility and the repurchase of $1.0 million of the Company's common shares, partially offset by the issuance of common shares and exercise of stock options.

In the first quarter of 2013, the Company's revolving line of credit facility with Golomt Bank in Mongolia expired. The line of credit facility was used by the Company's Mongolian Coal Division as part of its working capital management. The revolving line of credit has not been renewed.

Contractual Obligations and Guarantees

Day-to-day mining, expansionary and sustaining capital expenditures as well as administrative operations give rise to commitments for future minimum payments. As at December 31, 2013, the Company's operating and capital commitments were:

	As at December 31, 2013			
$ in thousands	Within 1 year	2-3 years	Over 3 years	Total
Capital expenditure commitments	$ 16,158	$ 11,273	$ -	$ 27,431
Operating expenditure commitments (i)	24,170	1,010	154	$ 25,334
Commitments	$ 40,328	$ 12,283	$ 154	$ 52,765

(i) Operating expenditure commitments include $18.4 million of fees related to the Company's toll wash plant agreement with Ejin Jinda. This amount reflects the minimum expenditure due under this agreement.

Ovoot Tolgoi Mine Impairment Analysis

Unchanged from the assessment made as at September 30, 2013, the Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at December 31, 2013. The impairment indicator was the continued weakness in the Company's share price during the fourth quarter of 2013 and the fact that the market capitalization of the Company, as at December 31, 2013, was less than the carrying value of its net assets.

Therefore, the Company conducted an impairment test whereby the carrying value of the Company's Ovoot Tolgoi Mine cash generating unit was compared to its "value in use" using a discounted future cash flow valuation model. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was $416.6 million as at December 31, 2013.

Key estimates and assumptions incorporated in the valuation model included the following:

- Long term real selling price of $110 per tonne for semi-soft coking coal FOB Australia;
- Life-of-mine coal production and operating costs; and
- A discount rate of 12.5% based on an analysis of market, country and company specific factors.

Key sensitivities in the valuation model are as follows:

- For each 1% increase/(decrease) in the long term real selling price of semi-soft coking coal FOB Australia, the calculated fair value of the cash generating unit increases/(decreases) by approximately $34.0/($34.0) million; and
- For each 1% increase/(decrease) in the discount rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately ($44.0)/$50.0 million.

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at December 31, 2013. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

Financial Instruments

The fair value of financial assets and financial liabilities at amortized cost is determined in accordance with generally accepted pricing models based on discounted cash flow analysis or using prices from observable current market transactions. The Company considers that the carrying amount of all its financial assets and financial liabilities recognized at amortized cost in the financial statements approximates their fair value.

The fair values of financial instruments that are traded on an active liquid market are determined with reference to the quoted market prices. The fair value of the Company's investment in the shares of Kangaroo, Aspire and its money market investments are determined using this methodology. The Company's investment in the shares of Kangaroo and its money market investments are classified as FVTPL. The Company's investment in the shares of Aspire is classified as available-for-sale.

The fair values of the embedded derivatives within the CIC convertible debenture are determined using a Monte Carlo simulation. The risks associated with the CIC convertible debenture relate to a potential breach of the Company's obligations under the terms of the CIC convertible debenture. The Company mitigates these risks by ensuring its corporate activities comply with all of its contractual obligations under the CIC convertible debenture.

The fair value of all the other financial instruments of the Company approximates their carrying value because of the demand nature or short-term maturity of these instruments.

	As at December 31,	
$ in thousands	**2013**	**2012**
Financial assets		
Loans-and-receivables		
Cash	**$ 21,837**	$ 19,674
Trade and other receivables	**2,578**	3,292
Available-for-sale		
Investment in Aspire	**6,175**	8,727
Fair value through profit or loss		
Investment in Kangaroo	**222**	1,455
Money market investments	**-**	15,000
Total financial assets	**$ 30,812**	$ 48,148

	As at December 31,	
$ in thousands	**2013**	**2012**
Financial liabilities		
Fair value through profit or loss		
Convertible debenture - embedded derivatives	**$ 3,395**	$ 8,876
Other-financial-liabilities		
Trade and other payables	**31,241**	10,216
Convertible debenture - debt host	**93,208**	97,092
Total financial liabilities	**$ 127,844**	$ 116,184

The net loss in 2013 and 2012 included the included the following amounts of unrealized losses/(gains) from the fair value adjustments to certain financial instruments which are classified as FVTPL:

	Year ended December 31,	
$ in thousands	**2013**	**2012**
Unrealized loss on FVTPL investments	**$ 656**	$ 4,482
Unrealized gain on embedded derivatives in CIC convertible debenture	**5,481**	39,512

The Company recognized impairment losses of $3.1 million and $19.2 million in other operating expenses in 2013 and 2012 related to the investment in Aspire, respectively.

7. REGULATORY ISSUES AND CONTINGENCIES

Regulatory Issues

Governmental and Regulatory Investigations

The Company is subject to investigations by the IAAC and the SIA regarding allegations against the Company and some of its former employees. The IAAC investigation concerns possible breaches of Mongolia's anti-corruption laws, while the SIA investigation concerns possible breaches of Mongolia's money laundering and taxation laws.

While the IAAC investigation into allegations of possible breaches of Mongolian anti-corruption laws has been suspended, the Company has not received formal notice that the IAAC investigation is completed. The IAAC has not formally accused any current or former Company employees of breach of Mongolia's anti-corruption laws.

A report issued by the experts appointed by the SIA on June 30, 2013 and again in January 2014 has recommended that the accusations of money laundering as alleged against the Company's three former employees be withdrawn. However, to date, the Company has not received notice or legal document confirming such withdrawal as recommended by the experts appointed by the SIA.

A third investigation ordered by the SIA and conducted by the National Forensic Center ("NFC") into alleged violations of Mongolian taxation law was concluded at the end of January 2014. The Company has received notice that the report with conclusions of the investigations by the NFC have been provided to the Prosecutor General of Mongolia. The Prosecutor General may undertake criminal actions against the three former employees for alleged violations of taxation laws and the Company may be held liable as "civil defendant" as a result of these alleged criminal actions. These actions could result in the investigation case being imminently transferred to a Court of Justice under the relevant Mongolian law. The likelihood or consequences of such an outcome or any civil action taken against the Company are uncertain and unclear at this time but could include financial or other penalties, which could be material, and which could have a material adverse effect on the Company.

The Company disputes and will vigorously defend itself against any civil or criminal actions. At this point, the three former employees remain designated as "accused" in connection with the allegations of tax evasion, and continue to be subject to a travel ban. The Company remains designated as a "civil defendant" in connection with the tax evasion allegations, and may potentially be held financially liable for the alleged criminal misconduct of its former employees under Mongolian Law.

The SIA also continues to enforce administrative restrictions, which were initially imposed by the IAAC investigation, on certain of the Company's Mongolian assets, including local bank accounts, in connection with its continuing investigation of these allegations. While the orders restrict the use of in-country funds pending the outcome of the investigation, they are not expected to have a material impact on the Company's activities in the short term, although they could create potential difficulties for the Company in the medium to long term. The Company will continue to take all appropriate steps to protect its ability to conduct its business activities in the ordinary course.

Internal Investigations

Through its Audit Committee (comprised solely of independent directors), the Company has conducted an internal investigation into possible breaches of law, internal corporate policies and codes of conduct arising from the allegations which have been raised. The Audit Committee has had the assistance of independent legal counsel in connection with its investigation.

The Chair of the Audit Committee has also participated in a tripartite committee, comprised of the Audit Committee Chairs of the Company and Turquoise Hill and a representative of Rio Tinto, which focused on the investigation of a number of those allegations, including possible violations of anti-corruption laws. Independent legal counsel and forensic accountants assisted this committee with its investigation. The tripartite committee substantially completed the investigative phase of its activities during the third quarter of 2013. The Company continues to cooperate with the IAAC, SIA and with Canadian and United States government and regulatory authorities that are monitoring the Mongolian investigations. It is possible that these authorities may subsequently conduct their own review or investigation or seek further information from the Company. Pending further reviews or questions from any of such government or regulatory authorities, the tripartite committee has been stood down and investigations have been paused.

The investigations referred to above could result in one or more Mongolian, Canadian, United States or other governmental or regulatory agencies taking civil or criminal action against the Company, its affiliates or its current or former employees. The likelihood or consequences of such an outcome are unclear at this time but could include financial or other penalties, which could be material, and which could have a material adverse effect on the Company. Refer to the risk factor, "the Company is subject to continuing governmental, regulatory and internal investigations, the outcome of which is unclear at this time but could have a material adverse effect on the Company", in section 14.

The Company, through its Board of Directors and new management, has taken a number of steps to address issues noted during the investigations and to focus ongoing compliance by employees with all applicable laws, internal corporate policies and codes of conduct, and with the Company's disclosure controls and procedures and internal controls over financial reporting.

Withdrawal of Notice of Investment Dispute

On July 11, 2012, the Company announced that SGQ Coal Investment Pte. Ltd., a wholly-owned subsidiary of the Company that owns 100% of the Company's Mongolian operating subsidiary SouthGobi Sands LLC, filed a Notice of Investment Dispute on the Government of Mongolia pursuant to the Bilateral Investment Treaty between Singapore and Mongolia. The Company filed the Notice of Investment Dispute following a determination by management that they had exhausted all other possible means to resolve an ongoing investment dispute between SouthGobi Sands LLC and the Mongolian authorities.

The Notice of Investment Dispute principally concerned the failure by MRAM to execute the PMAs associated with certain exploration licenses of the Company pursuant to which valid PMA applications had been lodged in 2011. The areas covered by the valid PMA applications included the Zag Suuj Deposit and certain areas associated with the Soumber Deposit outside the existing mining license.

On August 22, 2013, the Company announced that it had withdrawn the Notice of Investment Dispute in recognition of the fact that the dispute was resolved following the grant of three PMAs on August 14, 2013 relating to the Zag Suuj Deposit and certain areas associated with the Soumber Deposit, and the earlier grant of a PMA on January 18, 2013 pertaining to the Soumber Deposit. Each of the PMAs was granted and executed by MRAM in accordance with Mongolian law.

Mining Prohibition in Specified Areas Law

Pursuant to the Mining Prohibition in Specified Areas Law, the Government of Mongolia has defined the boundaries of certain areas in which exploration and mining is purportedly prohibited. A list of licenses has been prepared that overlap with the prohibited areas described in the law based on information submitted by water authority agencies, forest authority agencies and local authorities for submission to the Government of Mongolia.

Portions of the Company's Ovoot Tolgoi and Tsagaan Tolgoi mining licenses and exploration licenses pertaining to the Zag Suuj Deposit and the South Biluut and Jargalant Fields within the Soumber Deposit are included on the list of licenses published by the Government of Mongolia, potentially affecting the status of those licenses under the Mining Prohibition in Specified Areas Law.

In regard to the Ovoot Tolgoi mining license, the potential area which may be affected is a relatively small area which represents approximately 3% of the entire area of the mining license and does not contain any of the Company's NI 43-101 reserves or resources or immovable assets. Accordingly, the loss of the potentially affected area would not materially and adversely affect the existing operations.

Activities historically carried out on the other licenses referred to above include drilling, trenching and geological reconnaissance. The Company has no immovable assets located in any of the potentially affected areas of these licenses and the loss of any or all of these potentially affected properties would not materially and adversely affect the existing operations.

The Company understands that the status of the Mining Prohibition in Specified Areas Law is unclear and it has not been enforced to date. Reports from Mongolia suggest that the law may be amended. The Company will continue to monitor developments and will ensure that it is fully compliant with Mongolian law.

Contingencies

Class Action Lawsuit

On or about January 6, 2014, Siskinds LLP, a Canadian law firm, filed a proposed securities class action (the "Ontario Action") against the Company, certain of its former senior officers and current directors, and its former auditors, Deloitte LLP, in the Ontario Superior Court of Justice in relation to the Company's restatement of financial statements as previously disclosed in the Company's public filings.

The plaintiff seeks leave to bring a claim under applicable Canadian securities legislation and seeks certification of a class action with respect to a class of persons who purchased shares of the Company between March 30, 2011 and November 7, 2013, alleging that the financial reporting of the Company during that period contained misrepresentations giving rise to liability at common law and under applicable Canadian securities legislation. The Ontario Action also seeks general damages against all defendants in the sum of Cdn$30 million, without particulars as to how such amount was determined, or such other amount that the Court deems appropriate. Assuming that leave is granted, the action is certified as a class proceeding, and there is a finding of liability, the actual quantum of damages will depend upon the evidence which is adduced in the court proceedings.

Named in the Ontario Action as individual defendants are the Company's former Chief Executive Officer, Alexander Molyneux, the Company's former Chief Financial Officers, Messrs. Terry Krepiakevich and Matthew O'Kane, and the members of its Audit Committee, Messrs. Andre Deepwell, Pierre Lebel and Gordon Lancaster, each of whom held those positions during the period at issue.

The Company disputes and will vigorously defend itself against these claims through independent Canadian litigation counsel retained by the Company and the other defendants for this purpose. Due to the inherent uncertainties of litigation, it is not possible to predict the final outcome of the Ontario Action or determine the amount of any potential losses, if any. However, in the opinion of management of the Company, at December 31, 2013 a provision for this matter is not required.

8. ENVIRONMENT

The Company is subject to the Environmental Protection Law of Mongolia ("EPL") and has the following duties with respect to environmental protection:

- To comply with the EPL and the decisions of the government, local self-governing organizations, local governors and Mongolian state inspectors;
- To comply with environmental standards, limits, legislation and procedures and to supervise their implementation within the organization;
- To keep records on toxic substances, adverse impacts, and waste discharged into the environment; and
- To report on measures taken to reduce or eliminate toxic chemicals, adverse impacts, and waste.

In addition to those duties imposed on them by the EPL, mining license holders are required to prepare an initial environmental impact assessment analysis before the mine comes into production. The mining license holders must also annually develop and implement an environmental management plan (including reclamation measures) in co-operation with the Ministry of Environment and Green Development, which should take into account the results of the environmental impact assessment. The Company received approval of its detailed Environmental Impact Assessment and Environmental Management Plan from the Mongolian Ministry of Environment for the mining operation at the Ovoot Tolgoi Mine in 2007 and renewed in 2013.

The Company has implemented a number of internal policies to embrace responsibility for the impact of its business activities on the environment. By conducting studies, carefully designing mine plans, implementing pollution control recommendations from internal and external sources, monitoring the effects of mining on mining areas and carefully designing mine closure plans, the Company seeks to minimize the impact of its activities on the environment.

The Company established an environmental policy in 2008. The environmental policy affirms the Company's commitment to environmental protection. The Company monitors its operations to ensure that it complies with all applicable environmental requirements, and takes actions to prevent and correct problems if needed.

The Board maintains a Health, Environment, Safety and Social Responsibility Committee. The Committee is composed of non-executive and executive directors. The primary objective of the Health, Environment, Safety and Social Responsibility Committee is to review and oversee the Company's established health, environmental, safety and social responsibility policies and procedures at the Company's project sites. The Committee also reviews any incidents that may occur and provides guidance on how to prevent any recurrences.

9. RELATED PARTY TRANSACTIONS

The Company had related party transactions with the following companies related by way of directors or shareholders in common:

- Turquoise Hill – Turquoise Hill is the Company's immediate parent company and at December 31, 2013 owned approximately 56% of the outstanding common shares of the Company. Turquoise Hill provides various administrative services to the Company on a cost-recovery basis. The Company also provided some office and investor relations services to Turquoise Hill in the Company's Hong Kong office and recovered the costs for those services on a cost-recovery basis. The Company's provision of office and investor relations services to Turquoise Hill ceased on June 30, 2012.
- Rio Tinto – Rio Tinto is the Company's ultimate parent company and at December 31, 2013 Rio Tinto controlled Turquoise Hill. The Company recovers administration and other costs incurred on behalf of Rio Tinto on a cost-recovery basis. Rio Tinto recovers from the Company the costs of salaries and benefits of employees assigned to work for the Company.
- Global Mining Management ("GMM") – GMM is a private company owned equally by seven companies, two of which include the Company and Turquoise Hill. GMM provides administration, accounting and other office services to the Company on a cost-recovery basis. The provision of these services ceased on October 31, 2013.
- Turquoise Hill Resources Singapore Pte. Ltd. ("Turquoise Hill Singapore") – Turquoise Hill Singapore (formerly I2MS.NET Pte. Ltd.) is a private company 100% owned by Turquoise Hill. Turquoise Hill Singapore provides information technology and other related services to the Company on a cost-recovery basis.
- Ivanhoe Energy Inc. ("Ivanhoe Energy") – Ivanhoe Energy is a publicly listed company and in 2012 had two directors in common with the Company. The Company provided some office and investor relations services to Ivanhoe Energy in the Company's Hong Kong office and recovered the costs for those services on a cost-recovery basis. The Company's provision of office and investor relations services to Ivanhoe Energy ceased on June 30, 2012.

The following tables summarize related party expense and recovery amounts with the related parties listed above:

	Year ended December 31,	
$ in thousands	**2013**	**2012**
Corporate administration	**$ 781**	$ 1,309
Salaries and benefits	**1,505**	919
Total related party expenses	**$ 2,286**	$ 2,228

	Year ended December 31,	
$ in thousands	**2013**	**2012**
GMM	**$ 40**	$ 1,012
Turquoise Hill	**205**	7
Rio Tinto	**1,353**	68
Turquoise Hill Singapore	**688**	1,141
Total related party expenses	**$ 2,286**	$ 2,228

	Year ended December 31,	
$ in thousands	**2013**	**2012**
Corporate administration	**$ 17**	$ 589
Total related party recoveries	**$ 17**	$ 589

$ in thousands	Year ended December 31, 2013		Year ended December 31, 2012	
Turquoise Hill	**$**	**-**	$	479
Ivanhoe Energy		**-**		77
Rio Tinto		**17**		33
Total related party recoveries	**$**	**17**	$	589

The Company had accounts receivable of $0.1 million as at December 31, 2013 (2012: $0.7 million) and accounts payable of $1.4 million as at December 31, 2013 (2012: $35.0 thousand) with related parties.

Emolument Policy

The emolument policy of the executives of the Company is administered by the Compensation and Benefits Committee on the basis of merit, qualifications and competence and approved by the Board. The emolument policy for the rest of the employees is determined on a department by department basis with the executive in charge of each department determining the emoluments for senior employees and managers in the department and the emoluments for non-senior employees being determined by an appropriately designated manager. The emolument policy for non-executives is administered in conjunction with the human resources department and is done on the basis of merit, qualifications and competence.

The emolument policy for the directors of the Company is administered by the Compensation and Benefits Committee and approved by the Board, having regard to comparable market statistics.

The Company has also adopted an equity incentive plan to incentivize directors and eligible employees. Details of the plan are set out in note 22 of the Company's consolidated financial statements for the year ended December 31, 2013.

As at December 31, 2013, the Company employed 441 employees.

10. OUTSTANDING SHARE DATA

During the year ended December 31, 2012, the Company repurchased 148 thousand common shares on the Toronto Stock Exchange and Hong Kong Stock Exchange at an average price of Cdn$6.44 per share. The share repurchase program concluded on June 14, 2012. The Company cancelled all of the repurchased common shares. No additional common shares were repurchased by the Company during the year ended December 31, 2013.

The Company is authorized to issue an unlimited number of common shares without par value and an unlimited number of preferred shares without par value. As at March 24, 2014, 187.3 million common shares were issued and outstanding. There are also incentive share options outstanding to acquire 2.0 million unissued common shares with exercise prices ranging from Cdn$0.84 to Cdn$12.99. There are no preferred shares outstanding.

As at March 24, 2014, Turquoise Hill directly owned 104.8 million common shares representing approximately 56% of the issued and outstanding common shares of the Company.

11. INTERNAL CONTROLS OVER FINANCIAL REPORTING

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

In conjunction with the restatement of the Company's December 31, 2012 consolidated financial statements in 2013, the Company's management identified a material weakness in the Company's internal controls over financial reporting as of December 31, 2012 and as of December 31, 2011, resulting in the failure to properly account for revenues in complex transactions. Specifically, the Company did not ensure that all aspects of sales arrangements were considered in the determination of the appropriate accounting for contracts in which the specified location of transfer of title in the contracts is the customer's stockpile in a stockyard located within the Ovoot Tolgoi mining license area. As a result of the material weakness, the Company's Chief Executive Officer and Chief Financial Officer concluded that internal controls over financial reporting were not effective as of December 31, 2012 and as of December 31, 2011.

Management has been enhancing internal controls over financial reporting by developing a more thorough review process in evaluating complex sales arrangements in each reporting period. The remedial controls have now been implemented and have operated for a sufficient period of time to conclude, through testing, that these controls were effective as at December 31, 2013.

Except for the above noted items, there has been no further significant changes in the Company's internal controls over financial reporting that occurred during the most recently completed year that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. As of December 31, 2013, the Chief Executive Officer and Chief Financial Officer have each concluded that the Company's disclosure controls and procedures, as defined in NI 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to achieve the purpose for which they have been designed.

Because of their inherent limitations, internal controls over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

12. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of financial statements in conformity with IFRS requires the Company to establish accounting policies and to make estimates and judgments that affect both the amount and timing of the recording of assets, liabilities, revenues and expenses.

A detailed summary of all of the Company's significant accounting policies is included in note 3 to the Company's consolidated financial statements for the year ended December 31, 2013. Information about judgments and estimates in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are as follows:

Liquidity and Going Concern Assumption

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had cash of $21.8 million and working capital of $41.7 million at December 31, 2013.

The Company has in place a planning, budgeting and forecasting process to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans.

The Company anticipates that coal prices in China will remain under pressure in 2014, which will continue to impact the Company's margins and liquidity. Based on the Company's forecasts for the year ended December 31, 2014, the Company is unlikely to have sufficient capital resources and does not expect to generate sufficient cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC convertible debenture. Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives.

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2014 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. While the Company is actively seeking additional sources of financing to continue operating and meet its objectives, there can be no assurance that such financing will be available on terms acceptable to the Company. If for any reason, the Company is unable to secure the additional sources of financing and continue as a going concern, then this could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

While the Company intends to secure additional sources of financing as soon as possible, a continued delay in securing additional financing could ultimately result in an event of default of the $250.0 million CIC convertible debenture, which if not cured within applicable cure periods in accordance with the terms of such debenture, may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

Valuation of Embedded Derivatives

The embedded derivatives in the Company's convertible debenture are valued using a Monte Carlo simulation valuation model. A Monte Carlo simulation model is a valuation model that relies on random sampling and is often used when modeling systems with a large number of inputs and where there is significant uncertainty in the future value of inputs and where the movement of the inputs can be independent of each other. The key inputs used by the Company in its Monte Carlo simulation are further disclosed in note 19.2 and note 19.3 of the Company's consolidated financial statements for the year ended December 31, 2013. Changes in the inputs to the valuation model could impact the carrying value of the embedded derivatives in the convertible debenture and the amount of unrealized gains or losses recognized in profit or loss.

Review of Carrying Value of Assets and Impairment Charges

In the determination of carrying values and impairment charges, management of the Company reviews the recoverable amount (the higher of the fair value less costs to sell or the value in use) in the case of non-financial assets and objective evidence indicating impairment in the case of financial assets. These determinations and their individual assumptions require that management make a decision based on the best available information at each reporting period. Changes in these assumptions may alter the results of non-financial asset and financial asset impairment testing, impairment charges recognized in profit or loss and the resulting carrying amounts of assets.

DCHF

Refer to section 5 "Processing Infrastructure – Dry Coal Handling Facility" for further analysis of the $66.9 million impairment charge recorded on the DCHF.

Prepaid Toll Washing Fees

Refer to section 5 "Processing Infrastructure – Wet Washing Facility" for further analysis of the $30.2 million impairment loss recorded on the prepaid toll washing fees which are part of the contract with Ejin Jinda.

Ovoot Tolgoi Mine Cash Generating Unit

Refer to section 6 "Liquidity and Capital Resources – Ovoot Tolgoi Mine Impairment Analysis" for further analysis of the impairment test performed as at December 31, 2013.

Estimated Recoverable Reserves

Reserve estimates involve expressions of judgment based on various factors such as knowledge, experience and industry practice, and the accuracy of these estimates may be affected by many factors, including estimates and assumptions with respect to coal prices, operating costs, mine plan and life, coal quality and recovery, foreign currency exchange rates and inflation rates. Reserve estimates are made by qualified persons, but will be impacted by changes in the above estimates and assumptions.

Estimated recoverable reserves are used to determine the depletion of mineral properties, in accounting for deferred production stripping costs, in performing impairment testing and for forecasting the timing of the payment of decommissioning, restoration and similar costs. Therefore, changes in the estimates and assumptions used to determine recoverable reserves could impact the carrying value of assets, depletion expense and impairment charges recognized in profit or loss and the carrying value of the decommissioning, restoration and similar liabilities.

Useful Lives and Depreciation Rates for Property, Plant and Equipment

Depreciation expense is allocated based on estimated property, plant and equipment useful lives and depreciation rates. Therefore, changes in the useful life or depreciation rates from the initial estimate could impact the carrying value of property, plant and equipment and an adjustment would be recognized in profit or loss.

Income Taxes and Recoverability of Deferred Tax Assets

Actual amounts of income tax expense are not final until tax returns are filed and accepted by the taxation authorities. Therefore, profit or loss in future reporting periods will be affected by the amount that income tax expense estimates differ from the final tax returns.

Judgment is required in determining whether deferred tax assets are recognized on the statement of financial position. Deferred tax assets, including those arising from unutilized tax losses, require management of the Company to assess the likelihood that the Company will generate sufficient taxable profit in future periods in order to utilize recognized deferred tax assets. Estimates of future taxable profit are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable profit differ from estimates, the ability of the Company to realize the deferred tax assets recorded on the statement of financial position could be impacted.

13. RECENT ACCOUNTING PRONOUNCEMENTS

The Company has adopted the new and revised standards and interpretations issued by the IASB listed below effective January 1, 2013. These changes were made in accordance with the transitional provisions outlined in the respective standards and interpretations.

IFRS 10 Consolidated Financial Statements

IFRS 10 replaces IAS 27 "Consolidated and Separate Financial Statements" and SIC 12 "Consolidation – Special Purpose Entities". IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls multiple entities. The new consolidation standard changes the definition of control so that the same criteria apply to all entities, both operating and special purpose entities, to determine control. The revised definition focuses on the need to have both power over the investee and exposure to variable returns before control is present. The adoption of IFRS 10 did not result in any change in the consolidation status of any of the Company's subsidiaries and investees.

IFRS 11 Joint Arrangements

IFRS 11 replaces IAS 31 "Interests in Joint Ventures". IFRS 11 classifies joint arrangements as either joint operations or joint ventures, depending on the rights and obligations of the parties involved in the joint arrangement. Joint arrangements that are classified as joint operations require the venturers to recognize the individual assets, liabilities, revenues and expenses to which they have legal rights or are responsible. Joint arrangements that are classified as a joint venture are accounted for using the equity method of accounting.

As a result of the adoption of IFRS 11, the Company's 40% interest in RDCC LLC is now classified as a joint venture (previously classified as a jointly-controlled entity under IAS 31). Prior to the adoption of IFRS 11, the Company accounted for its investment in RDCC LLC under the equity method of accounting. Therefore, the adoption of IFRS 11 did not have an impact on the Company's consolidated financial statements for the current or prior periods presented.

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 outlines the disclosure requirements for interests in subsidiaries and other entities. The adoption of IFRS 12 has resulted in additional disclosures in the Company's consolidated financial statements for the year ended December 31, 2013.

IFRS 13 Fair Value Measurement

IFRS 13 provides a definition of fair value, sets out a single IFRS framework for measuring fair value and outlines disclosure requirements for fair value measurements. The adoption of IFRS 13 resulted in additional fair value measurement disclosures in the Company's consolidated financial statements for the year ended December 31, 2013.

IAS 1 Presentation of Financial Statements (Amendment)

The amendments to IAS 1 requires companies preparing financial statements under IFRS to group items within other comprehensive income that may be reclassified to profit or loss and those that will not be reclassified. The consolidated statement of comprehensive income in the Company's consolidated financial statements has been amended to reflect the presentation requirements under the amended IAS 1.

IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine

IFRIC 20 provides guidance on the accounting for the costs of stripping activities during the production phase of a surface mine. Under IFRIC 20, stripping activity assets are recognized when the following three criteria are met:

- it is probable that the future economic benefit (improved access to the ore body) associated with the stripping activity will flow to the entity;
- the entity can identify the component of the ore body for which access has been improved; and
- the costs relating to the stripping activity associated with that component can be measured reliably

If not all of the criteria are met, the stripping activity costs are included in the costs of inventory produced during the period incurred.

The Company assessed its open-pit mining operations at the Ovoot Tolgoi Mine and concluded that as at January 1, 2012 there are identifiable coal seams with which the predecessor stripping activity related to. Therefore, no adjustment to the Company's consolidated financial statements was required upon initial transition to IFRIC 20.

The adoption of IFRIC 20 has not resulted in a change in the Company's capitalization of stripping activity costs, and therefore no adjustment was required to the Company's consolidated financial statements in the current or prior periods presented. The Company classifies stripping activity assets capitalized under IFRIC 20 as mineral property costs within property, plant and equipment and these costs are amortized on a units-of-production basis based on proven and probable reserves.

Other

The IASB also amended IAS 19 "Post-Employment Benefits" and IAS 28 "Investments in Associates" (2003) effective January 1, 2013. The amendments to these standards did not impact the Company's Consolidated Financial Statements.

14. RISK FACTORS

There are certain risks involved in the Company's operations, some of which are beyond its control. These risks can be broadly categorized into: (i) risks relating to its liquidity and capital resources; (ii) risks relating to its projects in Mongolia; and (iii) risks relating to its business and industry. Additional risks and uncertainties not presently known, or not expressed or implied below, or that are presently deemed immaterial, could also harm the Company's business, financial condition and operating results. Some of the following statements are forward-looking and actual results may differ materially from the results anticipated in these forward-looking statements.

Risks Relating to the Company's Liquidity and Capital Resources

Unless the Company acquires additional sources of financing, the ability of the Company to continue as a going concern is threatened

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had cash of $21.8 million and working capital of $41.7 million at December 31, 2013.

The Company has in place a planning, budgeting and forecasting process to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans.

The Company anticipates that coal prices in China will remain under pressure in 2014, which will continue to impact the Company's margins and liquidity. Based on the Company's forecasts for the year ended December 31, 2014, the Company is unlikely to have sufficient capital resources and does not expect to generate sufficient cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC convertible debenture. Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives.

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2014 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. While the Company is actively seeking additional sources of financing to continue operating and meet its objectives, there can be no assurance that such financing will be available on terms acceptable to the Company. If for any reason, the Company is unable to secure the additional sources of financing and continue as a going concern, then this could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

While the Company intends to secure additional sources of financing as soon as possible, a continued delay in securing additional financing could ultimately result in an event of default of the $250.0 million CIC convertible debenture, which if not cured within applicable cure periods in accordance with the terms of such debenture, may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

Due to the inherent uncertainties of litigation, it is not possible to predict the final outcome of the Ontario Action or determine the amount of any potential losses, if any

On or about January 6, 2014, Siskinds LLP, a Canadian law firm, filed the Ontario Action against the Company, certain of its former senior officers and current directors, and its former auditors, Deloitte LLP, in the Ontario Superior Court of Justice in relation to the Company's restatement of financial statements as previously disclosed in the Company's public filings.

The plaintiff seeks leave to bring a claim under applicable Canadian securities legislation and seeks certification of a class action with respect to a class of persons who purchased shares of the Company between March 30, 2011 and November 7, 2013, alleging that the financial reporting of the Company during that period contained misrepresentations giving rise to liability at common law and under applicable Canadian securities legislation. The Ontario Action also seeks general damages against all defendants in the sum of Cdn$30 million, without particulars as to how such amount was determined, or such other amount that the Court deems appropriate. Assuming that leave is granted, the action is certified as a class proceeding, and there is a finding of liability, the actual quantum of damages will depend upon the evidence which is adduced in the court proceedings.

Named in the Ontario Action as individual defendants are the Company's former Chief Executive Officer, Alexander Molyneux, the Company's former Chief Financial Officers, Messrs. Terry Krepiakevich and Matthew O'Kane, and the members of its Audit Committee, Messrs. Andre Deepwell, Pierre Lebel and Gordon Lancaster, each of whom held those positions during the period at issue.

The Company disputes and will vigorously defend itself against these claims through independent Canadian litigation counsel retained by the Company and the other defendants for this purpose. Due to the inherent uncertainties of litigation, it is not possible to predict the final outcome of the Ontario Action or determine the amount of any potential losses, if any.

In the event the Company incurs any liability in connection with the Ontario Action, it maintains insurance with respect thereto. While the Company believes that such insurance coverage is in an amount that would be sufficient to cover any amounts the Company may be required or determines to pay with respect thereto, there can be no assurance that such coverage will be adequate to do so, and, if so, any amounts not so covered would be required to be paid by the Company.

<u>Risks Relating to the Company's Projects in Mongolia</u>

The Company is subject to continuing governmental, regulatory and internal investigations, the outcome of which is unclear at this time but could have a material adverse effect on the Company

The investigations referred in section 7 "Regulatory Issues and Contingencies" could result in one or more Mongolian, Canadian, United States or other governmental or regulatory agencies taking civil or criminal action against the Company, its affiliates or its current or former employees. The likelihood or consequences of such an outcome are unclear at this time but could include financial or other penalties, which could be material, and which could have a material adverse effect on the Company.

Legislation in Mongolia may be subject to conflicting interpretations, which may have adverse consequences on the Company's business

The Mongolian legal system shares several of the qualitative characteristics typically found in a developing country and many of its laws, particularly with respect to matters of taxation, are still evolving. A transaction or business structure that would likely be regarded under a more established legal system as appropriate and relatively straightforward might be regarded in Mongolia as outside the scope of existing Mongolian law, regulation or legal precedent. As a result, certain business arrangements or structures and certain tax planning mechanisms may carry significant risks. In particular, when business objectives and practicalities dictate the use of arrangements and structures that, while not necessarily contrary to settled Mongolian law, are sufficiently novel within a Mongolian legal context, it is possible that such arrangements may be invalidated.

The legal system in Mongolia has inherent uncertainties that could limit the legal protections available to the Company, which include: (i) inconsistencies between laws; (ii) limited judicial and administrative guidance on interpreting Mongolian legislation; (iii) substantial gaps in the regulatory structure due to delay or absence of implementing regulations; (iv) the lack of established interpretations of new principles of Mongolian legislation, particularly those relating to business, corporate and securities laws; (v) a lack of judicial independence from political, social and commercial forces; and (vi) bankruptcy procedures that are not well developed and are subject to abuse. The Mongolian judicial system has relatively little experience in enforcing the laws and regulations that currently exist, leading to a degree of uncertainty as to the outcome of any litigation; it may be difficult to obtain swift and equitable enforcement, or to obtain enforcement of a judgment by a court of another jurisdiction.

In addition, while legislation has been enacted to protect private property against expropriation and nationalization, due to the lack of experience in enforcing these provisions and political factors, these protections may not be enforced in the event of an attempted expropriation or nationalization. Expropriation or nationalization of any of the Company's assets, or portions thereof, potentially without adequate compensation, could materially and adversely affect its business and results of operations.

If an event of default occurs under the convertible debenture, CIC has the right to accelerate amounts owing thereunder

With the exception of an insolvency event, if an event of default occurs under the convertible debenture, and such event of default has not been cured or waived, the principal amount owing and all accrued and unpaid interest will become immediately due and payable upon notice to the Company by CIC which would have a material adverse effect on the business and operations of the Company.

If an insolvency event occurs under the convertible debenture, the principal amount owing and all accrued and unpaid interest will become immediately due and payable without the necessity for notice to the Company by CIC, which would have a material adverse effect on the business and operations of the Company.

Application of and amendments to legislation could adversely affect the Company's mining rights in its projects or make it more difficult or expensive to develop its projects and carry out mining

The 2006 Minerals Law of Mongolia (the "2006 Minerals Law"), which preserves to a limited extent some of the substance of the former 1997 minerals legislation, was drafted with the assistance of legal experts in the area of mining legislation and was widely regarded as progressive, internally consistent and effective legislation. However, the 2006 Minerals Law contains new provisions that have increased the potential for political interference and weakened the rights and security of title holders of mineral tenures in Mongolia. Certain provisions of the 2006 Minerals Law are ambiguous and it is unclear how they will be interpreted and applied in practice. Examples of such provisions include those relating to the designation of a mineral deposit as a Mineral Deposit of Strategic Importance as described in the risk factor entitled "The Government of Mongolia could determine that any one or more of the Company's projects in Mongolia is a Mineral Deposit of Strategic Importance."

In addition, the introduction of new Mongolian laws and regulations and the interpretation of existing ones may be subject to policy changes reflecting domestic political or social changes. For example, on July 16, 2009, Parliament enacted the Mining Prohibition in Specified Areas Law that prohibits minerals exploration and mining in areas such as headwaters of rivers and lakes, forest areas as defined in the Forest Law of Mongolia and areas adjacent to rivers and lakes as defined in the Water Law of Mongolia. Pursuant to the Mining Prohibition in Specified Areas Law, the Government of Mongolia was instructed to define the boundaries of certain areas in which exploration and mining would be prohibited. A list of licenses has been prepared that overlap with the prohibited areas described in the law based on information submitted by water authority agencies, forest authority agencies and local authorities for submission to the Government of Mongolia. New exploration licenses and mining licenses overlapping the defined prohibited areas will not be granted, and previously granted licenses that overlap the defined prohibited areas will be terminated within five months following the adoption of the law. It is not clear whether such termination will only apply to the overlap areas. The Mining Prohibition in Specified Areas Law provides that affected license holders shall be compensated, but there are no specifics as to the way such compensation will be determined. The Company understands that the status of the Mining Prohibition in Specified Areas Law is unclear and it has not been enforced to date.

Portions of the Company's Ovoot Tolgoi and Tsagaan Tolgoi mining licenses and exploration licenses pertaining to the Zag Suuj Deposit and the South Biluut and Jargalant Fields within the Soumber Deposit are included on the list of licenses published by the Government of Mongolia, potentially affecting the status of those licenses under the Mining Prohibition in Specified Areas Law.

In regard to the Ovoot Tolgoi mining license, the potential area which may be affected is a relatively small area which represents approximately 3% of the entire area of the mining license and does not contain any of the Company's NI 43-101 reserves or resources or immovable assets. Accordingly, the loss of the potentially affected area would not materially and adversely affect the existing operations.

Activities historically carried out on the other licenses referred to above include drilling, trenching and geological reconnaissance. The Company has no immovable assets located in any of the potentially affected areas and the loss of any or all of the potentially affected properties would not materially and adversely affect its existing operations. However, the loss of the Tsagaan Tolgoi mining license and exploration licenses pertaining to the Zag Suuj Deposit and the South Biluut and Jargalant fields within the Soumber Deposit would impact the Company's resources.

The Minerals Law has been subject to several proposals for reform, including draft amendments developed by the President's Office of Mongolia in December 2012. However reports from Mongolia indicate that MRAM is now responsible for reforming the law and that its proposed amendments will be made publicly available and submitted to the Parliament for review and approval in 2014. On January 16, 2014, the Parliament adopted a State Minerals Policy (the "Minerals Policy") which is intended to form the basis for the amendments to the Minerals Law. The Minerals Policy promotes four key principles. First, to establish a stable investment environment. Second, to improve the quality of mineral exploration, mining and processing in Mongolia. Third, to encourage the use of environmentally friendly and modern technology. Finally, to strengthen the competitiveness of the Mongolian mining sector on the international market. It remains to be seen how these principles will be reflected in the final amendments to the Minerals Law.

As such, there can be no assurance that future political and economic conditions in Mongolia will not result in the Government of Mongolia adopting different policies in relation to foreign development and ownership of mineral resources. Any such changes in government or policy may result in changes in laws affecting ownership of assets, environmental protection, labor relations, repatriation of income, return of capital, investment agreements, income tax laws, royalty regulation, government incentive and other areas, each of which may materially and adversely affect the Company's ability to undertake exploration and development activities in the manner currently contemplated. Similarly, any restrictions imposed, or Government of Mongolia charges levied or raised (including royalty fees), under Mongolian law for the export of coal could harm the Company's competitiveness.

The Application of the new Foreign Investment Law approved by the Parliament of Mongolia is uncertain

Prior to October 3, 2013, the Company was subject to the Foreign Investment Law described in the 2012 MD&A. The Company considers that this risk factor has been substantially mitigated following the repeal of the Foreign Investment Law and introduction of the Investment Law on October 3, 2013, which appears to provide greater certainty for foreign investment in Mongolia. However, that certainty remains subject to the inherent uncertainties of the legal system in Mongolia as described in the risk factor above entitled the "Legislation in Mongolia may be subject to conflicting interpretations, which may have adverse consequences on the Company's business".

The Company's ability to carry on business in Mongolia is subject to political risk

The Company's ability to efficiently conduct its exploration and development activities is subject to changes in government policy or shifts in political attitudes within Mongolia that are beyond the Company's control.

Government policy may change to discourage foreign investment, nationalization of mining industries may occur or other government limitations, restrictions or requirements not currently foreseen may be implemented. There is no assurance that the Company's assets will not be subject to nationalization, requisition or confiscation, whether legitimate or not, by any authority or body. The provisions under Mongolian law for compensation and reimbursement of losses to investors under such circumstances may not be effective to restore the value of the Company's original investment.

In addition, Mongolia may experience political instability. Such instability could have a material adverse effect on economic or social conditions in Mongolia and may result in outbreaks of civil unrest, terrorist attacks or threats or acts of war in the affected areas, any of which could materially and adversely affect the Company's business and results of operations.

The Government of Mongolia could determine that any one or more of the Company's projects in Mongolia is a Mineral Deposit of Strategic Importance

Under the 2006 Minerals Law, the Parliament has wide discretion to designate mineral deposits to be Mineral Deposits of Strategic Importance. The Government of Mongolia is empowered to participate on an equity basis with the license holder in the exploitation and/or mining of each Mineral Deposit of Strategic Importance on terms to be negotiated between the Government of Mongolia and such license holder. Details of any minerals reserves must be filed by the relevant license holder with the Government of Mongolia, and those deposits on the Strategic Deposits List represent most of the largest and highest profile deposits in Mongolia. In addition to deposits currently on the Strategic Deposits List and the additional Tier 2 Deposits List, the Mongolian Parliament may at any time designate other deposits not yet currently on such Lists to be Mineral Deposits of Strategic Importance, add such deposits to either the Strategic Deposits List or the Tier 2 Deposits List and, in the former case, commence negotiations with the relevant license holder with respect to the terms under which the Government of Mongolia will take an interest in such deposit. While the Government of Mongolia is in the process of adding the exact location and coordinates for each Mineral Deposit of Strategic Importance, a number of deposits on the Strategic Deposits List are identified by name only with no indication of the latitude and longitude coordinates for the deposit, and it is therefore not always possible to precisely determine the intended geographic area covered by each designated Mineral Deposit of Strategic Importance or to accurately determine whether or not any given license area is within, or overlaps, a Mineral Deposit of Strategic Importance.

Under the 2006 Minerals Law, the size of the Government of Mongolia's participation is determined largely by the level of state funding which has been provided for the exploration and development of the relevant deposit, with the Government of Mongolia entitled to participate up to 50% in the event that there has been state funding of such deposit and up to 34% if there has not. However, the 2006 Minerals Law is very vague as to the details and method by which the Government of Mongolia will take its interest and the final arrangements in respect of the Government of Mongolia's interest in each Mineral Deposit of Strategic Importance, including the amount of compensation to be paid to the license holder and the actual form of the Government of Mongolia's interest are subject to negotiation between the Government of Mongolia and the license holder.

The 2006 Minerals Law also contains provisions requiring any company which holds a Mineral Deposit of Strategic Importance to list no less than 10% of its shares on the Mongolian Stock Exchange. This particular provision of the 2006 Minerals Law has not yet been enforced and it is not clear how it will work in practice.

In recent years there have been a number of proposed amendments to the 2006 Minerals Law suggested by various parties, many of which have centered on amending the 2006 Minerals Law to increase the Government of Mongolia's participating interest in excess of 50%. While the 2006 Minerals Law provides that the interest of the Government of Mongolia should take the form of an equity interest, based on past practice, and depending on the results of individual negotiations, the interest may be in the form of production or profit sharing or some other arrangement negotiated between the license holder and the Government of Mongolia. There can be no assurance that legislation will not be enacted which further strengthens the Government of Mongolia's right to participate in privately held mineral resources in Mongolia.

None of the deposits covered by the Company's existing mining licenses or exploration licenses are currently designated as Mineral Deposits of Strategic Importance. However, there can be no assurance that any one or more of these deposits will not be so designated in the future, in which case the Company's business and results of operations may be materially and adversely affected.

Risks relating to the Company's business and industry

Some of the Company's projects may not be completed as planned; costs may exceed original budgets and may not achieve the intended economic results or commercial viability

The Company's business strategy depends in large part on expanding its production capacity at the Ovoot Tolgoi Mine and further developing its other coal projects into commercially viable mines. Whether a mineral deposit will be commercially viable depends on a number of factors, including: (i) the particular attributes of the deposit, such as size, grade and proximity to infrastructure; (ii) commodity prices, which are highly cyclical; and (iii) government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, importing and exporting of mineral resources and environmental protection. The Company's long term intention to develop mines at the Soumber Deposit, the Zag Suuj Deposit, and the Ovoot Tolgoi Underground Deposit in the future is based on geological, engineering, environmental and mine planning evaluations. The feasibility of mining at these projects as well as at the Tsagaan Tolgoi Deposit has not been and may never be established. If the Company is unable to develop all or any of its projects into a commercial working mine, its business, financial condition and results of operations will be materially and adversely affected.

The Company's projects are subject to technical risk in that they may not perform as designed. Increased development costs, lower output or higher operating costs may all combine to make a project less profitable than expected at the time of the development decision. This would have a negative impact on the Company's business and results of operations. No assurance can be given that the Company would be adequately compensated by third party project design and construction companies (if not performed by the Company) in the event that a project did not meet its expected design specification.

The Ovoot Tolgoi Mine 43-101 Technical Report dated March 19, 2012 assumed that the Ejin Jinda wet wash plant at Ceke would process 1.5 million tonnes of coal in 2012. Construction of the wet wash plant was completed in 2012. The Ovoot Tolgoi Mine 43-101 Technical Report also assumes that the Ejin Jinda wet wash plant is expanded to process 7.0 million tonnes annually from mid-2014. The Company is currently cooperating with Ejin Jinda in studying the utilization of the wet washing facility. Any delay in expanding annual capacity to 7.0 million tonnes by mid-2014, would likely impact the project economics, as the coal would be sold as lower value coal.

As with all exploration properties or projects taken on by mining companies, there is a risk that exploration projects will not be converted to commercially viable mines, in part because actual costs from capital projects may exceed the original budgets. As a result of project delays, cost overruns, changes in market circumstances or other reasons, the Company may not be able to achieve the intended economic benefits or demonstrate the commercial feasibility of these projects, which in turn may materially and adversely affect the Company's business, results of operations and growth projects.

The Company's coal reserves and resources are estimates based on a number of assumptions, and the Company may produce less coal than its current estimates

The coal reserve and resource estimates are based on a number of assumptions that have been made by the qualified persons in accordance with NI 43-101. Reserve and resource estimates involve expressions of judgment based on various factors such as knowledge, experience and industry practice, and the accuracy of these estimates may be affected by many factors, including quality of the results of exploration drilling and analysis of coal samples, as well as the procedures adopted by and the experience of the person making the estimates.

The Ovoot Tolgoi Mine 43-101 Technical Report dated March 19, 2012 assumes that the Company's mining activity will extend across its lease boundary and into the lease held by Mongolyn Alt Corporation ("MAK"). A memorandum of understanding covering mining across the lease boundary was signed in May 2007. Discussions have led the parties to conclude various cooperation agreements in February 2014 and relevant authorities' expected approval on certain aspects of the cooperation agreements are to be finalized in the course of 2014. The resource and reserve estimates in the Ovoot Tolgoi Mine 43-101 Technical Report do not include any coal within the MAK lease; however, the geological models and mining pits extend into the MAK lease. If an operational agreement cannot be finalized, then the reserve estimate could be materially affected.

Estimates of the reserves and resources at the Company's projects may change significantly when new information becomes available or new factors arise, and interpretations and deductions on which reserves and resources estimates are based may prove to be inaccurate. Should the Company encounter mineralization different from that predicted by past drilling, sampling and similar examination, mineral resource and/or reserve estimates may have to be adjusted downward. This downward adjustment could materially affect the Company's development and mining plans, which could materially and adversely affect its business and results of operations.

In addition, the rank of coal ultimately mined may differ from that indicated by drilling results. There can be no assurance that coal recovered in laboratory tests will be duplicated under on-site conditions or in production-scale operations. In the event that the actual level of impurities is higher than expected or the coal mined is of a lower quality than expected, the demand for, and realizable price of, the Company's coal may decrease. Short term factors relating to reserves, such as the need for orderly development of coal seams or the processing of new or different quality coals, may also materially and adversely affect the Company's business and results of operations.

The inclusion of reserve and resource estimates should not be regarded as a representation that all these amounts can be economically exploited and nothing contained herein (including, without limitation, the estimates of mine lives) should be interpreted as assurance of the economic lives of the Company's coal reserves and resources or the profitability of its future operations.

The Company commenced mining in 2008, and has recorded operating losses and cash outflows to date. Due to the Company's limited operating history and curtailment of operations, there may not be an adequate basis on which to evaluate the Company's future operating results and prospects. Investors may have difficulties evaluating the Company's business and prospects because the Company's past results may not be indicative of the Company's results in the future.

The Company does not insure against all risks to which it may be subject to in planned operations and insurance coverage could prove inadequate to satisfy potential claims

For certain aspects of the Company's business operations, insurance coverage, in particular business interruption insurance, is restricted or prohibitively expensive. The Company currently holds its primary insurance policies through Canadian insurance providers to insure its properties. The Company has taken out insurance for risks including commercial general liability and aviation premises liability. The Company maintains mining property insurance for all of its mining assets wherever located, property insurance on its office premises and liability insurance for its directors and officers. However, no assurance can be given that the Company will elect or be able to obtain such insurance coverage at economically reasonable premiums (or at all), or that any coverage it obtains will be adequate to cover the extent of any claims brought against it.

Exploration, development and production operations on mineral properties involve numerous risks, including environmental risks, such as unexpected or unusual geological operating conditions, rock bursts or slides, fires, floods, earthquakes or other environmental occurrences, and political and social instability. The Company does not maintain insurance against any environmental or political risks. Should any liabilities arise for which it is not insured or insurance coverage is inadequate to cover the entire liability, they could reduce or eliminate the Company's actual or prospective profitability, result in increasing costs and a decline in the value of the common shares and could materially and adversely affect the Company's business and results of operations.

Licenses and permits are subject to renewal and various uncertainties and the Company may only renew its exploration licenses a limited number of times for a limited period of time

In Mongolia, the Company's exploration licenses are subject to periodic renewal and may only be renewed a limited number of times for a limited period of time. There is no assurance that such renewals will be given as a matter of course and there is no assurance that new conditions will not be imposed in connection therewith. Although the Mongolian Government may have renewed the Company's licenses and permits in the past, the Mongolian Government may retroactively revoke such renewals which could potentially result in the loss of the Company's exploration licenses, PMA's or mining licenses. The Company's business objectives may also be impeded by the costs of holding and/or renewing the exploration licenses in Mongolia. License fees for exploration licenses increase substantially upon the passage of time from the original issuance of each individual exploration license. The Company needs to continually assess the mineral potential of each exploration license, particularly at the time of renewal, to determine if the costs of maintaining the exploration licenses are justified by the exploration results to date, and may elect to let some of its exploration licenses lapse. A moratorium on transfers of exploration licenses has been imposed on two separate occasions and there is a risk that a similar moratorium could be imposed such that letting the exploration licenses lapse may be the only practical option in some circumstances. Furthermore, the Company will require mining licenses and permits to mine in order to conduct mining operations in Mongolia. There can be no assurance, however, that such licenses and permits will be obtained on terms favorable to it or at all for the Company's future intended mining and/or exploration targets in Mongolia.

In April 2012, MRAM announced the suspension of exploration and mining activity on certain of the Company's licenses including the license pertaining to the Ovoot Tolgoi Mine. Although the Company did not receive official notification of a suspension of licenses and had no reason to believe its licenses were not in good standing, this announcement caused a significant disruption in the Company's business which ultimately led to the curtailment of operations at the Ovoot Tolgoi Mine. Although the Company received a letter from MRAM on September 6, 2012 confirming that all exploration and mining licenses were in good standing there is still a risk that its licenses could be revoked.

In addition, certain provisions of the Land Law of Mongolia and the 2006 Minerals Law provide for the revocation of previously granted land use rights, exploration licenses or mining licenses on the grounds that the affected area of land has been designated as "special needs" territory. The Land Law of Mongolia grants the discretion to declare an area of land for special needs purposes to local governing authorities and identifies various broad categories which qualify as special needs. The 2006 Minerals Law requires the local governing authority that designates an area of land as a special needs territory to compensate the license holder whose rights or license status are affected. If any of the Company's land use rights, exploration licenses or mining licenses in Mongolia are revoked because the underlying land is declared as special needs territory, there is no assurance that the Company will receive adequate compensation or any compensation at all and its business and results of operation might be adversely and materially affected. The Company has had no land use rights or exploration/mining licenses revoked to date.

Prolonged periods of severe weather conditions could materially and adversely affect the Company's business and results of operations

Severe weather conditions may require the Company to evacuate personnel or curtail operations and may cause damages to the project site, equipment or facilities, which could result in the temporary suspension of operations or generally reduce the Company's productivity. Severe weather conditions have not caused any delay or damages to the Company's operations to date. However, there can be no assurance that severe weather will not occur. Any damages to the Company's projects or delays in its operations caused by prolonged periods of severe weather could materially and adversely affect its business and results of operations.

The Company's business and results of operations are susceptible to the cyclical nature of coal markets and are vulnerable to fluctuations in prices for coal

The Company expects to derive substantially all of its revenue and cash flow from the sale of coal. Therefore, the market price of the shares, the Company's ability to raise additional financing and maintain ongoing operations and its financial condition and results of operations will be directly related to the demand for, and price of, coal and coal-related products. Coal demand and price are determined by numerous factors beyond the Company's control, including the international demand for steel and steel products, the availability of competitive coal supplies, international exchange rates, political and economic conditions in Mongolia, China and elsewhere in the world, milder or more severe than normal weather conditions, and production costs in major coal producing regions. Chinese and international coal markets are cyclical and have in the past exhibited significant fluctuations in supply, demand and prices from year to year. There has been significant price volatility on the coal spot market. An oversupply of coal in China or a general downturn in the economies of any significant markets for the Company's coal and coal-related products could materially and adversely affect its business and results of operations. In addition, the Company's dependence on Asian markets may result in instability in its operations due to political and economic factors in those Asian jurisdictions which are beyond the Company's control. The combined effects of any or all of these factors on coal prices or volumes are impossible for the Company to predict.

If realized coal prices are below the full cost of production of any of the Company's future mining operations and remain at such a level for any sustained period, the Company could experience increased losses and may decide to discontinue operations, which could require the Company to incur closure costs and result in further reduced revenues.

The Company's coal mining activities are subject to operational risks, including equipment breakdown

The Company's coal mining operations are subject to a number of operational risks, some of which are beyond its control, which could delay the production and delivery of coal. These risks include unexpected maintenance or technical problems, periodic interruptions to its mining operations due to inclement or hazardous weather conditions and natural disasters, industrial accidents, power or fuel supply interruptions and critical equipment failure, including malfunction and breakdown of its excavators, upon which its coal mining operations are heavily reliant and which would require considerable time to replace. These risks and hazards may result in personal injury, damage to, or destruction of, properties or production facilities, environmental damage, business interruption and damage to its business reputation. In addition, breakdowns of equipment, difficulties or delays in obtaining replacement excavators and other equipment, natural disasters, industrial accidents or other causes could temporarily disrupt the Company's operations, which in turn may also materially and adversely affect its business, prospects, financial condition and results of operations.

The unavailability or shortage of reliable and sufficient coal transportation capacity that meets Mongolian authority regulations will reduce the Company's coal revenue by causing it to reduce its production volume or impairing its ability to supply coal to its customers

The Company anticipates that the majority of its coal production from the projects in Mongolia will be exported into China. Inadequate transportation infrastructure is likely to affect the pricing terms on which it can sell the coal to customers and the willingness and ability of such customers to purchase coal from it. Potential customers are likely to factor in any delays and the costs and availability of transportation in determining the price they are prepared to pay to purchase the Company's coal. Therefore, its mining operations are anticipated to be highly dependent on road and rail services in Mongolia and China.

In Mongolia, a bottleneck in the transportation of coal from the Ovoot Tolgoi Mine to customers in China may arise if the road connecting the Ovoot Tolgoi Mine to the Shivee Khuren Border Crossing does not have sufficient capacity to support the increased amount of cargo traffic, is affected by external factors such as disruptions caused by bad weather or is closed for repair. During 2012, the road connecting the Ovoot Tolgoi Mine to the Shivee Khuren Border Crossing was closed for over four weeks for repair, which impacted customers' ability to export coal.

The opening hours of the Shivee Khuren Border Crossing also affect the Company's ability to expedite the movement of its coal shipments. There can be no assurance that there would be any other cost effective means of transporting the coal to the Company's primary market in China. As a result, the Company may experience difficulty expediting the movement of its coal shipments and/or significant cost escalation for the transportation services, which could affect its production and reduce its profitability.

In China, rail and road infrastructure and capacity has in the past been affected by extreme weather conditions, earthquakes, delays caused by major rail accidents, the diversion of rolling stock needed to deliver emergency food relief and seasonal congestion during public holidays. There can be no assurance that these problems will not recur or that new problems will not occur. In any of these circumstances, the customers may not be able to take delivery of the Company's coal, which may lead to delays in payment, or refusal to pay, for the Company's coal and, as a result, the Company's business and results of operations could be materially and adversely affected.

The Company's prospects depend on its ability to attract, retain and train key personnel

Recruiting, retaining and training qualified personnel is critical to the Company's success. The number of persons skilled in the acquisition, exploration and development of mining properties is limited and competition within the mining industry for such persons is intense, in particular, Mongolian law requires that at least 90% of a mining company's employees be of Mongolian nationality. This provision of the law, coupled with the large number of active mining projects in Mongolia, further limits the number of available personnel and increases competition for skilled personnel. The reputation and capability to operate continuously over the longer term are key factors in also attracting key personnel to its business. The Company is reinforcing its core values of ethical behavior in dealing with all its stakeholders from senior management down in order to ensure the Company attracts the right people to its business. As the Company's business activity grows, it will require additional key financial, administrative, mining, marketing and public relations personnel as well as additional operations staff. If the Company is not successful in attracting such key personnel, or retaining existing key personnel, its business and results of operations could be materially and adversely affected.

In addition, the Company's ability to train operating and maintenance personnel is a key factor for the success of its business activities. If the Company is not successful in recruiting, training and retaining such personnel, its business and results of operations could be materially and adversely affected.

Competition in the coal industry may hinder development plans and adversely affect the Company's coal sales if it is not able to compete effectively

Continued growth in mining and mineral exploration activities in Mongolia could create an increasing demand for mining equipment and related services. Shortages of, or higher costs for, equipment and services could restrict the Company's ability to carry out the exploration, development and production activities, increase its costs of operations and adversely affect its future plans.

The Company intends to sell a majority of the coal it produces to China. Competition in the Chinese coal industry is based on many factors, including, among others, price, production capacity, coal quality and characteristics, transportation capability and costs, blending capability and brand name. The Company's coal business will most likely compete in China with other large Chinese and international coal mining companies. Due to their location, some of the Company's Chinese competitors may have lower transportation costs than the Company does. The Chinese coal market is highly fragmented and the Company faces price competition from some small local coal producers that produce coal for significantly lower costs than the Company due to various factors, including their lower expenditure on safety and regulatory compliance. Some of the Company's international competitors, including the Mongolian coal producers, may have greater coal production capacity as well as greater financial, marketing, distribution and other resources than the Company does, and may benefit from more established brand names in international markets. The Company's future success will depend on its ability to respond in an effective and timely manner to competitive pressure.

There are a number of risks associated with dependence on a limited number of customers and inability to attract additional customers

The Company depends on a relatively small number of customers. The incremental cost of transporting coal products from the Ovoot Tolgoi Mine and its other coal projects over long distances effectively limits the Company's potential customer base to a relatively proximate geographical area. This market has also been price sensitive and significant price volatility impacts contract performance.

Additionally, the Company has been selling its coal products only since 2008. The Company had 6 active customers with the largest customer representing approximately 52%, the second largest customer representing approximately 17%, the third largest customer representing approximately 16% and the remaining customers accounting for 15% of the Company's total sales for the year ended December 31, 2013. In order to mitigate this risk, the Company is continually expanding its customer base.

In addition, the Company expects to sell the majority of the coal from its Mongolian mining operations to the customers in China. Chinese law requires specific authorization to be obtained by entities responsible for the import of coal into China. In the event that the Company's customers, or the agents of such customers who are responsible for importing coal into China on their behalf, fail to obtain and retain the necessary authorizations, their ability to import coal into China may be affected, which could materially and adversely affect the Company's business and results of operations.

The Company's operations are exposed to risks in relation to environmental protection and rehabilitation

The operations of coal mines involve substantial environmental risks and hazards and the Company's operations are subject to laws and regulations relating to the environment, health and safety and other regulatory matters in Mongolia.

The risk of environmental liability is inherent in the operation of the Company's business. Environmental hazards may occur in connection with the Company's operations as a result of human negligence, force majeure, or otherwise. Claims may be asserted against the Company arising out of its operations in the normal course of business, including claims relating to land use, safety, health and environmental matters. The Company is not insured against environmental liabilities and there can be no assurance that environmental liabilities would not materially and adversely affect its business and results of operations.

In addition, the Company is subject to reclamation requirements. The Company's mine contains a finite amount of reserves and will eventually close. The key tasks in relation to the closure of the mines involves (i) long-term management of permanent engineered structures (for example, spillways, roads, waste dumps); (ii) achievement of environmental closure standards; (iii) orderly retrenchment of employees and contractors; and (iv) relinquishment of the site with associated permanent structures and community development infrastructure and programs to new owners. The successful completion of these tasks is dependent on the Company's ability to successfully implement negotiated agreements with the relevant government, community and employees. The consequences of a difficult closure range from increased closure costs and handover delays to ongoing environmental impacts and corporate reputation damage if desired outcomes cannot be achieved, which could materially and adversely affect the Company's business and results of operations.

Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. The Company may experience increased costs of production arising from compliance with environmental laws and regulations. Should the Company fail to comply with current or future environmental laws and regulations, the Company may be required to pay penalties or take corrective actions, any of which may have a material adverse effect on its results of operations and financial condition.

Foreign currency fluctuations could affect expenses and any future earnings

The Company is exposed to foreign exchange fluctuations with respect to the Mongolian Tugrik, Chinese Renminbi, Hong Kong, Australian and Canadian dollars. The Company's financial results are reported in U.S. dollars. The salaries for local laborers in Mongolia are paid in local currency. Sales of coal into China have been and may continue to be settled in U.S. dollars and Renminbi. The Company has a subsidiary in Hong Kong where some expenses are incurred in Hong Kong dollars. The Company has long term investments denominated in Australian dollars. Since the Company's headquarters is in Canada, a minor portion of its expenses are in Canadian dollars and the Company holds a portion of its cash in Canadian dollars. As a result, its financial position and results are impacted by the exchange rate fluctuations between the aforementioned currencies and the U.S. dollar.

The Company's results of operations are subject, to a significant extent, to economic, political and legal developments in China

The Company expects that a majority of coal sales from the Ovoot Tolgoi Mine will be made to customers based in China. Accordingly, the economic, political and social conditions, as well as government policies of China may affect its business. The Chinese economy differs from the economies of most developed countries in many respects, including: (i) structure; (ii) level of government involvement; (iii) level of development; (iv) growth rate; (v) control of foreign exchange; and (vi) allocation of resources. The Chinese economy has been transitioning from a planned economy to a more market-oriented economy. For the past two decades, the Chinese government has implemented economic reform measures emphasizing the utilization of market forces in the development of the Chinese economy. Changes in China's political, economic and social conditions, laws, regulations and policies could materially and adversely affect the Company's business and results of operations.

In addition, the Chinese government indirectly influences coal prices through its regulation of power tariffs and its control over allocation of the transportation capacity of the national rail system. Any significant downturn in the prices in China could materially and adversely affect the Company's business and results of operations. Additionally, the Chinese government could adopt new policies that could shift demand away from coal to other energy sources. Any significant decline in demand for, or over-supply of, coal could materially and adversely affect the Company's revenues from coal export sales.

The interests of the Company's principal shareholder, Turquoise Hill, may differ from those of its other shareholders

As of March 24, 2014, Turquoise Hill holds approximately 56% of the Company's issued and outstanding common shares. The interests of Turquoise Hill may conflict with the interests of the Company's other shareholders and there is no assurance that Turquoise Hill will vote its common shares in a way that benefits the Company's minority shareholders. Subject to the CIC's right to appoint a director, Turquoise Hill's ownership interest enables Turquoise Hill to elect the entire Board without the concurrence of any of the Company's other shareholders. Accordingly, unless applicable laws or regulations would require approval by the Company's minority shareholders, Turquoise Hill is in a position to: (i) control the Company's policies, management and affairs; (ii) subject to applicable laws, regulations and the Articles, adopt amendments to certain provisions of the Articles; and (iii) otherwise determine the outcome of most corporate actions, including a change in control, merger or sale of all or substantially all of the Company's assets.

The Company believes that third parties may be discouraged from making a tender offer or bid to acquire the Company because of this concentration of ownership.

Information in this document regarding future plans reflects current intentions and is subject to change

Whether the Company ultimately implements the business strategies described in this document will depend on a number of factors including, but not limited to: the political situation in Mongolia and China; the availability and cost of capital; current and projected coal prices; coal markets; costs and availability of drilling services, costs and availability of heavy equipment, supplies and personnel; success or failure of activities in similar areas to those in which the Company's projects are situated; and changes in estimates of project completion costs. The Company will continue to gather information about its projects, and it is possible that additional information will cause it to alter its schedule or determine that a project should not be pursued at all. Accordingly, the Company's plans and objectives may change from those described in this document.

Future stock market conditions may change

There are risks involved with any equity investment. The market price of common shares may rise or fall depending upon a range of factors and stock market conditions, which are unrelated to the Company's future financial performance. Movements on international stock markets, local interest rates and exchange rates, domestic and international economic and political conditions, as well as government, taxation and other policy changes may affect the stock market. As the Company is a listed company on the TSX and the HKEX, its common share price will also be subject to numerous influences including broad trends in the stock market and the share prices of individual companies or sectors.

Future issuances or sales, or perceived possible issuances or sales, of substantial amounts of common shares in the public market could materially and adversely affect the prevailing market price of the common shares and the Company's ability to raise capital in the future

The market price of the common shares could decline as a result of future sales of substantial amounts of the common shares or other securities relating to the common shares in the public market, including sales by its substantial shareholders, or the issuance of new common shares by the Company, or the perception that such sales or issuances may occur. Future sales, or perceived possible sales, of substantial amounts of the common shares could also materially and adversely affect the Company's ability to raise capital in the future at a time and at a price favorable to it, and the Company's shareholders may experience dilution in their holdings upon issuance or sale of additional common shares or other securities in the future.

15. OUTLOOK

Excess supply within the coking coal markets in 2013 continued with further growth from Australian producers and strong exports from North America and Russia also impacting global trade. Chinese domestic washed coking coal production increased in 2013 as a result of continued capacity expansion in Shanxi.

Coal prices in China declined progressively through 2013 before flattening out at four year lows in the third quarter and then improving slightly in the fourth quarter of 2013. However, prices remained well below the levels achieved over the last three years and the Mongolian coal industry faced strong competition from seaborne and domestic Chinese coal producers. These factors led to both lower prices and a reduction in market share of 16% for Mongolian coal producers in Chinese coking coal imports in 2013 compared to 2012.

The increase in sales volumes and the reduction in cash costs per tonne sold partially offset pricing pressures experienced in 2013 compared to 2012. The reduction in cash costs per tonne sold was driven by an improvement in mining equipment productivity and cost control measures. While the strip ratio was slightly higher in 2013 compared to 2012, it remained below long term trend. Cash costs were also favorably impacted by the depreciation of the Mongolian Tugrik versus the U.S. Dollar. The Company minimized capital expenditures and exploration expenses throughout 2013 to preserve its financial resources. As a result, despite difficult coal market conditions, the Company's cash position and liquidity[3] increased by $3.3 million in 2013 exclusive of $16.2 million of cash interest payments on the CIC convertible debenture.

[3] Cash position and liquidity comprises cash and short term money market investments

The outlook for Mongolian coal exports remains dependent on China. Demand at the beginning of 2014 has been seasonally weak with the impact of the Chinese New Year lasting longer than expected and prices have again declined after rising in the fourth quarter of 2013.

The Company anticipates that coal prices in China will remain under pressure in 2014, which will continue to impact the Company's margins and liquidity. The Company continues to strive for further cost reductions and where possible delay expenditures. However, based on its forecasts for the year ended December 31, 2014, the Company is unlikely to have sufficient capital resources and does not expect to generate sufficient cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC convertible debenture. Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives.

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2014 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. While the Company is actively seeking additional sources of financing to continue operating and meet its objectives, there can be no assurance that such financing will be available on terms acceptable to the Company. If for any reason, the Company is unable to secure the additional sources of financing and continue as a going concern, then this could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

While the Company intends to secure additional sources of financing as soon as possible, a continued delay in securing additional financing could ultimately result in an event of default of the $250.0 million CIC convertible debenture, which if not cured within applicable cure periods in accordance with the terms of such debenture, may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

The Company is focused on securing additional sources of financing and continues to minimize uncommitted capital expenditures while preserving the Company's growth options.

Longer term, the Company remains well positioned, with a number of key competitive strengths, including:

- **Strategic location** – The Ovoot Tolgoi Mine is located approximately 40km from China, which represents the main coal market. The Company has an infrastructure advantage, being approximately 50km from a major Chinese coal distribution terminal with rail connections to key coal markets in China.
- **Large resource base** – The Company's aggregate coal resources (including reserves) include measured and indicated resources of 533 million tonnes and inferred resources of 302 million tonnes.

- **Several growth options** – The Company has several growth options including an anticipated increase to 9 million tonnes annual run-of-mine capacity at the Ovoot Tolgoi Mine as well as greenfield options with the Soumber Deposit and Zag Suuj Deposit, located approximately 20km east and approximately 150km east of the Ovoot Tolgoi Mine, respectively.

- **Flexible product offering** – Most of the Company's coal resources have coking properties, including a mixture of semi-soft coking coals and hard coking coals. The Company is currently studying options to supply washed coal to the market to further improve its market position and access to end customers.

Objectives

The Company's objectives for 2014 and the medium term are as follows.

- Drive operational excellence – The Company is focused on further improving operational efficiency in delivering production to meet market requirements and to further reduce operating and administrative costs.

- Continue to develop regional infrastructure – Subject to the Company having available financial resources to fund its portion of the construction costs, the Company's priority is to complete the construction of the paved highway from the Ovoot Tolgoi Mine to the Shivee Khuren Border Crossing as part of the existing consortium. Construction of the paved highway was substantially complete by the end of 2013 with the remaining construction work and commissioning expected to be completed by the end of the first half of 2014.

- Deliver value through marketing by improving our access to market and end customers and the overall quality of our product – Subject to available financial resources, implement an effective business structure and beneficiation process based on wet washing that is capable of delivering a sustainable and profitable product mix to the Chinese market and expand the Company's customer base further inland in China.

- Progress growth options – Subject to available financial resources, the Company plans to further the development of the Soumber Deposit, while staying compliant with all government requirements in relation to its licenses and agreements.

- Operating in a socially responsible manner – The Company is focused on maintaining our vigilance on health, safety and environmental performance.

- Re-establish the Company's reputation – The Company's vision is to be a respected and profitable Mongolian coal company. To achieve this, the Company will continue to work on re-establishing good working relationships with all external stakeholders.

March 24, 2014