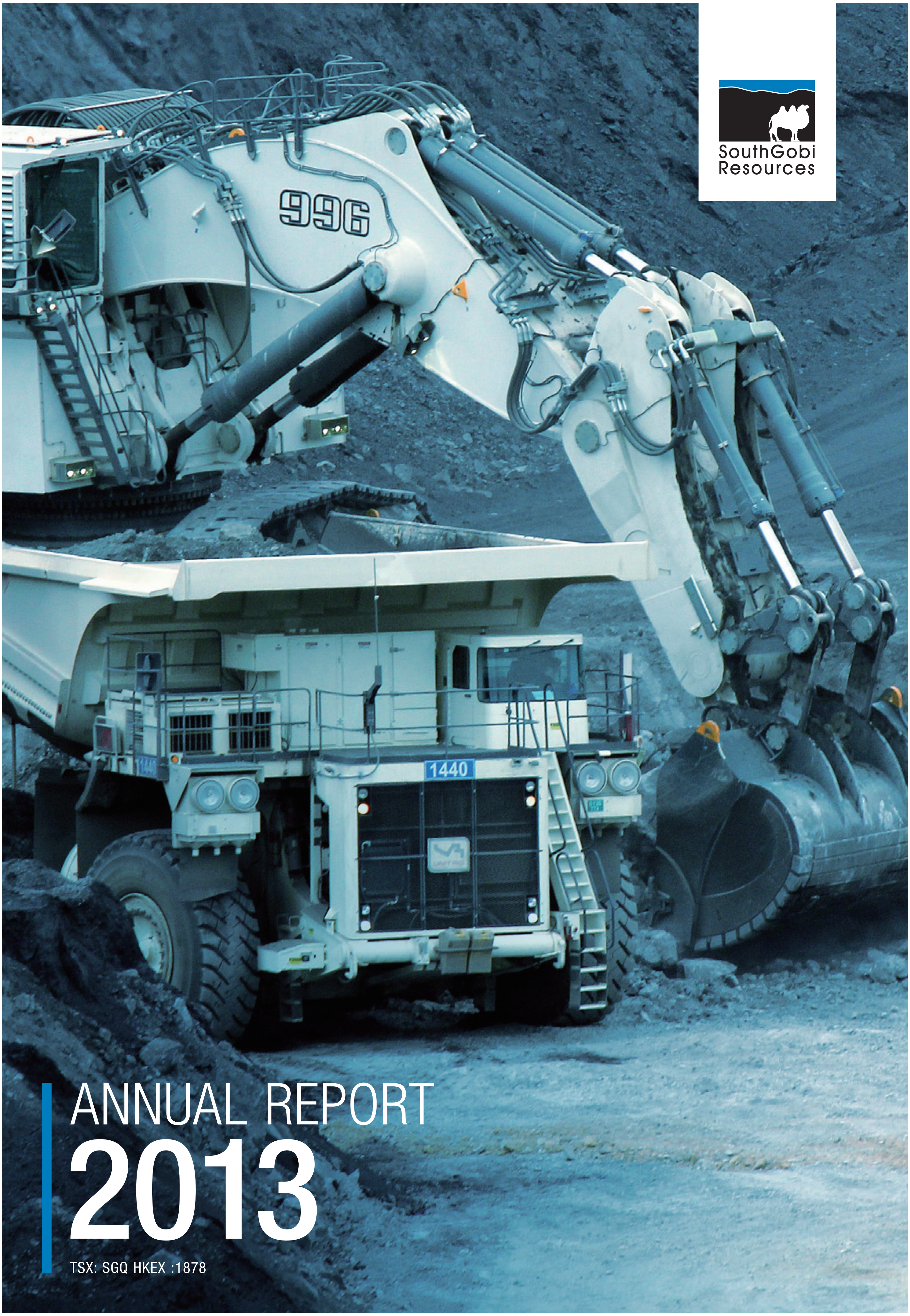
SouthGobi Resources



ANNUAL REPORT 2013

TSX: SGQ HKEX :1878

SouthGobi Resources Ltd.
Annual Report 2013

Contents

SouthGobi Resources Ltd. (the "Company" or "SouthGobi") is focused on the exploration, development and production of its coking coal deposits in Mongolia's South Gobi Region. The Company has a 100% shareholding in SouthGobi Sands LLC, the Mongolian registered company that holds SouthGobi's mining and exploration licenses in Mongolia and operates the flagship Ovoot Tolgoi coal mine. Ovoot Tolgoi produces and sells coal to customers in China.

Significant events

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 the Management's Discussion and Analysis 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 the Management's Discussion and Analysis section 5 "Processing Infrastructure – Wet Washing Facility" for further analysis.

Message from the Chairman

Last year was another year of change for SouthGobi, with a number of improvements delivered by the management team throughout the course of the year amid challenging market conditions.

Kay Priestly

Chairman of the Board,
Non-Executive Director

Last year was another year of change for SouthGobi, with a number of improvements delivered by the management team throughout the course of the year amid challenging market conditions.

Following the board and management changes in 2012, the Company undertook a comprehensive strategic review of the business, which resulted in a specifically designed program to return SouthGobi to sustainable and profitable long-term operations. A key component of the program was a safe, cost effective and sustainable restart of operations at the Ovoot Tolgoi Mine which recommenced on March 22, 2013. The Company produced 3.06 million tonnes of coal to meet total sales of 3.26 million tonnes during 2013. Since operations have recommenced at the mine in March 2013 there have been no lost time injuries recorded and I would like to take this opportunity to commend the management team on this important achievement.

One of the key objectives for the Board for 2013 was to ensure the Company had a senior management team in place to support Ross Tromans, President & CEO, in driving improved business performance. The Company welcomed Bertrand Troiano in April 2013 as Chief Financial Officer of SouthGobi Resources. Bertrand spent the last 13 years in finance roles in the mining and metals industry, most recently as Finance Director for Rio Tinto Alcan's Business Development, Major Projects and Technology group.

In July, our Mongolian subsidiary SouthGobi Sands LLC welcomed Enkh-Amgalan Sengee as the new President and Executive Director. Enkh-Amgalan is a seasoned executive with extensive management skills and in-depth knowledge of the Mongolian mining and energy industries. Also in July we have announced that one of our non-executive directors and member of the Mergers and Acquisition Committee, Brett Salt, would resign from the Board and be appointed as Chief Commercial Officer. Brett brings onboard extensive experience in a variety of senior Rio Tinto commercial roles including General Manager Business Development for Rio Tinto and Chief Financial Officer of the Rio Tinto Marine business.

The Board is confident that the additions we made to SouthGobi's senior management team during 2013 provide a broad set of complementary skills which will strengthen the company.

We have also further strengthened our collective Board experience by appointing Bold Baatar, currently President, International Operations of Rio Tinto Copper group, to the SouthGobi Board in September 2013. Prior to joining Rio Tinto, Mr. Baatar was CEO of Golden East LLC, a gold exploration and mining company in Mongolia. He also held senior-level investment banking positions with JP Morgan in London, Moscow and New York, where he acquired extensive experience in leveraged buyouts and mergers and acquisitions.

Two of our current directors – Sean Hinton and Lindsay Dove – will not be standing for re-election at the Company's 2014 annual meeting of shareholders. I would like to personally thank Sean and Lindsay for their valuable service to the company.

The Board of Directors will continue to ensure the Company complies with the best practice in all aspects of corporate governance, and will serve the best interest of the Company.

Despite continuing coal market weakness, I still believe that the Company's fundamentals remain strong in the long run. SouthGobi's Ovoot Tolgoi Mine is strategically positioned next to China, the world's largest coal consumer. Furthermore, the Company's access to critical infrastructure, flexible product offering and large resource base underpin SouthGobi's competitive strengths.

This year will involve consolidating and building on the first improvements made as part of the program focused on laying the foundation for sustainable long-term operations that capture SouthGobi's competitive advantages.

On behalf of the Board of Directors, I would like to thank all SouthGobi staff for their dedication and hard work during this difficult year. I am also very grateful to the Directors for the invaluable advice and assistance and to all our customers and you – our shareholders – for your support.

Kay Priestly
Chairman of the Board, Non-Executive Director

Message from the President and CEO

We remain resolved to overcome the number of issues our company has endured over the last two years in 2014. We have the people and resources to move towards our vision as a respected and profitable Mongolian coal company.

K. Ross Tromans

President, Chief Executive Officer
and Executive Director

The Company continued to experience headwinds from a number of sources following the resumption of our operations in March 2013. There were however some positive achievements through-out the year that provide a good basis for our continued drive to be a profitable and respected Mongolian coal company.

I would like to begin with safety. I am proud to report that the company did not have a recordable lost-time –injury (LTI) in 2013 and has extended the time injury free to 755 days. The all injuries frequency rate (AIFR) also reduced to 0.3 by the end of the year with this ongoing effort. Safety is and continues to be a very important priority for our company and I commend the efforts of our employees and contractors in ensuring that our good safety performance continues throughout 2014. However it is also with sadness, I report that a fatality occurred in August in our non-managed 40% owned joint venture, RDCC LLC during the construction of the paved road to the Shivee Khuren Border Crossing. This accident is a very poignant reminder to all why safety matters to all of us and our families. The Company worked with RDCC LLC on the investigation and subsequent recommendations to further improve the safety practices on the project.

The company finished the year with production of saleable coal of 3.06 million tonnes and sales of 3.26 million tonnes. This represented a 1.73 million tonnes increase in production and a 1.28 million tonnes increase in sales over 2012. As a result of continuing oversupply in Chinese coal market the prices remained at historic low levels for the majority of the year.

The production and sales increase was achieved with a significant reduction in total cash costs of product sold at $12.81 per tonne. This reduction was partially reflective of a lower strip ratio of 2.76 in overburden removal than life of mine but was primarily achieved through overall cost control, improvements in mining equipment productivity and a smaller workforce. Reduction in overheads will continue to be a focus going forward but in part are dependent on the outcome of a number of external issues concerning the company. The cost improvements captured are expected to continue in 2014.

The management team was strengthened throughout the year in order to better focus on improving the company and delivering against its strategy and priorities. Bertrand Troiano and Brett Salt joined as Chief Financial Officer and Chief Commercial Officer for SouthGobi Resources respectively and Enkh-Amgalan Sengee as President and Executive Director of our wholly owned Mongolian subsidiary, SouthGobi Sands LLC. These changes have finalized our organization structure at the senior level.

The construction of the paved highway from Ovoot Tolgoi to the Shivee Khuren Border Crossing, to increase the ability of the Company to expedite its coal to China was a priority in 2013. Substantial progress was made on the highway in 2013 with major works substantially completed.

There were two other priorities in 2013 that the company did not finalize as we had planned. These two priorities were substantially advancing the feasibility, planning and physical preparation for a mine at the Soumber Deposit by 2014 and the implementation of a strategy to effectively utilize the wet washing facility contracted with Ejin Jinda, a subsidiary of China Mongolia Coal Co. Ltd, to toll-wash coal from the Ovoot Tolgoi Mine and further develop our product mix and expand our customer base.

On the Soumber Deposit in 2013,the Company focused on completing additional drilling and bulk sampling to improve our understanding of potential development options while working with stakeholders, including Soum, Aimag and national Governments, to address the special protected area (SPA) issues for sections of the area. This remains a priority in 2014 in order to fully understand the commercial implications for when this deposit should be brought to market.

Looking ahead, the expectations for the Mongolian coal industry remain heavily dependent on China. Economic growth is expected to continue to grow at levels slightly lower than previously experienced. The impact this may have on the Chinese steel and coal industry is however less certain with continued reform policies likely to impact specific regions differently which then has flow on effects within the different markets in China. Pressure is likely to remain on the supply side and prices are not expected to rise significantly. Coal producers will still need to maintain focus on costs and improving the logistics of getting their product to market.

We remain resolved to overcome the number of issues our company has endured over the last two years in 2014. We have the people and resources to move towards our vision as a respected and profitable Mongolian coal company. We look forward to enhancing relationships with our current and prospective customers and our numerous external stakeholders, and putting our vision for the Company into action throughout the year.

K. Ross Tromans
President, Chief Executive Officer
and Executive Director

STRATEGIC LOCATION CLOSE TO CHINA

The Ovoot Tolgoi Mine is approximately 40km from the Shivee Khuren-Ceke crossing at the Mongolia-China border and 50km from a major Chinese coal distribution terminal with rail connections to key coal markets in China

BUCYRUS®
MT4400A
1432
4649
УБ

Board of directors

Kay Priestly
Chairman of the Board, Non-Executive Director

Ms. Priestly, 58, joined the Company as the Chairman of the Board and a Non-Executive Director on September 3, 2012. She is a Director and the Chief Executive Officer of Turquoise Hill Resources Ltd. Ms. Priestly has more than 30 years of experience in the financial, mining and energy sectors. She previously was a senior executive at Rio Tinto, most recently serving as Chief Financial Officer of the company's global Copper product group. Ms. Priestly joined Rio Tinto in 2006 as Chief Financial Officer at Rio Tinto's Kennecott Utah Copper operations. Prior to Rio Tinto, she spent more than 25 years with global professional services firm Arthur Andersen, where she provided tax and consulting services to global companies in the energy and mining sectors and was a member of Andersen's global executive team.

Ms. Priestly holds a Bachelor of Science degree in Accounting, summa cum laude, from Louisiana State University. She was a Certified Public Accountant and a member of the American Institute of Certified Public Accountants for over 25 years. Ms. Priestly is a member of the Institute of Corporate Directors.

K. Ross Tromans
President, Chief Executive Officer and Executive Director

Mr. Tromans, 57, joined the Company as President and Chief Executive Officer on September 17, 2012 and was appointed to the Board of Directors on November 7, 2012. Mr. Tromans has over 30 years of sales and marketing experience in the coal and energy sectors covering the Asian and North American markets. Most recently, he was General Manager Marketing at Rio Tinto Coal Australia where he was responsible for the development and implementation of the overall marketing strategy for thermal, coking and semi-soft coal. Previously, Mr. Tromans held senior roles at Rio Tinto including General Manager Marketing and Sales at Rio Tinto Alcan, Director New Markets and Service at Kennecott Energy and General Manager Marketing at Kaltim Prima Coal.

Mr. Tromans holds a Bachelor of Commerce, Accounting and Finance Management from the University of New South Wales, Australia. He is a member of the Institute of Corporate Directors.

Mr. Tromans is based in Ulaanbaatar, Mongolia.

Sean Hinton
Deputy Chairman and
Non-Executive Director

Mr. Hinton, 47, joined the Company as the Deputy Chairman and Non-Executive Director on September 3, 2012. Mr. Hinton is founder and principal of Terbish Partners, an advisory firm mainly focused on energy and mining projects. Mr. Hinton has more than 25 years' experience in Mongolia, from 1997 to 2000 he served as Mongolia's Honorary Consul-General in Australia, and speaks fluent Mongolian. Mr. Hinton worked at McKinsey and Co. in Sydney and London from 1995-2000.

Mr. Hinton holds a Masters of Philosophy from the University of Cambridge and was a Sloan Visiting Fellow at the MIT Sloan School of Management. Mr. Hinton was named a Henry Crown Fellow of the Aspen Institute in 2005. Mr. Hinton is a member of the Institute of Corporate Directors.

Pierre Lebel
Independent Non-Executive
Director and Lead Director

Mr. Lebel, 64, joined the Company as an Independent Non-Executive Director on August 13, 2003. Mr. Lebel is the Company's Lead Director and served as its Chairman from 2003 until June 2007. He has a distinguished career in mining spanning over 30 years, with a primary focus on mine financing, construction and development. Mr. Lebel currently serves as Chairman and a Director of Imperial Metals Corporation, a TSX-listed mine developer and operator. In 1998, Mr. Lebel was awarded the E.A. Scholz Medal by the British Columbia and Yukon Chamber of Mines for excellence in mine development in British Columbia and was recognized by the Mining Association of British Columbia as its 2012 Mining Person of the Year.

Mr. Lebel holds a Masters of Business Administration from McMaster University and a Bachelor of Laws (LLB) from the University of Western Ontario. He is a member of the Law Society of British Columbia. Mr. Lebel is also a member of the Board of Directors of the Mining Association of Canada, the Mining Association of British Columbia, Lions Gate Hospital Foundation and a member of the Institute of Corporate Directors.

André Deepwell
Independent
Non-Executive Director

Mr. Deepwell, 59, joined the Company as an Independent Non-Executive Director on August 13, 2003. He has been the Chief Financial Officer and Corporate Secretary of a number of natural resource companies over the last 15 years and is currently Chief Financial Officer and Corporate Secretary of Imperial Metals Corporation, a TSX-listed mine developer and operator. Mr. Deepwell has been involved in all aspects of debt and equity financings and financial reporting for mining enterprises ranging from grassroots exploration to mine development and production.

Mr. Deepwell is a Chartered Accountant, certified by the Institute of Chartered Accountants of British Columbia, and a graduate of the University of British Columbia. Mr. Deepwell is a member of the Institute of Corporate Directors.

W. Gordon Lancaster
Independent
Non-Executive Director

Mr. Lancaster, 70, joined the Company as an Independent Non-Executive Director on May 11, 2010. He is currently an independent business consultant. Mr. Lancaster was Chief Financial Officer of Ivanhoe Energy Inc., an international heavy-oil development and production company whose core operations are in Canada, Ecuador and China. Prior to joining Ivanhoe Energy Inc. in 2004, he was Chief Financial Officer of Power Measurement Inc., a high-tech company that is a world leader in the design, development, manufacture and marketing of enterprise energy management systems.

Mr. Lancaster is a Chartered Accountant certified by the Institute of Chartered Accountants of British Columbia and, prior to entering industry in 1982, he had a twenty year career in public accounting with Deloitte & Touche with the last five years as a partner in that firm's Vancouver office. Mr. Lancaster is a member of the Institute of Corporate Directors.

Lindsay Dove
Non-Executive Director

Mr. Dove, 65, joined the Company as a Non-Executive Director on September 3, 2012. Mr. Dove is currently an independent mining consultant and has over 30 years of experience in the international oil, coal and shipping industries with BP p.l.c. and Rio Tinto, where he held a variety of senior management positions. Since retiring from Rio Tinto in 2006, Mr. Dove has been an independent consultant advising on acquisitions and corporate transactions, primarily in the international coal mining industry.

Mr. Dove holds a First Mates Foreign Going Certificate of Competency in the British Merchant Navy and has a Bachelor of Science in Maritime Studies from the City of London Polytechnic. He has completed the Program for Management Development at Harvard University. Mr. Dove is a member of the Institute of Corporate Directors.

Kelly Sanders
Non-Executive Director

Mr. Sanders, 56, joined the Company as a Non-Executive Director on September 3, 2012. He currently is Managing Director, HME2014, Rio Tinto. Prior to this position, Mr. Sanders was President and CEO of Rio Tinto's Kennecott Utah Copper operations. Mr. Sanders has worked in the mining industry for 30 years, including 28 years involved with coal mining operations. Mr. Sanders previously held senior positions with Rio Tinto Energy America and Ziegler Coal, both in Wyoming's famed Powder River Basin coal mining district.

Mr. Sanders holds a Bachelor of Science in Agronomy from Purdue University. He is an Executive Board member with the National Mining Association, the Utah Museum of Natural History and the Salt Lake City Chamber of Commerce. Mr. Sanders is also a member of the Institute of Corporate Directors.

Bold Baatar
Non-Executive Director

Mr. Bold, 40, joined the Company as a Non-Executive Director on September 3, 2013. Mr. Bold is currently President, International Operations of Rio Tinto's Copper group. Prior to joining Rio Tinto, Mr. Bold was CEO of Golden East LLC, a gold exploration and mining company in Mongolia. Previously, Mr. Bold was CEO of Newcom Group, where he managed and built a diverse investment portfolio across the telecom, airlines, property management, mining services and renewable energy sectors. He held senior-level investment banking positions with JPMorgan in London, Moscow and New York, where he acquired extensive experience in leveraged buyouts and mergers & acquisitions.

Mr. Bold holds a Bachelor of Industrial Engineering degree from the Mongolian Technical University and a Masters of Business Administration from the University of Bridgeport, United States. Mr. Bold is Chair of the Board of the Mongolian National Mining Association and a member of the Executive Board of the Business Council of Mongolia. Mr. Bold is a member of the Institute of Corporate Directors.

Senior management

Bertrand Troiano
Chief Financial Officer

Mr. Troiano, 40, joined the Company as Chief Financial Officer on April 8, 2013. Prior to joining the Company, Mr. Troiano was Finance Director for Rio Tinto Alcan's Business Development, Major Projects and Technology group. Mr. Troiano began his career in corporate banking with BNP-Paribas in Japan and has spent the past 13 years in finance roles in the mining and metals industry. During this time, he worked for Pechiney, Alcan and Rio Tinto in the United States, the Netherlands and Canada.

He has a Master's degree in Business from Ecole Superieure de Commerce de Paris and holds an MBA from Columbia University in New York and London Business School.

Brett Salt
Chief Commercial Officer

Mr. Salt, 38, joined the Company as a Non-Executive Director on September 3, 2012. On August 1, 2013, he was appointed Chief Commercial Officer of the Company and resigned as a Non-Executive Director. Prior to his appointment as Chief Commercial Officer of the Company, he was Senior Vice President, Strategy and Development at Turquoise Hill Resources Ltd. Previously, Mr. Salt was with Rio Tinto for 15 years in a variety of senior product group and corporate level commercial roles. Most recently, he was General Manager Business Development and Chief Financial Officer of the Rio Tinto Marine business.

Mr. Salt holds a Bachelor of Commerce – Economics and Commercial Law from the Curtin University of Technology in Perth, Australia. He has completed the Investment and Risk Management in Shipping program at the IMD Business School in Lausanne, Switzerland and the Rio Tinto Business Leadership Development Program at Duke University. Mr. Salt is a member of the Institute of Corporate Directors.

Enkh-Amgalan Sengee
President and Executive Director, SouthGobi Sands LLC

Mr. Enkh-Amgalan, 38, joined the Company as President and Executive Director of SouthGobi Sands LLC, a wholly-owned subsidiary of the Company, on July 15, 2013. Mr. Enkh-Amgalan joined the Company from Clean Energy LLC, a subsidiary of Newcom Group, where he was CEO and led the successful development of the first commercial scale wind farm in Mongolia. Prior to this, he gained extensive experience in the extractive industry through a number of senior management positions at the MCS Group of companies. Most recently this included CEO of Nordstar Resources LLC and MCS Petro Mongolia LLC. Before this, he was Vice President, Corporate Development, at Mongolian Mining Corporation (SEHK: 0975).

Mr. Enkh-Amgalan has a Master's degree from the Monterey Institute of International Studies, a graduate school of Middlebury College, in the United States, and holds a Bachelor of Arts degree in International Relations from the National University of Mongolia. Mr. Enkh-Amgalan is a member of the Executive Board of the Business Council of Mongolia.


1442
1442

LARGE RESOURCE BASE

Aggregate coal resources (including reserves) include measured and indicated resources of 533 million tonnes and inferred resources of 302 million tonnes

Directors' report

The Board of Directors (the "Board") of SouthGobi Resources Ltd. is pleased to present their report along with the audited consolidated financial statements (the "Financial Statements") of SouthGobi Resources Ltd. together with its subsidiaries (collectively the "Company") for the financial year ended December 31, 2013 ("Financial Year").

Principal activities and geographical analysis of operations

The Company is an integrated coal mining, development and exploration company. The Company's principal subsidiaries are set out in Note 26 of the Financial Statements and the activities of all subsidiaries of the Company at December 31, 2013 are set out in the table below:

Name	Country of incorporation	Issued and fully paid share capital	Principal activities
SGQ Coal Investment Pte. Ltd.	Singapore	US$1	Investment holding
SGQ Dayarcoal Mongolia Pte. Ltd.	Singapore	US$1	Investment holding
Mazaatt Holdings Pte. Ltd.	Singapore	US$1	Investment holding
SouthGobi Sands LLC	Mongolia	MNT 132,455,700	Coal mining, development and exploration of properties in Mongolia
Mazaalai Resources LLC	Mongolia	MNT 1,000,000	Investment holding
Mazaatt Holdings LLC	Mongolia	MNT 131,636,000	Investment holding
Dayarbulag LLC	Mongolia	MNT 137,712,300	Investment holding
SouthGobi Resources (Hong Kong) Limited	Hong Kong	HK$1	Business services
TST Holdings Limited	Hong Kong	HK$1	Investment holding

The analysis of the principal activities by geographical location of the operations of the Company for the Financial Year is set out in Note 4 of the Financial Statements. There were no significant changes in the nature of the Company's or its subsidiaries' principal activities during the year ended December 31, 2013.

Results

The results of the Company for the Financial Year are set out in the Consolidated Statement of Comprehensive Income on page 102.

Dividends

The Board has not recommended, declared or paid any dividends for the Financial Year.

Property, plant and equipment

Details of the movement in the property, plant and equipment of the Company during the Financial Year are set out in Note 16 of the Financial Statements.

Share capital

Details of the movement in the share capital of the Company during the Financial Year are set out in the Consolidated Statement of Changes in Equity on page 104.

During the year ended December 31, 2013, no common shares were repurchased by the Company on the Toronto Stock Exchange and Hong Kong Stock Exchange (in 2012, approximately 148,000 common shares at an average price of Cdn$6.44 per share were repurchased).

Reserves

Details of the reserves available for distribution to the shareholders as at December 31, 2013 are set out in the Consolidated Statement of Changes in Equity on page 104.

Directors

The directors during the Financial Year and up to the date of this report are as follows:

Independent non-executive directors

Mr. Pierre Lebel *(Lead Director)*	Mr. W. Gordon Lancaster	Mr. André Deepwell

Executive director

Mr. K. Ross Tromans

Non-executive directors

Ms. Kay Priestly *(Chairman)*	Mr. Sean Hinton *(Deputy Chairman)*	Mr. Kelly Sanders
Mr. Lindsay Dove	Mr. Bold Baatar (1)	Mr. Brett Salt (2)

Notes:
(1) Mr. Baatar joined the Board of Directors on September 3, 2013.
(2) Mr. Salt resigned from the Board of Directors on August 1, 2013.

Except where such director has already resigned from the Board, the term of office for each of the directors will end at the conclusion of the forthcoming annual general meeting. Each of the directors who currently sit on the Board, other than Messrs. Dove and Hinton, offer themselves for re-election at the annual general meeting scheduled for May 6, 2014.

In accordance with article 14.1 of the articles of continuation for the Company, each of the directors, including the independent non-executive directors, are subject to retirement and re-election annually at the annual general meeting.

Directors' service contracts

None of the directors proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment of compensation other than statutory compensation.

Directors' interests in contracts of significance

No contracts of significance to which the Company was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at December 31, 2013 or at any time during the Financial Year.

Directors' interests in competing businesses

During the Financial Year and up to the date of this report, to the best knowledge of the directors, none of the directors had any interests in businesses that compete or are likely to compete, either directly or indirectly, with the Company.

Directors' and senior management's interests in shares and share options

At December 31, 2013, or in the case of departed directors as at their resignation date, the interests of the directors and senior management in the shares and share options of the Company and its associated corporations were as follows:

Shares

Name	Name of company	Nature of interest	Shares held	Approximate % interest in the company
Ms. Kay Priestly	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	Personal	63,318(1)	0.00%
Mr. K. Ross Tromans	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	Personal	24,905(2)	0.00%
	Rio Tinto plc	N/A	Nil	Nil
Mr. Sean Hinton	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. Pierre Lebel	SouthGobi Resources Ltd.	Personal	5,100	0.00%
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. André Deepwell	SouthGobi Resources Ltd.	Personal/Indirect(3)	45,000	0.02%
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. W. Gordon Lancaster	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. Lindsay Dove	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	Indirect(4)	11,000	0.00%
Mr. Kelly Sanders	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	Personal	76,739(5)	0.00%
Mr. Bold Baatar	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. Bertrand Troiano	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	Personal	3,477	0.00%
Mr. Brett Salt	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	Personal	1,883	0.00%
	Rio Tinto plc	Personal	2,099	0.00%
Mr. Enkh-Amgalan Sengee	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil

(1) Includes 18,337 vested shares and 44,981 unvested shares.

(2) Incudes 6,970 vested shares and 17,935 unvested shares.

(3) 43,000 shares of SouthGobi Resources Ltd. held by the spouse of Mr. André Deepwell.

(4) 11,000 shares of Rio Tinto plc held by the spouse of Mr. Lindsay Dove.

(5) Includes 23,031 vested shares and 53,708 unvested shares.

Share options

Name	Name of company	Options held
Ms. Kay Priestly	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	6,298
Mr. K. Ross Tromans	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	6,901
	Rio Tinto plc	Nil
Mr. Sean Hinton	SouthGobi Resources Ltd.	112,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Pierre Lebel	SouthGobi Resources Ltd.	150,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. André Deepwell	SouthGobi Resources Ltd.	145,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. W. Gordon Lancaster	SouthGobi Resources Ltd.	220,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Lindsay Dove	SouthGobi Resources Ltd.	50,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Kelly Sanders	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	9,601
Mr. Bold Baatar	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Bertrand Troiano	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Brett Salt	SouthGobi Resources Ltd.	150,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Enkh-Amgalan Sengee	SouthGobi Resources Ltd.	70,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil

Other than the holdings disclosed in the preceding tables, none of the directors, senior management and their associates had any interests or short positions in any shares, underlying shares or debentures of the Company or of its associated corporations as at December 31, 2013.

Management contracts

No contracts concerning the management and administration of the Company were entered into or existed during the Financial Year.

Share option plan

The particulars of the Company's share option plan are set out in Note 22 of the Financial Statements. The following table discloses movements in the Company's share options for the Financial Year:

Name	Outstanding at beginning of year	Granted during the year	Exercise Price (Cdn$)	Exercised during the year	Forfeited during the year	Expired during the year	Outstanding at year end
Ms. Kay Priestly	–	–	–	–	–	–	–
Mr. K. Ross Tromans	–	–	–	–	–	–	–
Mr. Sean Hinton	50,000	62,000	2.10	–	–	–	112,000
Mr. Pierre Lebel	195,000	–	–	–	–	(45,000)	150,000
Mr. André Deepwell	190,000	–	–	–	–	(45,000)	145,000
Mr. W. Gordon Lancaster	220,000	–	–	–	–	–	220,000
Mr. Lindsay Dove	50,000	–	–	–	–	–	50,000
Mr. Kelly Sanders	–	–	–	–	–	–	–
Mr. Bold Baatar	–	–	–	–	–	–	–
Mr. Bertrand Troiano	–	–	–	–	–	–	–
Mr. Brett Salt	–	150,000	1.16	–	–	–	150,000
Mr. Enkh-Amgalan Sengee	–	70,000	1.16	–	–	–	70,000
Total for directors and senior management	705,000	282,000		–	–	(90,000)	897,000
Total for other share option holders	6,802,730	–		–	(806,703)	(4,309,465)	1,686,562
Total	7,507,730	282,000		–	(806,703)	(4,399,465)	2,583,562

Details of the accounting policy for the Company's share option plan are set out in Note 3.10 of the Financial Statements.

Arrangement to purchase shares and debentures

Eligible directors, employees and members of management are able to participate in the Company's share purchase plan, which allows participants to contribute up to 7% of their basic annual salary to purchase shares in the Company. The Company contributes 50% of the participant's contribution and at the end of each calendar quarter shares are purchased on behalf of the participant.

Substantial shareholders

The register of interests in shares and short positions of the Company showed that as at December 31, 2013, the Company has been notified of the following interests in shares representing 5% or more of the Company's issued share capital:

Name	Nature of interest	Shares held	Approximate % of issued shares
Turquoise Hill Resources Ltd.	Beneficial	104,807,155	56%
China Investment Corporation	Beneficial	30,849,444	16%

Other than as disclosed above, the Company has not been notified of any relevant interests or short positions in the issued share capital of the Company as at December 31, 2013.

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 Financial Statements.

Pension scheme

The Company operates a Mandatory Provident Fund Scheme (the "MPF Scheme") under the Hong Kong Mandatory Provident Fund Schemes Ordinance for employees in Hong Kong under the jurisdiction of the Hong Kong Employment Ordinance. The assets of the MPF Scheme are held separately from those of the Company and are administered by an independent trustee. Under the MPF Scheme, the Company and its employees in Hong Kong are each required to make a contribution to the MPF Scheme at 5% of the employees' relevant income subject to a cap of monthly relevant income as specified in the rules. No forfeited contribution is available to reduce the contribution payable in future years. During the Financial Year, US$11,837 was charged to the income statement relating to mandatory contributions made by the Company to the MPF Scheme. The Company does not operate any other pension scheme.

Pre-emptive rights

There are no provisions for pre-emptive rights under the Company's articles of continuation or under the laws of Canada which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

Sufficiency of public float

Pursuant to the Toronto Stock Exchange rules and regulations, a company's securities may be delisted if the number of freely-tradeable, publicly held securities is less than 500,000 or the number of public security holders, each holding a board lot consisting of 100 common shares or more, is less than 150. The requirement that a prescribed percentage of shares of any class of listed securities must at all times be held by the public does not apply to the Company.

Major customers and suppliers

Details of the Company's transactions with its major suppliers and customers during the Financial Year are set out below:

Purchases

The largest supplier accounted for 16% of the Company's purchases.

The five largest suppliers accounted for 60% of the Company's purchases.

Sales

The largest customer accounted for 52% of the Company's sales.

The five largest customers accounted for 96% of the Company's sales.

At no time during the Financial Year did a director, an associate of a director or a shareholder of the Company (which to the knowledge of the directors owns more than 5% of the Company's share capital) have an interest in any of the Company's five largest suppliers or five largest customers.

Charitable donations

During the Financial Year the Company made charitable donations amounting to US$59,934.

Events after reporting period

Details of events occurring after December 31, 2013 are set out in Note 29.4 of the Financial Statements.

Independent auditor

A resolution will be submitted at the annual general meeting to appoint PricewaterhouseCoopers LLP as auditors of the Company.

On behalf of the Board

Kay Priestly
Chairman of the Board, Non-Executive Director
March 24, 2014

Corporate governance report

Corporate governance

The Board of Directors considers good corporate governance practices to be an important factor in the continued and long-term success of the Company by helping to maximize shareholder value over time.

To further this philosophy and ensure the Company follows good governance practices, the Board has taken the following steps:

- approved and adopted a mandate for the Board, which sets out its stewardship responsibilities;
- appointed Mr. Pierre Lebel, an independent non-executive director, as "Lead Director", with the specific responsibility of, among other things, maintaining the independence of the Board and ensuring the Board carries out its responsibilities mandated by applicable statutory and regulatory requirements and stock exchange listing standards;
- appointed an Audit Committee (composed of independent directors), a Nominating and Corporate Governance Committee (composed of a majority of independent and non-executive directors), a Compensation and Benefits Committee (composed of independent and non-executive directors), a Health, Environment, Safety and Social Responsibility Committee (composed of independent, non-executive and executive directors) and a Mergers and Acquisition Committee (composed of independent, non-executive and executive directors), although such committee is currently inactive at the request of the Board;
- approved charters for the Audit, Nominating and Corporate Governance, Compensation and Benefits, and Health, Environment, Safety and Social Responsibility Board committees;
- established a management Disclosure Committee for the Company, with the mandate to oversee the Company's disclosure practices;
- formalized the Company's Corporate Disclosure, Confidentiality and Securities Trading Policy, and Disclosure Controls and Procedures;
- adopted formalized written position descriptions for the Chairman, Lead Director, CEO and CFO, as well as the Chairs of the Audit, Compensation and Benefits and Nominating and Corporate Governance Committees clearly defining their respective roles and responsibilities;
- adopted and implemented a robust compliance program for all Directors and employees; including business integrity policies and the Speak-Out whistleblower program;
- formalized a process for assessing the effectiveness of the Board as a whole, the committees of the Board and the contribution of individual directors, on a regular basis; and
- adopted an executive compensation model for the Company.

Compliance with corporate governance

The Company has, throughout the Financial Year, applied the principles and complied with the requirements of its corporate governance practices as defined by the Board and all applicable statutory, regulatory and stock exchange listings standards. The Company's current practices are reviewed and updated regularly to ensure that the latest developments in corporate governance are followed and observed.

In December 2012 the Company approved the adoption and implementation of a compliance program based on a Rio Tinto Group model, such as The Way We Work and the Business Integrity standards which include Anti-corruption and Conflict of Interest policies (collectively "Code of Conduct Standards"), and the Speak-Out program. Throughout 2013, the new compliance program was provided to the Company's employees, consultants, contractors and Directors.

The Code of Conduct Standards provides that the Company's employees, consultants, officers and directors will uphold its commitment to a culture of honesty, integrity and accountability and that the Company requires the highest standards of professional and ethical conduct from its employees, consultants, officers and directors. The various policies forming the Code of Conduct Standards have been filed on SEDAR and is available at www.sedar.com. A copy of the Company's Code of Conduct Standards may be obtained, without charge, by request to SouthGobi Resources Ltd., 354 – 200 Granville Street, Vancouver, British Columbia, Canada V6C 1S4, Attention: Corporate Department, or by phone to 604-681-6799.

Speak-Out is the Company whistleblowing service and it is available for use when someone suspects or is aware of illegal, unsafe or inappropriate activity at work. Speak-Out provides an avenue for employees to raise concerns confidentially and anonymously.

The Code of Conduct Standards and Speak-Out program have been implemented across all sites and offices of the Company. In May 2013, the Company has created a new role and recruited a Corporate Compliance Specialist to manage and implement the Code of Conduct Standards and Speak-Out program under the legal function of the Company.

All of the Company's Directors, management and senior employees have completed, or are in the process of completing, an online e-learning training course relating to Anti-Corruption & the Foreign Corrupt Practices Act. All of the Company's employees are required to complete the FCPA Training Program.

The Audit Committee monitors compliance with the Code of Conduct Standards. The Nominating and Corporate Governance Committee monitors the disclosure of conflicts of interest by directors with a view to ensuring that no director votes or participates in any board deliberations on a matter in respect of which such director has a material interest.

The Nominating and Corporate Governance Committee will oversee the implementation of the standards to ensure they are fine tuned to conform to the Company's needs.

Board composition

Corporate governance guidelines adopted by the Canadian Securities Administrators ("CSA") recommend that a majority of the directors of a corporation be independent directors. Under the CSA corporate governance guidelines, an "independent director" is a director who has no direct or indirect material relationship with the Company, including as a partner, shareholder or officer of an organization that has a relationship with the Company. A "material relationship" is one that would, or in the view of the Board be reasonably expected to, interfere with the exercise of a director's independent judgment.

Based on information regarding personal and business circumstances provided in a comprehensive questionnaire completed annually by each of the Company's directors and reasonable enquiry of the Board to determine whether or not the members of the Board are independent, the Company's Board is satisfied that three (3) of its nine (9) current members representing approximately 33% of all Board members are independent. Following the Company's May 6, 2014, annual general meeting, it is expected that three (3) of seven (7) Board members (approximately 43%) will be independent.

Following the change of control whereby Rio Tinto moved to a 51% ownership position in Turquoise Hill Resources Ltd. ("Turquoise Hill"), the Company announced significant changes to the Board in September 2012 which saw three (3) board members resign and an additional five (5) board members appointed. Each of the newly appointed board members did not meet the definition of independence due to their relationships with either Turquoise Hill or the Rio Tinto Group of companies.

Although the majority of the board members are not independent, eight (8) of the nine (9) directors are non-executive directors. Following the May 6, 2014, annual general meeting, it is expected that six (6) of seven (7) directors will be non-executive directors. In the event the board must consider a potential or actual conflict, such matter is referred to the independent directors to ensure processes are in place to receive independent scrutiny. To facilitate the exercise of their respective independent judgment, each of the independent and non-executive members of the Board holds regular meetings. In 2013, the independent non-executive directors met six (6) times and the non-executive directors met seven (7) times.

Independent non-executive directors	Non-Independent Directors
Mr. Pierre Lebel *(Lead Director)*	Mr. K. Ross Tromans *(President and Chief Executive Officer)*(1)
Mr. André Deepwell	Ms. Kay Priestly *(Chairman)*(2)
Mr. W. Gordon Lancaster	Mr. Sean Hinton *(Deputy Chairman)*(3)(7)
	Mr. Bold Baatar(4)
	Mr. Lindsay Dove(5)(7)
	Mr. Kelly Sanders(6)

Notes:

(1) Mr. Tromans is a non-independent director in his capacity as a senior officer of the Company.

(2) Ms. Priestly, is an executive officer of Turquoise Hill, is considered to be a non-independent director as a result of the material relationship between the Company and Turquoise Hill.

(3) Mr. Hinton provides consulting services to Rio Tinto plc.

(4) Mr. Baatar is a senior officer of Rio Tinto Copper group.

(5) Mr. Dove provides consulting services to Turquoise Hill.

(6) Mr. Sanders is a managing director, HME2014, Rio Tinto.

(7) Messrs. Hinton and Dove have advised that they will not be standing for re-election at the Company's May 6, 2014 annual general meeting.

As at March 24, 2014, Turquoise Hill held approximately 56% of the Company's issued and outstanding common shares. The Board has determined that Messrs. Lebel, Deepwell and Lancaster are independent directors.

The Board is of the view that appropriate structures and procedures are in place to allow the Board to function independently of management while continuing to provide the Company with the benefit of having a Chairman of the Board with extensive experience and knowledge of the Company's business.

The role of the Chairman and Chief Executive Officer are separate and exercised by different individuals. The Chairman of the Company is responsible for the function of the Board while the Chief Executive Officer of the Company is responsible for the Company's operations.

The Board has in place a Lead Director with the specific responsibility of maintaining the independence of the Board and ensuring that the Board carries out its responsibilities. Mr. Lebel has served as the Company's Lead Director since 2007. Mr. Lebel does not serve in a similar capacity with any other company.

The Company has received from each of the independent non-executive directors, their respective confirmation of independence pursuant to listing rules in all applicable jurisdictions. The Company considers all three (3) independent directors as independent.

To the best knowledge of the Company, none of the directors of the Company are related. Relationships include financial, business or family relationships. Each director is free to exercise their independent judgment.

Mandate of the board

Under the British Columbia Business Corporations Act ("BCBCA"), the directors of the Company are required to manage the Company's business and affairs, and in doing so to act honestly and in good faith with a view to further the best interests of the Company. In addition, each director must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The Board is responsible for supervising the conduct of the Company's affairs and the management of its business. The Board's mandate includes setting long-term goals and objectives for the Company, formulating the plans and strategies necessary to achieve those objectives and supervising senior management in their implementation. Although the Board delegates the responsibility for managing the day-to-day affairs of the Company to senior management personnel, the Board retains a supervisory role in respect of, and ultimate responsibility for, all matters relating to the Company and its business.

The Board's mandate requires that the Board be satisfied that the Company's senior management will manage the affairs of the Company in the best interest of the shareholders, in accordance with the Company's principles, and that the arrangements made for the management of the Company's business and affairs are consistent with their duties described above. The Board is responsible for protecting shareholder interests and ensuring that the incentives of the shareholders and of management are aligned. The obligation of the Board must be performed continuously, and not merely from time to time, and in times of crisis or emergency the Board may have to assume a more direct role in managing the affairs of the Company.

In discharging this responsibility, the Board's mandate provides that the Board oversees and monitors significant corporate plans and strategic initiatives. The Board's strategic planning process includes annual budget reviews and approvals, and discussions with management relating to strategic and budgetary issues. At least one (1) Board meeting per year is devoted to a comprehensive review of strategic corporate plans proposed by management.

As part of its ongoing review of business operations, the Board periodically reviews the principal risks inherent in the Company's business, including financial risks, through periodic reports from management of such risks, and assesses the systems established to manage those risks. Directly and through the Audit Committee, the Board also assesses the integrity of internal controls over financial reporting and management information systems.

In addition to those matters that must, by law, be approved by the Board, the Board is required under its mandate to approve annual operating and capital budgets, any material dispositions, acquisitions and investments outside of the ordinary course of business or not provided for in the approved budgets, long-term strategy, organizational development plans and the appointment of senior executive officers. Management is authorized to act, without Board approval, on all ordinary course matters relating to the Company's business.

The mandate provides that the Board also expects management to provide the directors, on a timely basis, with information concerning the business and affairs of the Company, including financial and operating information and information concerning industry developments as they occur, all with a view to enabling the Board to discharge its stewardship obligations effectively. The Board expects management to efficiently implement its strategic plans for the Company, to keep the Board fully apprised of its progress in doing so and to be fully accountable to the Board in respect to all matters for which it has been assigned responsibility.

The Board has instructed management to maintain procedures to monitor and promptly address shareholder concerns and has directed and will continue to direct management to apprise the Board of any major concerns expressed by shareholders.

Each Committee of the Board is empowered to engage external advisors as it sees fit. Any individual director is entitled to engage an outside advisor at the expense of the Company provided such director has obtained the approval of the Nominating and Corporate Governance Committee to do so. In order to ensure that the principal business risks borne by the Company are identified and appropriately managed, the Board receives periodic reports from management of the Company's assessment and management of such risks. In conjunction with its review of operations, the Board considers risk issues when appropriate and approves corporate policies addressing the management of the risk of the Company's business.

The Board takes ultimate responsibility for the appointment and monitoring of the Company's senior management. The Board approves the appointment of senior management and reviews their performance on an annual basis.

The Company has a disclosure policy addressing, among other things, how the Company interacts with analysts and the public, and contains measures for the Company to avoid selective disclosure. The Company has a management Disclosure Committee responsible for overseeing the Company's disclosure practices. The Disclosure Committee assesses materiality and determines when developments justify public disclosure. The committee reviews the disclosure policy annually and as otherwise needed to ensure compliance with regulatory requirements as well as review all documents which are reviewed by the Board and Audit Committee. The Board reviews and approves the Company's material disclosure documents, including its Annual Report, Annual Information Form and Management Proxy Circular. The Company's annual and quarterly financial statements, Management's Discussion and Analysis and other financial disclosure are reviewed by the Audit Committee and recommended to the Board prior to release.

Committees of the board

Audit committee

The Board has established an Audit Committee, which operates under a charter approved by the Board. It is the Board's responsibility to ensure that the Company has an effective internal control framework. This includes internal controls to deal with both the effectiveness and efficiency of significant business processes, the safeguarding of assets, the maintenance of proper accounting records, and the reliability of financial information as well as non-financial considerations such as the benchmarking of operational key performance indicators.

The Company's Audit Committee consists of Messrs. Deepwell, Lebel and Lancaster. Mr. Deepwell is the Chair of the Audit Committee.

The primary objective of the Audit Committee of the Company is to act as a liaison between the Board and the Company's independent auditors (the "Auditors") and to assist the Board in fulfilling its oversight responsibilities with respect to (a) the financial statements and other financial information provided by the Company to its shareholders, the public and others, (b) the Company's compliance with legal and regulatory requirements, (c) the qualification, independence and performance of the Auditors and (d) the Company's risk management and internal financial and accounting controls, and management information systems.

Although the committee has the powers and responsibilities set forth in its charter, the role of the committee is oversight. The members of the committee are not employees of the Company and may or may not be accountants or auditors by profession or experts in the fields of accounting or auditing and, in any event, do not serve in such a capacity. Consequently, it is not the duty of the committee to conduct audits or to determine that the Company's financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These are the responsibilities of management and the Auditors.

All services to be performed by the Company's independent auditor must be approved in advance by the Audit Committee or a designated member of the Audit Committee ("Designated Member"). The Designated Member is a member of the Audit Committee who has been given the authority to grant pre-approvals of permitted audit and non-audit services. Pre-approvals by the Designated Member are ratified by the Audit Committee at the next meeting thereof.

The Audit Committee has considered whether the provision of services other than audit services is compatible with maintaining the auditors' independence and has adopted a policy governing the provision of these services. This policy requires the pre-approval by the Audit Committee or the Designated Member of all audit and non-audit services provided by the external auditor, other than any *de minimis* non-audit services allowed by applicable law or regulation. The decisions of the Designated Member to pre-approve permitted services need to be reported to the Audit Committee at its regularly scheduled meetings. Pre-approval from the Audit Committee or Designated Member can be sought for planned engagements based on budgeted or committed fees. No further approval is required to pay pre-approved fees. Additional pre-approval is required for any increase in scope or in final fees. Pursuant to these procedures, 100% of each of the services provided by the Company's external auditor relating to the fees reported as audit, audit-related, tax and other fees were pre-approved by the Audit Committee or the Designated Member.

The Audit Committee held nine (9) meetings during the Financial Year. In performing its duties in accordance with the Audit Committee Charter, the Audit Committee has:

- overseen the relationship with the Company's auditors;
- reviewed the interim and annual financial statements;
- reviewed and assessed the effectiveness of systems of risk management and internal controls; and
- reported to the Board on the proceedings and deliberations of the Committee.

Nominating and corporate governance committee

The Board has established a Nominating and Corporate Governance Committee, which operates under a charter approved by the Board. The primary objective of the Nominating and Corporate Governance Committee is to assist the Board in fulfilling its oversight responsibilities by (a) identifying individuals qualified to become Board and committee of the Board members and recommending that the Board select director nominees for appointment or election to the Board; and (b) developing and recommending to the Board corporate governance guidelines for the Company and making recommendations to the Board with respect to corporate governance practices. The Nominating and Corporate Governance Committee monitors the disclosure of conflicts of interest to the Board and ensures that no director will vote or participate in a discussion on a matter in respect of which such director has a material interest. Committee Chairs perform the same function with respect to meetings of each Board committee.

The members of the Nominating and Corporate Governance Committee are Messrs. Lebel, Deepwell, Lancaster, Hinton and Ms. Priestly. Mr. Lebel is the chairman of the Nominating and Corporate Governance Committee. Mr. Hinton is not standing for re-election and will cease to be a member of the committee on May 6, 2014. It is not anticipated that Mr. Hinton will be replaced on the Nominating and Corporate Governance Committee at this time.

During the course of 2013, the Nominating and Corporate Governance Committee met four (4) times. In performing its duties in accordance with the Nominating and Corporate Governance Committee Charter, the Nominating and Corporate Governance Committee has:

- reviewed the Nominating and Corporate Governance Committee charter to ensure the Company has the appropriate procedures and processes in place to facilitate the nomination of Directors;

- reviewed the structure, size and diversity (including but not limited to the skills, knowledge, experience, gender, age, cultural and educational background, ethnicity, professional experience and length of service) of the Board and recommending adjustments from time to time, at least annually, to ensure that the Board is of a size and composition that facilitates effective decision making and complements the Company's strategy;
- identifying individuals qualified to become Directors based on merit and against objective criteria, with due regard to the Board's diversity policy (the "Diversity Policy");
- made recommendations to the Board on the selection of individuals nominated for directorship in view of their qualifications and related expertise;
- made recommendations to the Board on the selection of individuals nominated for senior management roles;
- evaluated the Company's executive management succession plans;
- ensured that the Board has the necessary structures and procedures so that it can function with an appropriate degree of independence from management;
- provided a forum without management present to receive expressions of concern, including any concern regarding matters involving the independence of the Board from management;
- re-established and conducted induction and continuing education programs for new Directors; and
- reviewed the practices and procedures of the Board in light of ongoing developments in regulatory requirements and industry best practices in matters of corporate governance and recommended to the Board any changes considered necessary or desirable.

Attached as Schedule "A" hereto, is a copy of the Diversity Policy.

Compensation and benefits committee

The Board has established a Compensation and Benefits Committee, which operates under a charter approved by the Board. The primary objective of the Compensation and Benefits Committee is to discharge the Board's responsibilities relating to compensation and benefits for the Directors and executive officers of the Company. This role includes reviewing and approving executive compensation including long-term incentive components and making applicable recommendations to the Board, administering the Employee Incentive Plan ("EIP"), determining the recipients of, and the nature and size of share compensation awards and bonuses granted from time to time, and reviewing reports as may be required under applicable laws and regulations.

The members of the Compensation and Benefits Committee are Messrs. Lancaster, Deepwell, Dove and Lebel. Mr. Lancaster is the Chair of the Compensation and Benefits Committee. Mr. Dove is not standing for re-election and will cease to be member of the committee on May 6, 2014. It is not anticipated that Mr. Dove will be replaced on the Compensation and Benefits Committee at this time.

During the course of 2013, the Compensation and Benefits Committee met four (4) times. In performing its duties in accordance with the Compensation and Benefits Committee Charter, the Compensation and Benefits Committee has:

- reviewed and approved corporate goals and objectives for the CEO's compensation, evaluating his performance and setting his compensation level;
- reviewed and made recommendations to the Board with respect to the adequacy and form of compensation and benefits of all executive officers and directors;
- administered and made recommendations to the Board with respect to the Company's incentive compensation plans and equity-based plans;
- recommended to the Board the CEO's performance evaluation, taking into consideration the CEO's annual objectives and performance; and

- determined the recipients of, and the nature and size of share compensation awards and bonuses granted from time to time.

Health, environment, safety and social responsibility committee

The Board has established a Health, Environment, Safety and Social Responsibility ("HESS") Committee. The primary objective of the HESS Committee is to review and oversee the Company's established HESS policies and procedures at the Company's project sites. The HESS Committee also reviews any incidents that occur and provides guidance on how to prevent any recurrences.

The members of the HESS Committee are Messrs. Sanders, Tromans and Dove. Mr. Sanders is the chairman of the HESS Committee. Mr. Dove is not standing for re-election and will cease to be member of the committee on May 6, 2014. Mr. Bold was appointed to the HESS Committee on March 18, 2014.

Mergers and acquisitions committee

The Board has established a Mergers and Acquisitions ("M&A") Committee currently consisting of Messrs. Dove, Baatar, Lebel, and Tromans. The primary objective of the M&A Committee is to review, assess and provide guidance on all potential acquisitions, divestitures and strategic investment transactions to which the Company may become a party; however, such committee is currently inactive due to the Board's desire for special committees of independent Directors to review, assess and provide guidance on all potential acquisitions, divestitures and strategic investment transactions to which the Company may become a party.

Ad Hoc/special committees

In appropriate circumstances, the Board may establish a special committee to review a matter in which several directors or management may have a conflict of interest. In 2013, three Special Committees composed of the Company's Independent Directors were formed to oversee the Company's interests in a proposed loan transaction with Turquoise Hill and in proposed transactions between Turquoise Hill and interested parties.

The Special Committee to oversee the loan was dissolved in November 2013 and the other two Special Committees continue to meet as required.

Through its Audit Committee (comprised solely of independent directors), the Company conducted an internal investigation into possible breaches of law, internal corporate policies and codes of conduct arising from the allegations which have been raised in the context of the investigations by the Mongolian authority. In addition the Chair of the Audit Committee participated in a tripartite committee, comprised of the Audit Committee Chairs of the Company and Turquoise Hill and a representative of Rio Tinto, focused on the investigation of a number of those allegations, including possible violations of anti-corruption laws. Independent legal counsel and other appropriate independent experts were engaged to assist with investigations.

The tripartite committee completed its investigation in October 2013. The investigation concluded there was no evidence to substantiate the allegations raised by the Mongolian authorities. However 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.

Following the conclusion of the internal investigations, the tripartite committee will be stood down pending further review or questions from any relevant regulatory authority.

Meetings of the board and committees of the board

The Board holds regular quarterly meetings. Between quarterly meetings, the Board meets as required, generally by means of telephone conferencing facilities. As part of the quarterly meetings, the non-management directors also have the opportunity to meet separately from management. If required, between regularly scheduled Board meetings, a meeting of independent non-executive Directors, chaired by the Lead Director, is held by teleconference to update the Directors on corporate developments since the last Board meeting. Management also communicates informally with members of the Board on a regular basis, and may solicit the advice of the Board members on matters falling within their special knowledge or experience.

During the Financial Year, 14 meetings of the Board of Directors, nine (9) meetings of the Audit Committee, four (4) meetings of the Nominating and Corporate Governance Committee, four (4) meetings of the Compensation and Benefits Committee, four (4) meetings of the Health, Environment, Safety and Social Responsibility Committee and five (5) meetings of the Mergers and Acquisitions Committee were held. Attendance by directors at the Board and Committee meetings is shown below:

Attendance record for the Board and Board Committee meetings during the Financial Year	**Board meetings**	**Audit committee meetings**	**Nominating and Corporate Governance committee meetings**	**Compensation and Benefits committee meetings**	**Health, Environment, Safety and Social Responsibility committee meetings**	**Mergers and Acquisitions committee meetings**
			(Number of Attendances/Number of Meetings)			
Executive Directors						
Mr. K. Ross Tromans	13/14	N/A	N/A	N/A	4/4	5/5
Non-Executive Directors						
Ms. Kay Priestly *(Chairperson)*	14/14	N/A	4/4	N/A	N/A	N/A
Mr. Sean Hinton *(Deputy Chairman)*	13/14	N/A	2/4	N/A	N/A	N/A
Mr. Bold Baatar [1]	5/7	N/A	N/A	N/A	N/A	2/2
Mr. Lindsay Dove	8/14	N/A	N/A	3/4	3/4	4/5
Mr. Kelly Sanders	14/14	N/A	N/A	N/A	4/4	N/A
Mr. Brett Salt [2]	5/5	N/A	N/A	N/A	2/2	2/2
Independent Non-Executive Directors						
Mr. Pierre Lebel *(Lead Director)*	11/14	9/9	4/4	4/4	N/A	4/5
Mr. André Deepwell	14/14	9/9	4/4	4/4	N/A	N/A
Mr. W. Gordon Lancaster	14/14	9/9	4/4	4/4	N/A	N/A

Notes:

1. Mr. Baatar joined the Board of Directors and the Merger and Acquisitions Committees on September 3, 2013.
2. Mr. Salt resigned from the Board of Directors and the Mergers and Acquisitions Committee on August 1, 2013.

The meeting of the shareholders of Company held on May 8, 2013 was attended by Messrs. Deepwell, Dove, Lancaster, Lebel, Priestly, Salt and Tromans. Mr. Baatar was not a member of the Board at the time of this meeting.

Professional development

The Company takes steps to ensure that prospective directors fully understand the role of the Board and its Committees and the contribution individual directors are expected to make, including, in particular, the commitment of time and energy that the Company expects. New directors are provided with a director orientation and are also briefed by management as to the status of the Company's business and are encouraged to visit the Company's properties.

In addition, all directors have received or will receive a comprehensive briefing on the duties, responsibilities and liabilities of directors, including the statutory duty of directors to act honestly and in good faith with a view to the best interests of the Company when exercising the powers and performing the functions of directors. In particular, the briefings focused on the directors' obligations to provide objective oversight of the Company on behalf of all shareholders notwithstanding other prior or current relationships.

Management and outside advisors provide information and education sessions to the Board and its committees on a continuing basis as necessary to keep the directors up-to-date with the Company, its business and the environment in which it operates as well as with developments in the responsibilities of directors. Presentations are made to the directors from time to time to educate and keep them informed of changes within the Company and of regulatory and industry requirements and standards. As a means of facilitating continuing education opportunities for directors, each independent director is enrolled as a member of the Institute of Corporate Directors. All Directors have participated in continuous professional development to develop and refresh their knowledge and skills during the Financial Year.

All Directors are members of the Canadian Institute of Corporate Directors and have the opportunity to attend courses relevant to the Company and its business, particularly with respect to corporate governance and the mining industry, at the Company's expense.

Ethical business conduct

The Company has adopted a Code of Business Conduct and Ethics and a Statement of Values and Responsibilities applicable to all employees, consultants, officers and directors regardless of their position in the organization, at all times and everywhere the Company does business. To reinforce the importance of ethical business conduct and to complement the existing policies, the Company has approved the adoption and implementation of compliance program based on a Rio Tinto model, such as The Way We Work and the Business Integrity standards which include Anti-corruption and Conflict of Interest policies (collectively "Code of Conduct Standards"), and the Speak-Out program.

The Code of Conduct Standards provides that the Company's employees, consultants, officers and directors will uphold its commitment to a culture of honesty, integrity and accountability and that the Company requires the highest standards of professional and ethical conduct from its employees, consultants, officers and directors. The various policies forming the Code of Conduct Standards have been filed on SEDAR and is available at www.sedar.com. A copy of the Company's Code of Conduct Standards may be obtained, without charge, by request to SouthGobi Resources Ltd., 354 – 200 Granville Street, Vancouver, British Columbia, Canada V6C 1S4, Attention: Corporate Department, or by phone to 604-681-6799.

Speak-Out is the Company whistleblowing service and it is available for use when someone suspects or is aware of illegal, unsafe or inappropriate activity at work. Speak-Out provides avenue for employees to raise concerns confidentially and anonymously.

The Code of Conduct Standards and Speak-Out program have been implemented across all sites and offices of the Company. In May 2013, the Company has created a new role and recruited a Corporate Compliance Specialist to manage and implement the Code of Conduct Standards and Speak-Out program under the legal function of the Company.

All of the Company's Directors, management and senior employees have completed, or are in the process of completing, an online e-learning training course relating to Anti-Corruption & the Foreign Corrupt Practices Act. All of the Company's employees are required to complete the FCPA Training Program.

The Audit Committee monitors compliance with the Code of Conduct Standards. The Nominating and Corporate Governance Committee monitors the disclosure of conflicts of interest by directors with a view to ensuring that no director votes or participates in any board deliberations on a matter in respect of which such director has a material interest.

The Nominating and Corporate Governance Committee will oversee the implementation of the standards to ensure they are fine tuned to conform to the Company's needs.

Appointment and re-election of directors

The Board determines, in light of the opportunities and risks facing the Company, what competencies, skills and personal qualities it should seek in new board members in order to add value to the Company. Based on this framework, the Nominating and Corporate Governance Committee developed a skills matrix outlining the Company's desired complement of directors' competencies, skills and characteristics. The specific make-up of the matrix includes such items and experiences as international business exposure, leading growth-orientated companies, mining exploration, diversity, financial literacy, legal knowledge, corporate governance, etc. The committee annually assesses the current competencies and skill-sets represented on the Board and utilizes the matrix to determine the Board's strengths and identify any gaps that need to be filled. This analysis assists the committee in discharging its responsibility for approaching and proposing to the full Board new nominees to the Board, and for assessing directors on an ongoing basis.

Unless a director dies, resigns or is removed from office in accordance with the BCBCA, the term of office of each of the incumbent director ends at the conclusion of the next annual meeting of the shareholders following his or her most recent election or appointment.

At every annual general meeting the shareholders entitled to vote at the annual general meeting for the election of directors are privy to elect a board consisting of the number of directors for the time being set under the articles of continuation for the Company and all the directors cease to hold office immediately before such election but are eligible for re-election. If the Company fails to hold an annual general meeting on or before the date by which the annual general meeting is required to be held under the BCBCA or the shareholders fail, at the annual general meeting, to elect or appoint any directors then each director then in office continues to hold office until the earlier of:

- the date on which his or her successor is elected or appointed; and
- the date on which he or she otherwise ceases to hold office under the BCBCA or the articles of continuation.

Securities transactions by directors

The Company has adopted policies in its Corporate Disclosure, Confidentiality and Securities Trading Policy that has terms that are no less exacting than those set out in Appendix 10 – (Model Code for Securities Transactions by Directors of Listed Issuers) of the rules governing the listing of securities on the Hong Kong Stock Exchange. The Company has received confirmation that the Directors received, reviewed and agree to abide to the terms of the Corporate Disclosure, Confidentiality and Securities Trading Policy,

Furthermore, if a director (a) enters into a transaction involving a security of the Company or, for any other reason, the direct or indirect beneficial ownership of, or control or direction over, securities of the Company changes from that shown or required to be shown in the latest insider report filed by the director, or (b) the director enters into a transaction involving a related financial instrument, the director must, within the prescribed period, file an insider report in the required form on the SEDI website at www.sedi.ca and a Form 3A is filed with the Stock Exchange of Hong Kong Limited.

A "related financial instrument" is defined as: (a) an instrument, agreement, security or exchange contract the value, market price or payment obligations of which are derived from, referenced to or based on the value, market price or payment obligations of a security, or (b) any other instrument, agreement or understanding that affects, directly or indirectly, a person's economic interest in respect of a security or an exchange contract.

Remuneration of directors

The Compensation and Benefits Committee periodically reviews and makes recommendations to the Board regarding the adequacy and form of the compensation for non-management directors to ensure that such compensation realistically reflects the responsibilities and risks involved in being an effective director, without compromising a director's independence. Directors who are executives of the Company receive no additional remuneration for their services as directors.

All non-executive directors receive Cdn$25,000 per annum for acting as such. Ms. Priestly, in the capacity of Chairman, and Mr. Lebel, in the capacity of Lead Director, each receive an additional fee of Cdn$60,000 per annum. Mr. Hinton, in the capacity of Deputy Chairman, receives an additional fee of Cdn$45,000 per annum. Mr. Deepwell in the capacity of Chairman of the Audit Committee receives an additional fee of Cdn$40,000 per annum. The Chairs of the Compensation and Benefits Committee, Corporate Governance and Nominating Committee, and Health, Environment, Safety and Social Responsibility Committee each receive an additional fee of Cdn$25,000 per annum for acting in such capacity. The Chair of the Mergers and Acquisitions Committee previously received Cdn$25,000 per annum for acting in such capacity; however, as such committee is now inactive, no additional fees will be paid in respect of such position.

Each non-executive director receives a fee of Cdn$1,500 for each Board meeting and each Committee meeting attended in person and Cdn$600 for each conference call meeting in which they participate. Directors also receive a travel allowance of Cdn$2,000 per round-trip in excess of four (4) hours travel time. To reflect his added responsibilities associated with his Deputy Chairman position, Mr. Hinton received 62,000 stock options in 2013.

In the ordinary course, non-executive directors, other than Rio Tinto seconded employees and Rio Tinto nominees to the boards of directors of subsidiary companies, receives an annual grant of incentive stock options. As of the date hereof, the Company has not made a grant of options to non-management directors for 2013.

Details regarding the remuneration of directors of the Company are set out in Note A2 of the Financial Statements.

Note:

(1) Pursuant to Rio Tinto compensation policies, Rio Tinto seconded employees and Rio Tinto nominees to the board of directors of direct or indirect subsidiaries of Rio Tinto are not permitted to receive securities of those subsidiary companies.

Internal controls

The Board is responsible for overseeing the internal controls of the Company. Internal controls are used by the Board to: facilitate the effectiveness and efficiency of operations, safeguard the investment of shareholders and assets of the Company and to ensure compliance with relevant statutory and regulatory requirements. The Company's internal control policies are designed to provide reasonable, but not absolute, assurance against material misstatements and help the Board identify and mitigate, but not eliminate, risk exposure.

The Board conducts annual reviews of the internal controls of the Company to ensure that internal control policies and procedures are adequate. On an ongoing basis, the Directors review the adequacy of the Company's resources, staff qualifications and experience, training programs and budget of the Company's accounting and financial reporting function. The Audit Committee reviewed the effectiveness of the Company's internal control policies as at December 31, 2013, and is of the view that the internal control system in place is effective in safeguarding the investment of shareholders and assets of the Company.

Auditors

PricewaterhouseCoopers LLP is the auditor of the Company and is independent within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of British Columbia. The financial reporting responsibilities and audit report of the independent auditors are set out on page 101.

PricewaterhouseCoopers LLP will be nominated at the upcoming annual general meeting for reappointment as auditors of the Company at remuneration to be fixed by the Board. PricewaterhouseCoopers LLP have served as the Company's auditors since April 3, 2012; previously, the Company's auditors were Deloitte LLP.

Fees paid/payable to the external auditors, PricewaterhouseCoopers LLP, in respect of audit and non-audit services provided during the year ended December 31, 2013 are as follows:

Nature of services rendered	**Fees paid/payable (C$000's)**
Audit fees (a)	299
Audit related fees (b)	103
Other fees (c)	16
Total	418

Notes:
(a) Includes audit fees and audits of subsidiaries
(b) Includes interim reviews
(c) Includes translation services

Responsibilities in respect of the financial statements

The directors acknowledge their responsibility in overseeing the preparation of financial statements that give a true and fair view of the financial affairs of the Company. With the assistance of the management of the Company, the directors ensure that the financial statements of the Company are being prepared and published in a timely manner and in accordance with the applicable accounting standards and statutory requirements.

Company secretary

The Corporate Secretary is a member of the Institute of Corporate Directors and the Canadian Society of Corporate Secretaries and through these organizations has completed the on-going development under Hong Kong Exchange Listing Rule 3.29.

Shareholders' rights

Under Canadian corporate law, shareholders' rights are governed by the business corporation's legislation of the jurisdiction of incorporation of a company and by a company's constating documents. In the case of the Company, the BCBCA and the Company's articles govern the rights of shareholders of the Company, as summarized in this section. The Company has not made any changes to its articles during the Financial Year.

How Shareholders can convene an Extraordinary General Meeting

A meeting other than an annual general may be called by shareholders who hold in the aggregate at least five per cent (5%) of the Common shares of the Company ("Common shares") for the purpose of transacting any business that may be transacted at a general meeting of shareholders by submitting a requisition to the Company in the proper form.

On receiving a requisition, directors must call a meeting (subject to certain exceptions) to transact the business stated therein. If notice of the meeting is not sent to holders of Common shares within 21 days after the date on which the requisition is received by the Company, any one or more shareholders holding, in the aggregate, more than two and a half per cent (2.5%) of the Common shares may send notice of a general meeting to be held to transact the business stated in the requisition. The quorum for the transaction of business at a meeting of shareholders is two (2) holders of Common shares who, in the aggregate, hold at least five per cent (5%) of the Common shares.

Procedures by which enquiries may be put to the board

The BCBCA does not legislate procedures by which shareholder enquiries may be put to the board of a company and the Company's constating documents do not mandate a specific process for enquiries to be put to the Board, however shareholders are kept informed of material information regarding the Company's financial position and operations through annual public disclosure in accordance with applicable Canadian securities laws. Further, the Directors are obliged to place the annual financial statements of the Company and any auditor's report made on those financial statements before shareholders at an annual general meeting and must send a copy of this information to shareholders who request such information within six (6) months of the annual general meeting.

Procedures for putting forward proposals at shareholders' meetings

Qualified shareholders (as herein defined) may put forward a written proposal setting out a matter that the qualified shareholder wishes to have considered at the next annual general meeting of the Company. A qualified shareholder is a shareholder who is, and who has been for an uninterrupted period of at least two (2) years before the date of the signing of the proposal, an owner of (a) Common share(s) (subject to certain exceptions).

A valid proposal must be signed by the submitter and by qualified shareholder(s) (each, a "supporter") who, together with the submitter, are holders of Common shares that, in the aggregate constitute at least one per cent (1%) of the issued Common shares. A declaration signed by the submitter and each supporter, must accompany the proposal, providing contact and details as to shareholdings of the submitter or supporter, as the case may be.

Each of the proposal and the declarations must be received at the registered office of the Company at least three (3) months before the anniversary of the previous year's annual general meeting and the Company must then (subject to certain statutory exceptions) send the text of the proposal to all holders of Common shares. The Company must allow a submitter to present the proposal at the annual general meeting in relation to which the proposal was made.

SCHEDULE "A"

DIVERSITY POLICY

1. Purpose

This Policy is intended to set out a framework to promote diversity on the Company's board of directors (the "Board").

2. Vision

The Company recognizes the importance and benefits of having a diverse Board to enhance the quality of its performance. The Company is committed to promoting diversity on the Board.

3. Policy Statement

The Company believes that a diverse board will enhance the decision making of the Board by utilizing the difference in skills, experience and background, geographical and industry experience, ethnicity, gender, knowledge and length of services, and other distinguishing qualities of the members of the Board. Diversity will be considered in determining the optimum composition of the Board, and all appointments will be based on merit, having due regard to the overall effectiveness of the Board.

The Nominating & Corporate Governance Committee of the Company (the "Committee") is responsible for reviewing and assessing the composition of the Board and will make recommendations to the Board on the appointment of new directors. The Committee will also review the structure, size and diversity of the Board annually and make recommendations on any proposed changes to the Board to complement the Company's objectives and strategy.

4. Measurable objectives

The Committee will discuss and agree annually the relevant measurable objectives for promoting diversity on the Board and make recommendations for consideration and approval by the Board. The final decision will be based on merit against objective criteria and with due regard for the benefits of diversity on the Board.

5. Monitoring and Reporting

The Committee will monitor and implement this Policy and report to the Board on the achievement of the measurable objectives for promoting diversity described in section 4 of this Policy.

6. Review of the Policy

The Committee will review this Policy from time to time as necessary, and make recommendations on any required changes to the Board for consideration and approval.

SEVERAL GROWTH OPTIONS

Growth options include ramping up 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


MT4400AC
LIEBHERR
SouthGobi
Sands

Management's discussion and analysis of financial condition and results of operations

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.

Table of contents

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/.

1. Overview continued

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

		Year ended December 31,		
$ in thousands, except per share and per tonne information		**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

		As at December 31,		
$ in thousands		**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.

3. Overview of operational data and financial results continued

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.

3. Overview of operational data and financial results continued

Overview of annual financial results continued

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.

3. Overview of operational data and financial results continued

Overview of annual financial results continued

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

	Year ended December 31,	
$ in thousands	**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.

3. Overview of operational data and financial results continued

Overview of annual financial results continued

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

		Year ended December 31,		
$ in thousands		**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.

3. Overview of operational data and financial results continued

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.

3. Overview of operational data and financial results continued

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.

3. Overview of operational data and financial results continued

Overview of quarterly financial results continued

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.

	Three months ended December 31,	
$ in thousands	**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

3. Overview of operational data and financial results continued

Overview of quarterly financial results continued

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.

	Three months ended December 31,			
$ in thousands		**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

4. Non-IFRS financial measures continued

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"). This is the most recent NI 43-101 compliant independent resource estimate for the Ovoot Tolgoi Mine. 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.

5. Properties continued

Operating mines continued

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.

5. Properties continued

Operating mines continued

Processing Infrastructure continued

Wet Washing Facility continued

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.

5. Properties continued

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. This is the most recent NI 43-101 compliant independent resource estimate for the Soumber Deposit. 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.

5. Properties continued

Development projects and exploration program continued

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. This is the most recent NI 43-101 compliant independent resource estimate for the Zag Suuj Deposit. 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. This is the most recent NI 43-101 compliant independent resource estimate for the Ovoot Tolgoi Underground Deposit. 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.

5. Properties continued

Development projects and exploration program continued

Ovoot Tolgoi Underground Deposit continued

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. This is the most recent resource estimate for the Tsagaan Tolgoi Deposit.

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.

[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.aspiremininglimited.com/.

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.

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.

6. Liquidity and capital resources continued

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.

6. Liquidity and capital resources continued

CIC convertible debenture continued

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.

6. Liquidity and capital resources continued

Cash flow highlights

$ in thousands		Year ended December 31, 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:

$ in thousands		As at December 31, 2013 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.

6. Liquidity and capital resources continued

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.

6. Liquidity and capital resources continued

Financial instruments continued

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.

7. Regulatory issues and contingencies continued

Regulatory issues continued

Internal Investigation continued

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.

7. Regulatory issues and contingencies continued

Regulatory issues continued

Mining Prohibition in Specified Areas Law continued

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

9. Related party transactions continued

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

		Year ended December 31,		
$ in thousands		**2013**		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.

12. Critical accounting estimates and judgments continued

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.

12. Critical accounting estimates and judgments continued

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.

13. Recent accounting pronouncements continued

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.

14. Risk factors continued

Risks relating to the company's liquidity and capital resources continued

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.

Risks relating to the Company's projects in Mongolia

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.

14. Risk factors continued

Risks relating to the Company's projects in Mongolia continued

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.

14. Risk factors continued

Risks relating to the Company's projects in Mongolia continued

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.

14. Risk factors continued

Risks relating to the Company's projects in Mongolia continued

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 continued

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.

14. Risk factors continued

Risks relating to the Company's projects in Mongolia continued

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.

14. Risk factors continued

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.

14. Risk factors continued

Risks relating to the Company's business and industry continued

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.

14. Risk factors continued

Risks relating to the Company's business and industry continued

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.

14. Risk factors continued

Risks relating to the Company's business and industry continued

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 continued

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.

14. Risk factors continued

Risks relating to the Company's business and industry continued

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.

14. Risk factors continued

Risks relating to the Company's business and industry continued

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.

14. Risk factors continued

Risks relating to the Company's business and industry continued

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.

14. Risk factors continued

Risks relating to the Company's business and industry continued

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

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.

14. Risk factors continued

Risks relating to the Company's business and industry continued

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.

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.

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

15. Outlook continued

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.

15. Outlook continued

Objectives continued

- 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


SEBAGO
SouthGobi
Sands

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

Consolidated financial statements

Table of contents

Independent auditor's report

To the Shareholders of SouthGobi Resources Ltd.:

We have audited the accompanying consolidated financial statements of SouthGobi Resources Ltd. ("SouthGobi" or the "Company"), which comprise the consolidated statements of financial position as at December 31, 2013 and December 31, 2012 and the consolidated statements of comprehensive income, cash flows and changes in equity for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2013 and December 31, 2012 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to Note 1 in the financial statements which describes matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

signed "PricewaterhouseCoopers LLP"
Chartered Accountants
Vancouver, Canada
March 24, 2014

Consolidated statements of comprehensive income

(Expressed in thousands of U.S. Dollars, except for share and per share amounts)

	Notes	Year ended December 31, 2013	2012
Revenue		**$ 58,636**	$ 78,061
Cost of sales	5	**(112,627)**	(127,407)
Gross loss		**(53,991)**	(49,346)
Other operating expenses	6	**(126,040)**	(41,645)
Administration expenses	7	**(15,629)**	(24,637)
Evaluation and exploration expenses	8	**(1,169)**	(8,598)
Loss from operations		**(196,829)**	(124,226)
Finance costs	9	**(21,162)**	(15,385)
Finance income	9	**5,566**	39,942
Share of earnings/(losses) of joint venture	13	**(53)**	635
Loss before tax		**(212,478)**	(99,034)
Current income tax expense	10	**(3)**	(354)
Deferred income tax recovery/(expense)	10	**(24,983)**	1,886
Net loss attributable to equity holders of the Company		**(237,464)**	(97,502)
Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods			
Change in value of available-for-sale financial asset, net of tax		**514**	(16,559)
Net comprehensive loss attributable to equity holders of the Company		**$ (236,950)**	$ (114,061)
Basic loss per share	11	**$ (1.30)**	$ (0.54)
Diluted loss per share	11	**$ (1.30)**	$ (0.60)

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

Consolidated statements of financial position

(Expressed in thousands of U.S. Dollars)

	Notes	As at December 31, 2013	2012
Assets			
Current assets			
Cash		**$ 21,837**	$ 19,674
Trade and other receivables	12	**2,578**	3,292
Short term investments	13	**–**	15,000
Inventories	14	**40,288**	59,735
Prepaid expenses and deposits	15	**11,506**	47,432
Total current assets		**76,209**	145,133
Non-current assets			
Prepaid expenses and deposits	15	**–**	16,778
Property, plant and equipment	16	**399,395**	521,473
Long term investments	13	**30,602**	24,084
Deferred income tax assets	10	**–**	24,984
Total non-current assets		**429,997**	587,319
Total assets		**$ 506,206**	$ 732,452
Equity and liabilities			
Current liabilities			
Trade and other payables	17	**$ 31,241**	$ 10,216
Deferred revenue		**997**	8,181
Current portion of convertible debenture	19	**2,301**	6,301
Total current liabilities		**34,539**	24,698
Non-current liabilities			
Convertible debenture	19	**94,302**	99,667
Decommissioning liability	20	**2,308**	4,104
Total non-current liabilities		**96,610**	103,771
Total liabilities		**131,149**	128,469
Equity			
Common shares		**1,067,839**	1,059,710
Share option reserve	23	**51,198**	51,303
Investment revaluation reserve	23	**514**	–
Accumulated deficit	21	**(744,494)**	(507,030)
Total equity		**375,057**	603,983
Total equity and liabilities		**$ 506,206**	$ 732,452
Net current assets		**$ 41,670**	$ 120,435
Total assets less current liabilities		**$ 471,667**	$ 707,754

Corporate information and going concern (Note 1), commitments for expenditure (Note 28) and contingencies (Note 29)

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

APPROVED BY THE BOARD:

André Deepwell *Pierre Lebel*

Director *Director*

Consolidated statements of changes in equity

(Expressed in thousands of U.S. Dollars and shares in thousands)

	Number of shares	Common shares	Share option reserve	Investment revaluation reserve	Accumulated deficit	Total
Balances, January 1, 2012	181,320	$1,054,298	$ 44,143	$ 16,559	$(409,433)	$ 705,567
Shares issued for:						
Interest settlement on convertible debenture	522	4,000	–	–	–	4,000
Exercise of stock options, net of redemptions	163	1,882	(1,368)	–	–	514
Employee share purchase plan	71	395	–	–	–	395
Share-based compensation charged to operations	–	–	8,528	–	–	8,528
Common shares repurchased and cancelled	(148)	(860)	–	–	(95)	(955)
Common share repurchase costs	–	(5)	–	–	–	(5)
Net loss for the year	–	–	–	–	(97,502)	(97,502)
Reclassification of gain on available-for-sale financial asset, net of tax	–	–	–	(16,559)	–	(16,559)
Balances, December 31, 2012	**181,928**	**$1,059,710**	**$51,303**	**$ –**	**$(507,030)**	**$603,983**
Balances, January 1, 2013	**181,928**	**1,059,710**	**51,303**	**–**	**(507,030)**	**$603,983**
Shares issued for:						
Interest settlement on convertible debenture	**5,310**	**8,000**	**–**	**–**	**–**	**8,000**
Employee share purchase plan	**71**	**129**	**–**	**–**	**–**	**129**
Share-based compensation recovery	**–**	**–**	**(105)**	**–**	**–**	**(105)**
Net loss for the year	**–**	**–**	**–**	**–**	**(237,464)**	**(237,464)**
Change in value of available-for-sale financial asset, net of tax	**–**	**–**	**–**	**514**	**–**	**514**
Balances, December 31, 2013	**187,309**	**$1,067,839**	**$ 51,198**	**$ 514**	**$(744,494)**	**$ 375,057**

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

Consolidated statements of cash flows

(Expressed in thousands of U.S. Dollars)

	Notes	Year ended December 31, 2013	2012
Operating activities			
Loss before tax		**$ (212,478)**	$ (99,034)
Adjustments for:			
Depreciation and depletion		**45,253**	46,495
Share-based compensation	22	**(105)**	8,528
Finance costs	9	**21,162**	15,385
Finance income	9	**(5,566)**	(39,942)
Share of losses/(earnings) of joint venture	13	**53**	(635)
Interest paid		**(16,184)**	(16,322)
Income taxes paid		**–**	(2,349)
Unrealized foreign exchange loss/(gain)		**(236)**	467
Loss on disposal of property, plant and equipment		**895**	720
Provision for doubtful trade and other receivables	12	**200**	1,032
Impairment loss on available-for-sale financial asset	13	**3,067**	19,184
Impairment of inventories	14	**35,697**	20,531
Impairment of prepaid expenses and deposits	15	**30,152**	–
Impairment of property, plant and equipment	16	**72,669**	15,245
Operating cash flows before changes in non-cash working capital items		**(25,421)**	(30,695)
Net change in non-cash working capital items	27	**32,980**	4,412
Cash generated from/(used in) operating activities		**7,559**	(26,283)
Investing activities			
Expenditures on property, plant and equipment		**(11,819)**	(97,388)
Proceeds from disposal of property, plant and equipment		**1,703**	1,030
Interest received		**94**	400
Proceeds from maturity or disposal of short and long term investments		**15,486**	31,485
Investment in joint venture		**(10,356)**	(13,264)
Cash used in investing activities		**(4,892)**	(77,737)
Financing activities			
Proceeds from issuance of common shares and exercise of stock options, net of issue costs		**129**	909
Repurchase of common shares, including transaction costs		**–**	(960)
Drawings under line of credit facility		**–**	26,753
Repayments of line of credit facility		**–**	(26,753)
Cash generated from/(used in) financing activities		**129**	(51)
Effect of foreign exchange rate changes on cash		**(633)**	178
Increase/(decrease) in cash		**2,163**	(103,893)
Cash, beginning of year		**19,674**	123,567
Cash, end of year		**$ 21,837**	$ 19,674

Supplemental cash flow information (Note 27)

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

Notes to the consolidated financial statements

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

1. Corporate information and going concern

SouthGobi Resources Ltd. is a publicly listed company incorporated in Canada with limited liability under the legislation of the Province of British Columbia and its shares are listed on the Toronto Stock Exchange (Symbol: SGQ) and Hong Kong Stock Exchange (Symbol: 1878). The company, together with its subsidiaries (collectively referred to as the "Company"), is an integrated coal mining, development and exploration company. 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 (Note 26). 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 producing coal mine ("Ovoot Tolgoi Mine") and the following significant development projects, the Soumber Deposit, the Zag Suuj Deposit and the Ovoot Tolgoi Underground Deposit. These projects are located in the Umnugobi Aimag (South Gobi Province) of Mongolia, within 150 kilometers of each other and in close proximity to the Mongolia-China border. The Company owns a 100% interest in these coal projects.

The head office, principal address and registered and records office of the Company is located at 354 – 200 Granville Street, Vancouver, British Columbia, Canada, V6C 1S4.

The Company curtailed its mining activities at the Ovoot Tolgoi Mine during the three months ended June 30, 2012 to varying degrees to manage coal inventories and to maintain efficient working capital levels. As at June 30, 2012, mining activities had been fully curtailed. The Company's mining activities remained fully curtailed until March 22, 2013, when the Company recommenced mining activities at the Ovoot Tolgoi Mine.

Going concern assumption

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had cash of $21,837 and working capital of $41,670 at December 31, 2013. However, 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 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 China Investment Corporation ("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 $250,000 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.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

2. Basis of preparation

2.1 Statement of compliance

The consolidated financial statements, including comparatives, have been prepared in accordance with and using accounting policies in compliance with the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the IFRS Interpretations Committee ("IFRIC").

The consolidated financial statements of the Company for the year ended December 31, 2013 were approved and authorized for issue by the Board of Directors of the Company on March 24, 2014.

2.2 Basis of presentation

The consolidated financial statements have been prepared on a historical cost basis except for certain financial assets and financial liabilities which are measured at fair value. The Company's financial instruments are further disclosed in Note 25.

The Company's reporting currency and the functional currency of all of its operations is the U.S. Dollar as this is the principal currency of the economic environment in which the Company operates.

2.3 Adoption of new and revised standards and interpretations

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 consolidated financial statements for the current or prior periods presented.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

2. Basis of preparation continued

2.3 Adoption of new and revised standards and interpretations continued

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. The additional disclosures are included in Note 13.

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 has resulted in additional fair value measurement disclosures in the Company's consolidated financial statements. The additional disclosures are included in Note 25.

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 these 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 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 "Employee benefits", IAS 28 "Investments in Associates" (2003), IAS 36 "Impairment of Assets", IFRS 7 "Financial Instruments" and set out amendments to a number of standards under the "Annual Improvements 2009-2011 Cycle" effective January 1, 2013. The amendments to these standards did not impact the Company's consolidated financial statements.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

2. Basis of preparation continued

2.4 Standards issued but not yet effective

The standards and interpretations that are issued up to the date of issuance of the Company's financial statements, but were not effective during the year ended December 31, 2013, are disclosed below. The Company intends to adopt these standards, if applicable, when they become effective.

IFRS 9	Financial Instruments[iii]
IFRS 9, IFRS 7 and IAS 39 Amendments	Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39[iii]
IFRS 10, IFRS 12 and IAS 27 (2011) Amendments	Amendments to IFRS 10, IFRS 12 and IAS 27 (2011) – Investment Entities[i]
IAS 19 Amendments	Amendments to IAS 19 Employee Benefits – Defined Benefit Plans: Employee Contributions[ii]
IAS 32 Amendments	Amendments to IAS 32 Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities[i]
IAS 39 Amendments	Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting[i]
IFRIC 21	Levies[i]

(i) Effective for annual periods beginning on or after January 1, 2014.
(ii) Effective for annual periods beginning on or after July 1, 2014.
(iii) Mandatory effective date not yet determined.

The Company anticipates that the adoption of these standards and interpretations in future periods will have no material impact on the financial statements of the Company.

3. Summary of significant accounting policies

3.1 Basis of consolidation

The consolidated financial statements include the financial statements of SouthGobi Resources Ltd. and its controlled subsidiaries and investees (Note 26).

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition or up to the effective date of disposal, as appropriate. All intercompany transactions, balances, income and expenses are eliminated in full on consolidation.

The Company controls an entity when the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Company's equity therein. Total comprehensive income of the Company's subsidiaries is attributed to the equity holders of the Company and to the non-controlling interests even if this results in the non-controlling interest having a deficit balance. The Company did not have any non-controlling interests in the net assets of consolidated subsidiaries during the years presented.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. Summary of significant accounting policies continued

3.2 Foreign currencies

The functional currency of all of the Company's operations is the U.S. Dollar as this is the principal currency of the economic environment in which the Company operates. Transactions in foreign currencies are initially recorded at the U.S. Dollar rate of exchange at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the U.S. Dollar rate of exchange ruling at the end of each reporting period. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate prevailing at the date of the transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rate at the date when the fair value is determined.

3.3 Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalized as part of the cost of those assets. All other borrowing costs are expensed and included in profit or loss.

3.4 Inventories

Coal stockpile inventories are measured at the lower of production cost and net realizable value. Production cost is determined by the weighted average cost method and includes direct and indirect labor, operating materials and supplies, processing costs, transportation costs and an appropriate portion of fixed and variable overhead expenses. Fixed and variable overhead expenses include depreciation and depletion. Net realizable value represents the future estimated selling price of the product, less estimated costs to complete production and costs necessary to bring the product to sale.

Materials and supplies inventory consists of consumable parts and supplies which are valued at the lower of weighted average cost and net realizable value, less allowances for obsolescence. Replacement cost is used as the best available measure of net realizable value. Supplies used in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost.

3.5 Property, plant and equipment

Property, plant and equipment includes the Company's operating equipment and infrastructure, construction in progress and mineral properties. Property, plant and equipment is stated at cost less accumulated depreciation and depletion and accumulated impairment losses.

Initial recognition

The cost of an item of operating equipment and infrastructure consists of the purchase price or construction cost, including vendor prepayments, any costs directly attributable to bringing the asset to the location and condition necessary for its intended use, an initial estimate of the decommissioning liability and capitalized borrowing costs.

Construction in progress is classified to the appropriate category of property, plant and equipment when it is completed and is ready for its intended use.

All direct costs related to the acquisition of mineral property interests are capitalized on a property by property basis. The cost of mineral properties also includes mineral property development costs, certain production stripping costs and decommissioning liabilities related to the reclamation of the Company's mineral properties.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. Summary of significant accounting policies continued

3.5 Property, plant and equipment continued

Depreciation and depletion

Depreciation and depletion are recorded based on the cost of an item of property, plant and equipment, less its estimated residual value, using the straight-line method or unit-of-production method over the following estimated useful lives:

Mobile equipment	5 to 7 years
Other operating equipment	1 to 10 years
Buildings and roads	5 to 20 years
Construction in progress	not depreciated
Mineral properties	unit-of-production basis based on proven and probable reserves

An item of property, plant and equipment is derecognized upon disposal, when held for sale or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on disposal of the asset, determined as the difference between the net disposal proceeds and the carrying amount of the asset, is recognized in profit or loss.

The Company conducts an annual assessment of the residual balances, estimated useful lives and depreciation methods being used for property, plant and equipment and any changes arising from the assessment are applied by the Company prospectively.

3.6 Mineral properties

Evaluation and exploration expenses

Evaluation and exploration expenses are charged to profit or loss in the period incurred until such time as it has been determined that a mineral property has proven and probable reserves, is technically feasible and commercially viable and management has determined that the mineral property will be developed.

Commencement of commercial production

On the commencement of commercial production, depletion of each mineral property is recorded on a unit-of-production basis using proven and probable reserves as the depletion base. Management's determination of when commercial production commences is based on several qualitative and quantitative factors including, but not limited to, the following:

- the elevation or bench where the coal to be mined has been reached
- the commissioning of major operating equipment and infrastructure is completed

3.7 Development and production stripping costs

Once a property is determined to have economically recoverable reserves, the Company's subsequent exploration and evaluation and development expenses are capitalized as mineral property costs within property, plant and equipment.

Production 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.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. Summary of significant accounting policies continued

3.8 Decommissioning, restoration and similar liabilities

The Company recognizes provisions for statutory, contractual, constructive or legal obligations, including those associated with the reclamation of mineral properties, when those obligations result from the acquisition, construction, development or normal operation of the assets. Initially, a provision for a decommissioning liability is recognized as its present value in the period in which it is incurred. Upon initial recognition of the liability, a corresponding amount is added to the carrying amount of the related asset and the cost is amortized as an expense over the estimated useful life of the asset using either the unit-of-production method or the straight-line method, as appropriate. Following the initial recognition of the decommissioning liability, the carrying amount of the liability is increased for the passage of time and adjusted for changes to the discount rate and the amount or timing of the underlying cash flows required to settle the obligation. The discount rate used is a credit adjusted risk free rate.

3.9 Joint arrangements

The Company 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.

3.10 Share-based payments

Share-based payment transactions

Employees (including directors and senior executives) of the Company receive a portion of their remuneration in the form of share-based payments, whereby employees render services as consideration for equity instruments ("equity-settled transactions").

In situations where equity instruments are issued to non-employees and the value of some or all of the goods or services received by the entity as consideration cannot be measured reliably, they are measured at the fair value of the share-based payment. Otherwise, share-based payments are measured at the fair value of goods or services received.

Equity-settled transactions

The costs of equity-settled transactions with employees are measured by reference to the fair value at the date on which the awards are granted.

The costs of equity-settled transactions are recognized, together with a corresponding increase in the share option reserve, over the period in which the performance and/or service conditions are fulfilled and end on the date on which the relevant employees become fully entitled to the award. The cumulative expense recognized for equity-settled transactions at each reporting date reflects the Company's best estimate of the number of equity instruments that will ultimately vest. No expense is recognized for awards that do not ultimately vest.

When the terms of an equity-settled award are modified, the minimum expense recognized is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of the modification.

3. Summary of significant accounting policies continued

3.11 Earnings per share

Basic earnings per share is calculated by dividing the profit or loss attributable to equity holders of the Company by the weighted average number of shares outstanding during the reporting period.

Diluted earnings per share is calculated by adjusting the profit or loss attributable to equity holders of the Company and the weighted average number of shares outstanding for the effects of all dilutive share equivalents. The Company's dilutive share equivalents include stock options and convertible debt.

3.12 Taxation

Income tax expense represents the sum of tax currently payable and deferred tax.

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are substantively enacted at the end of each reporting period.

Deferred income tax

Deferred income tax is provided using the liability method on temporary differences, at the end of each reporting period, between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences, except:

- where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, where the timing of the reversal of the temporary differences can be controlled by the parent, investor or venturer and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognized for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry forward of unused tax credits and unused tax losses can be utilized except:

- where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and joint ventures, deferred income tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred income tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. Summary of significant accounting policies continued

3.12 Taxation continued

Deferred income tax continued

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been substantively enacted at the end of each reporting period.

Deferred income tax relating to items recognized directly in equity is recognized in equity and not in profit or loss.

Deferred income tax assets and deferred income tax liabilities are offset if, and only if, a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities which intend to either settle current tax liabilities and assets on a net basis, or to realize the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax assets or liabilities are expected to be settled or recovered.

3.13 Financial assets

All financial assets are initially recorded at fair value and designated upon inception into one of the following four categories: held-to-maturity, available-for-sale, loans-and-receivables or at fair value through profit or loss (“FVTPL”).

Financial assets classified as FVTPL are measured at fair value with unrealized gains and losses recognized through profit or loss.

Financial assets classified as loans-and-receivables and held-to-maturity are measured at amortized cost using the effective interest method less any allowance for impairment. The effective interest method is a method of calculating the amortized cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period.

Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income except when there is objective evidence that the financial asset is impaired. Impairment losses on available-for-sale financial assets are recognized in profit or loss.

Transaction costs associated with FVTPL financial assets are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

3.14 Financial liabilities

All financial liabilities are initially recorded at fair value and designated upon inception as FVTPL or other-financial-liabilities.

Financial liabilities classified as other-financial-liabilities are initially recognized at fair value less directly attributable transaction costs. After initial recognition, other-financial-liabilities are subsequently measured at amortized cost using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

3. Summary of significant accounting policies continued

3.14 Financial liabilities continued

Financial liabilities classified as FVTPL include financial liabilities designated upon initial recognition as FVTPL. Derivatives, including separated embedded derivatives, are also classified as FVTPL unless they are designated as effective hedging instruments. Transaction costs on financial liabilities classified as FVTPL are expensed as incurred. At the end of each reporting period subsequent to initial recognition, financial liabilities classified as FVTPL are measured at fair value, with changes in fair value recognized directly in profit or loss in the period in which they arise. The net gain or loss recognized in profit or loss excludes any interest paid on the financial liabilities.

3.15 Impairment of financial assets

The Company assesses at the end of each reporting period whether a financial asset is impaired.

Assets carried at amortized cost

If there is objective evidence that an impairment loss on assets carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is then reduced by the amount of the impairment. The amount of the loss is recognized in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed to the extent that the carrying value of the asset does not exceed what the amortized cost would have been had the impairment not been recognized. Any subsequent reversal of an impairment loss is recognized in profit or loss.

Available-for-sale

A significant or prolonged decline in the fair value of an available-for-sale financial asset below its cost provides objective evidence that the asset is impaired. If an available-for-sale financial asset is impaired, an amount comprising the difference between its cost and its current fair value, less any impairment loss previously recognized in profit or loss, is transferred from equity to profit or loss. Reversals of impairment losses in respect of equity instruments classified as available-for-sale are not recognized in profit or loss.

3.16 Derecognition of financial assets and financial liabilities

Financial assets are derecognized when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Company has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized directly in equity is recognized in profit or loss.

Financial liabilities are derecognized when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. Summary of significant accounting policies continued

3.17 Impairment of non-financial assets

At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is an indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash- generating unit to which the assets belong.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing fair value less costs to sell, recent market transactions are taken into account. The Company also considers the results of an appropriate valuation model which would generally be determined based on the present value of estimated future cash flows arising from the continued use and eventual disposal of the asset. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre- tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in the statement of comprehensive income.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior periods.

3.18 Cash and cash equivalents

Cash and cash equivalents include cash at banks and short term money market instruments with original maturities of three months or less.

3.19 Revenue recognition

Revenue is recognized to the extent it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable, excluding discounts, rebates or duties. Revenue from the sale of goods is recognized when the significant risks and rewards of ownership pass to the buyer, collection is reasonably assured and the selling price is reasonably determinable.

Revenue from the sale of coal is recognized when the significant risks and rewards of ownership and effective control of the coal are transferred to the buyer and the selling prices are known or can be reasonably estimated. Revenue recognition occurs when the coal is loaded into customer trucks at mine-gate.

3.20 Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) that has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the obligation. The increase in the provision due to the passage of time is recognized as a finance cost.

3. Summary of significant accounting policies continued

3.21 Related party transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control; related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties.

3.22 Significant accounting judgments and estimates

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

In the determination of the Company's ability to meet its ongoing obligations and future contractual commitments, management relies on the Company's 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 key inputs used by the Company in this process include forecasted capital deployment, results from operations, results from the exploration and development of its properties and general industry conditions.

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. 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 (refer to Note 1).

If for any reason, the Company is unable to 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.

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. 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. The carrying value of the embedded derivatives in the Company's convertible debenture as at December 31, 2013 was a liability of $3,395 (December 31, 2012: $8,876).

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. Summary of significant accounting policies continued

3.22 Significant accounting judgments and estimates continued

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.

Dry coal handling facility

Refer to Note 16.3 for further analysis of the $66,325 impairment charge recorded on the dry coal handling facility ("DCHF") at the Ovoot Tolgoi Mine.

Prepaid toll washing fees

Refer to Note 15 for further analysis of the $30,152 impairment loss recorded on the prepaid toll washing fees which are part of the contract with Ejinaqi Jinda Coal Industry Co. Ltd ("Ejin Jinda").

Ovoot Tolgoi Mine cash generating unit

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 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 $416,559 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 coal FOB Australia, the calculated fair value of the cash generating unit increases/(decreases) by approximately $34,000/($34,000); and
- For each 1% increase/(decrease) in the discount rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately ($44,000)/$50,000.

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.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. Summary of significant accounting policies continued

3.22 Significant accounting judgments and estimates continued

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. The carrying value of the Company’s deferred income tax assets as at December 31, 2013 was $nil (December 31, 2012: $24,984).

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

4. Segmented information

The Company's one reportable operating segment is its Mongolian Coal Division. The Company's Chief Executive Officer (chief operating decision maker) reviews the Mongolian Coal Division's discrete financial information in order to make decisions about resources to be allocated to the segment and to assess its performance. The division is principally engaged in coal mining, development and exploration in Mongolia. The Company's Corporate Division does not earn revenues and therefore does not meet the definition of an operating segment.

During the year ended December 31, 2013, the Mongolian Coal Division had 6 active customers with the largest customer accounting for 52% of revenues, the second largest customer accounting for 17% of revenue, the third largest customer accounting for 16% of revenue and the other customers accounting for the remaining 15% of revenue.

The carrying amounts of the Company's assets, liabilities, reported income or loss and revenues analyzed by operating segment are as follows:

	Mongolian Coal Division	Unallocated[i]	Consolidated Total
Segment assets			
As at December 31, 2013	**$ 490,949**	**$ 15,257**	**$ 506,206**
As at December 31, 2012	676,981	55,471	732,452
Segment liabilities			
As at December 31, 2013	**$ 25,393**	**$ 105,756**	**$ 131,149**
As at December 31, 2012	19,496	108,973	128,469
Segment loss			
For the year ended December 31, 2013	**$ (199,248)**	**$ (38,216)**	**$ (237,464)**
For the year ended December 31, 2012	(84,992)	(12,510)	(97,502)
Segment revenues			
For the year ended December 31, 2013	**$ 58,636**	**$ –**	**$ 58,636**
For the year ended December 31, 2012	78,061	–	78,061
Impairment charge on assets [ii] [iii]			
For the year ended December 31, 2013	**$ 138,718**	**$ 3,067**	**$ 141,785**
For the year ended December 31, 2012	36,808	19,184	55,992

(i) The unallocated amount contains all amounts associated with the Corporate Division.

(ii) The impairment charge on assets for the year ended December 31, 2012 relates to trade and other receivables (Note 12), investments (Note 13), inventories (Note 14) and property, plant and equipment (Note 16).

(iii) The impairment charge on assets for the year ended December 31, 2013 relates to trade and other receivables (Note 12), investments (Note 13), inventories (Note 14), prepaid expenses and deposits (Note 15) and property, plant and equipment (Note 16).

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

4. Segmented information continued

The operations of the Company are primarily located in Mongolia, Hong Kong and Canada.

	Mongolia	Hong Kong	Canada	Consolidated Total
Revenues				
For the year ended December 31, 2013	**$ 58,636**	**$ –**	**$ –**	**$ 58,636**
For the year ended December 31, 2012	78,061	–	–	78,061
Non-current assets				
As at December 31, 2013	**$ 422,679**	**$ 81**	**$ 7,237**	**$ 429,997**
As at December 31, 2012	566,629	100	20,590	587,319

5. Cost of sales

The Company's cost of sales consists of the following amounts:

	Year ended December 31, 2013	2012
Operating expenses	**$ 41,746**	$ 39,671
Share-based compensation expense/(recovery) (Note 22)	**(293)**	1,205
Depreciation and depletion	**20,000**	13,042
Impairment of coal stockpile inventories (Note 14)	**20,735**	20,531
Cost of sales from mine operations	**82,188**	74,449
Cost of sales related to idled mine assets [(i)]	**30,439**	52,958
Cost of sales	**$ 112,627**	$ 127,407

(i) Cost of sales related to idled mine assets for the year ended December 31, 2013 includes $25,053 of depreciation expense (2012: includes $33,198 of depreciation expenses and $942 of share-based compensation expense). The depreciation expense relates to the Company's idled plant and equipment.

The Company curtailed its mining activities at the Ovoot Tolgoi Mine during the three months ended June 30, 2012 to varying degrees to manage coal inventories and to maintain efficient working capital levels. As at June 30, 2012, mining activities had been fully curtailed and remained curtailed for the remainder of 2012. The 2012 idled mine asset depreciation expense relates to the Company's idled plant and equipment during the curtailment of its mining activities. The Company's mining activities remained fully curtailed until March 22, 2013, when the Company recommenced mining activities at the Ovoot Tolgoi Mine. The 2013 idled mine asset depreciation expense relates to the Company's idled plant and equipment as the 2013 production plan did not fully utilize the Company's existing mining fleet.

6. Other operating expenses

The Company's other operating expenses consist of the following amounts:

	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 (Note 12)	**200**	1,032
Mark-to-market loss on available-for-sale financial asset (Note 13)	**3,067**	19,184
Loss on disposal of property, plant and equipment (Note 16)	**895**	720
Impairment of property, plant and equipment (Note 16)	**72,669**	15,245
Impairment of prepaid expenses and deposits (Note 15)	**30,152**	–
Impairment of materials and supplies inventories (Note 14)	**14,962**	–
Other	**2,194**	71
Other operating expenses	**$ 126,040**	$ 41,645

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

7. Administration expenses

The Company's administration expenses consist of the following amounts:

	Year ended December 31, 2013	2012
Corporate administration	**$ 3,269**	$ 5,525
Professional fees	**8,252**	7,293
Salaries and benefits	**3,748**	5,556
Share-based compensation expense (Note 22)	**167**	6,048
Depreciation	**193**	215
Administration expenses	**$ 15,629**	$ 24,637

8. Evaluation and exploration expenses

The Company's evaluation and exploration expenses consist of the following amounts:

	Year ended December 31, 2013	2012
Drilling and trenching	**$ 243**	$ 3,708
Other direct expenses	**84**	655
License fees	**657**	773
Share-based compensation expense (Note 22)	**21**	333
Overhead and other	**164**	3,129
Evaluation and exploration expenses	**$ 1,169**	$ 8,598

9. Finance costs and income

The Company's finance costs consist of the following amounts:

	Year ended December 31, 2013	2012
Interest expense on convertible debenture (Note 19)	**$ 20,290**	$ 10,466
Unrealized loss on FVTPL investments	**656**	4,482
Interest expense on line of credit facility	**11**	322
Realized loss on disposal of FVTPL investments (Note 13)	**91**	–
Accretion of decommissioning liability (Note 20)	**114**	115
Finance costs	**$ 21,162**	$ 15,385

The Company's finance income consists of the following amounts:

	Year ended December 31, 2013	2012
Unrealized gain on embedded derivatives in convertible debenture (Note 19)	**$ 5,481**	$ 39,512
Interest income	**85**	406
Realized gain on disposal of FVTPL investments	**–**	24
Finance income	**$ 5,566**	$ 39,942

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

10. Taxes

10.1 Income tax recognized in profit or loss

A reconciliation between the Company's tax expense/(recovery) and the product of the Company's loss before tax multiplied by the Company's domestic tax rate is as follows:

	Year ended December 31,	
	2013	2012
Loss before tax	**$ 212,478**	$ 99,034
Statutory tax rate	**25.75%**	25.00%
Income tax recovery based on combined Canadian federal and provincial statutory rates	**(54,713)**	(24,759)
Deduct:		
Lower effective tax rate in foreign jurisdictions	**1,467**	323
Tax effect of tax losses and temporary differences not recognized	**59,878**	15,563
Non-deductible expenses	**18,354**	7,341
Income tax expenses/(recovery)	**$ 24,986**	$ (1,532)

10.2 Income tax recognized in other comprehensive income

	Year ended December 31,	
	2013	2012
Fair value remeasurement of available-for-sale financial asset	**$ –**	$ (2,366)
Deferred tax recovery	**$ –**	$ (2,366)

10.3 Deferred tax balances

The Company's deferred tax assets consist of the following amounts:

	As at December 31,	
	2013	2012
Tax loss carryforwards	**$ 332**	$ 8,473
Property, plant and equipment	**–**	5,048
Other assets	**(332)**	11,463
Total deferred tax balances	**$ –**	$ 24,984

(i) Deferred income tax expense for the year ended December 31 2013 includes a $17,487 expense related to the derecognition of deferred tax assets (2012: $nil).

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

10. Taxes continued

10.4 Unrecognized deductible temporary differences and unused tax losses

The Company's deductible temporary differences and unused tax losses for which no deferred tax asset is recognized consist of the following amounts:

	As at December 31, 2013	2012
Non-capital losses	**$ 136,185**	$ 46,130
Capital losses	**2,676**	–
Deductible temporary differences	**257,016**	103,589
Total unrecognized amounts	**$ 395,877**	$ 149,719

10.5 Expiry dates

The expiry dates of the Company's unused tax losses are as follows:

	As at December 31, 2013 U.S. Dollar Equivalent	Expiry dates
Non-capital losses		
Canada	**$ 65,494**	2032 – 2033
Mongolia	**57,890**	2016 – 2017
Hong Kong	**13,990**	indefinite
Singapore	**137**	indefinite
	$ 137,511	
Capital losses		
Canada	**2,676**	indefinite

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

11. Loss per share

The calculation of basic loss and diluted loss per share is based on the following data:

	Year ended December 31, 2013	2012
Net loss	$ **(237,464)**	$ (97,502)
Weighted average number of shares	**182,883**	181,859
Basic loss per share	$ **(1.30)**	$ (0.54)
Loss		
Net loss	$ **(237,464)**	$ (97,502)
Interest expense on convertible debenture	**–**	10,466
Unrealized gain on embedded derivatives in convertible debenture	**–**	(39,512)
Diluted net loss	$ **(237,464)**	$ (126,548)
Number of shares		
Weighted average number of shares	**182,883**	181,859
Convertible debenture (i)	**–**	28,406
Diluted weighted average number of shares	**182,883**	210,265
Diluted loss per share	$ **(1.30)**	$ (0.60)

(i) The convertible debenture was anti-dilutive for the year ended December 31, 2013

Potentially dilutive items not included in the calculation of diluted loss per share for the year ended December 31, 2013 were 2,583 stock options that were anti-dilutive.

12. Trade and other receivables

The Company's trade and other receivables consist of the following amounts:

	As at December 31, 2013	2012
Trade receivables	$ **1,818**	$ 1,439
Other receivables	**760**	1,853
Total trade and other receivables	$ **2,578**	$ 3,292

The aging of the Company's trade and other receivables is as follows:

	As at December 31, 2013	2012
Less than 1 month	$ **396**	$ 2,376
1 to 3 months	**1,321**	95
3 to 6 months	**141**	159
Over 6 months	**720**	662
Total trade and other receivables	$ **2,578**	$ 3,292

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

12. Trade and other receivables continued

Included in trade and other receivables are amounts due from related parties which are further disclosed in Note 26. The amounts due from related parties are unsecured, interest free and repayable upon written notice from the Company.

Trade receivables are normally due within 30 days from the date of billing. Customers with balances that are more than 30 days past due are normally requested to settle all outstanding balances before any further credit is granted.

For the year ended December 31, 2013, the Company recorded a $200 loss provision on its trade and other receivables in other operating expenses (2012: $1,032). The loss provisions relate to a reduction in expected insurance proceeds. The Company anticipates full recovery of its remaining outstanding trade and other receivables; therefore, no further loss provisions have been recorded in respect of the Company's trade and other receivables. As at December 31, 2013, amounts past due for which a loss provision is not recorded are $2,182 (2012: $916). These amounts are included in the following aging categories: 1 to 3 months, 3 to 6 months and over 6 months.

13. Investments

The Company's investments consist of the following amounts:

	As at December 31, 2013	2012
Current investments at fair value		
Money market investments	**$ –**	$ 15,000
Non-current investments at fair value		
Investment in Kangaroo Resources Limited (i)	**222**	1,455
Investment in Aspire Mining Limited (ii)	**6,175**	8,727
Non-current investment in joint venture		
Investment in RDCC LLC	**24,205**	13,902
	30,602	24,084
Total investments	**$ 30,602**	$ 39,084

(i) At December 31, 2013, the Company owned 0.5% of Kangaroo's issued and outstanding shares.

(ii) At December 31, 2013, the Company owned 18.8% of Aspire's issued and outstanding shares.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

13. Investments continued

13.1 Investment in Kangaroo Resources Limited

Kangaroo Resources Limited ("Kangaroo") is a company listed on the Australian Securities Exchange. Kangaroo's primary focus is its coal projects in Indonesia. The Company classifies its investment in Kangaroo as a FVTPL financial asset with any change in value being recognized in profit or loss. During the year ended December 31, 2013, the Company disposed of 22,236 shares of Kangaroo for gross proceeds of $486 and realized a loss of $91. For the year ended December 31, 2013, the Company recognized an unrealized mark to market loss of $656 related to its investment in Kangaroo (2012: loss of $4,515).

13.2 Investment in Aspire Mining Limited

Aspire Mining Limited ("Aspire") is a company listed on the Australian Securities Exchange. Aspire's primary focus is its mineral exploration and mining licenses in Mongolia, particularly those pertaining to the Ovoot Coking Coal Project. The Company classifies its investment in Aspire as an available-for-sale financial asset.

During the year ended December 31, 2012, it was determined that objective evidence of impairment in the Company's investment in Aspire existed and such evidence continued to exist during the year ended December 31, 2013. Therefore, an impairment loss of $3,067 was recognized for the year ended December 31, 2013 in other operating expenses (2012: loss of $19,184). The impairment loss represents the difference between the acquisition cost of the Company's investment in Aspire and its fair market value at December 31, 2013.

13.3 Investment in RDCC LLC

The Company has a 40% interest in RDCC LLC, a joint venture. RDCC LLC has signed a concession agreement with the State Property Committee of Mongolia to construct a paved highway from the Company's Ovoot Tolgoi Mine to the Mongolia-China border. The concession agreement is structured as a 17-year build, operate and transfer agreement.

RDCC LLC accounts for the concession agreement in accordance with IFRIC 12 "Service Concession Arrangements" under the intangible asset model. In accordance with IFRIC 12, infrastructure associated with the concession agreement is recorded by RDCC LLC as an intangible asset. Construction revenue is recognized during the construction phase of the concession agreement as an exchange of construction services for the intangible asset and toll revenue is recognized during the operational phase of the concession agreement.

The movement of the Company's investment in RDCC LLC is as follows:

	Year ended December 31,	
	2013	2012
Balance, beginning of year	**$ 13,902**	$ 3
Funds advanced	**10,356**	13,264
Share of earnings/(losses) of joint venture	**(53)**	635
Balance, end of year	**$ 24,205**	$ 13,902

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

13. Investments continued

13.3 Investment in RDCC LLC continued

Summarized financial statement information of RDCC LLC is as follows:

	As at December 31,	
	2013	2012
Current assets	**$ 3,254**	$ 1,850
Non-current assets	**37,292**	20,075
Total assets	**$ 40,546**	$ 21,925
Current liabilities	**$ 1**	$ 97
Total liabilities	**$ 1**	$ 97

	Year ended December 31,	
	2013	2012
Construction revenue	**$ 21,219**	$ 20,203
Gross profit margin	**12**	1,837
Other operating and finance costs	**(144)**	(248)
Income/(loss) before tax	**(133)**	1,588
Net income/(loss)	**$ (133)**	$ 1,588

14. Inventories

The Company's inventories consist of the following amounts:

	As at December 31,	
	2013	2012
Coal stockpiles	**$ 8,305**	$ 16,048
Materials and supplies	**31,983**	43,687
Total inventories	**$ 40,288**	$ 59,735

Cost of sales for the year ended December 31, 2013 includes an impairment loss of $20,735 related to the Company's coal stockpile inventories (2012: $20,531). As at December 31, 2013, $4,853 of the Company's coal stockpile inventories are carried at their net realizable value (2012: $7,858).

Other operating expenses for the year ended December 31, 2013 includes an impairment loss of $14,962 related to surplus materials and supplies inventories. These items are not expected to be utilized with the Company's existing mining fleet and, therefore, were adjusted to their net realizable value during the year ended December 31, 2013.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

15. Prepaid expenses and deposits

The Company's prepaid expenses and deposits consist of the following amounts:

	As at December 31, 2013	2012
Vendor prepayments	**$ 6,044**	$ 11,628
Ejin Jinda toll coal washing prepayment	**3,405**	16,778
Other prepaid expenses and deposits	**2,057**	19,026
Total short term prepaid expenses and deposits	**11,506**	47,432
Ejin Jinda toll coal washing prepayment	**–**	16,778
Total short and long term prepaid expenses and deposits	**$ 11,506**	$ 64,210

15.1 Ejin Jinda toll coal washing prepayment

During the year ended December 31, 2011, the Company entered into an agreement with Ejin Jinda, a subsidiary of China Mongolia Coal Co. Ltd., to toll wash coal from the Ovoot Tolgoi Mine. The agreement has a duration of 5-years from commencement and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input raw coal.

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 $30,152 impairment loss on the $33,556 of prepaid toll washing fees was recorded in other operating expenses during the year ended December 31, 2013.

16. Property, plant and equipment

The Company's property, plant and equipment consist of the following amounts:

	Mobile equipment	Other operating equipment	Buildings and roads	Mineral properties	Construction in progress	Total
Cost						
As at December 31, 2012	$ 366,159	$ 28,043	$ 69,922	$ 116,084	$ 55,912	$ 636,120
Additions	**1,162**	**266**	**2,129**	**10,984**	**122**	**14,663**
Disposals	**(3,632)**	**(507)**	**-**	**-**	**-**	**(4,139)**
Reclassifications	**-**	**548**	**163**	**-**	**(711)**	**-**
As at December 31, 2013	**$ 363,689**	**$ 28,350**	**$ 72,214**	**$ 127,068**	**$ 55,323**	**$ 646,644**
Accumulated depreciation and impairment charges						
As at December 31, 2012	$ (93,519)	$ (7,359)	$ (9,299)	$ (4,470)	$ -	$ (114,647)
Charge for the year	**(39,908)**	**(4,581)**	**(6,565)**	**(10,420)**	**-**	**(61,474)**
Impairment charges	**(6,267)**	**(5,765)**	**(11,590)**	**-**	**(49,047)**	**(72,669)**
Eliminated on disposals	**1,067**	**474**	**-**	**-**	**-**	**1,541**
As at December 31, 2013	**$ (138,627)**	**$ (17,231)**	**$ (27,454)**	**$ (14,890)**	**$ (49,047)**	**$ (247,249)**
Carrying amount						
As at December 31, 2012	$ 272,640	$ 20,684	$ 60,623	$ 111,614	$ 55,912	$ 521,473
As at December 31, 2013	**$ 225,062**	**$ 11,119**	**$ 44,760**	**$ 112,178**	**$ 6,276**	**$ 399,395**

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

16. Property, plant and equipment continued

		Mobile equipment		Other operating equipment		Buildings and roads		Mineral properties		Construction in progress		Total
Cost												
As at December 31, 2011	$	333,245	$	10,253	$	31,155	$	94,641	$	82,569	$	551,863
Additions		46,375		1,677		2,844		20,215		29,022		100,133
Disposals		(13,461)		(1,279)		(10)		–		–		(14,750)
Reclassifications		–		17,392		35,933		1,228		(54,553)		–
As at December 31, 2012	$	366,159	$	28,043	$	69,922	$	116,084	$	57,038	$	637,246
Accumulated depreciation and impairment charges												
As at December 31, 2011	$	(41,498)	$	(3,465)	$	(4,631)	$	(3,736)	$	–	$	(53,330)
Charge for the year		(39,509)		(4,873)		(4,677)		(734)		–		(49,793)
Impairment charges		(14,119)		–		–		–		(1,126)		(15,245)
Eliminated on disposals		1,607		979		9		–		–		2,595
As at December 31, 2012	$	(93,519)	$	(7,359)	$	(9,299)	$	(4,470)	$	(1,126)	$	(115,773)
Carrying amount												
As at December 31, 2011	$	291,747	$	6,788	$	26,524	$	90,905	$	82,569	$	498,533
As at December 31, 2012	$	272,640	$	20,684	$	60,623	$	111,614	$	55,912	$	521,473

16.1 Borrowing costs

For the year ended December 31, 2013, the Company did not capitalize borrowing costs into construction in progress as the Company suspended active development of its qualifying assets (2012: $9,628).

16.2 Prepayments on property, plant and equipment

As at December 31, 2013, the cost of the Company's property, plant and equipment includes $41,240 of prepayments to vendors (December 31, 2012: $81,370). The prepayments primarily relate to ordered but not yet delivered mobile equipment or mobile equipment delivered to the location of its intended use but not yet commissioned.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

16. Property, plant and equipment continued

16.3 Impairment charges

For the year ended December 31, 2013, the Company recorded $72,669 of impairment charges to reduce various items of property, plant and equipment to their recoverable amounts. The impairments relate to the following items of property, plant and equipment:

- DCHF – 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 $66,325 impairment charge 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 Company has assessed, using updated 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 in the foreseeable future. Subsequent to the impairment charge, the DCHF has a carrying value of $11,200 at December 31, 2013 (December 31, 2012: $80,458).
- Surplus capital spares – the Company recorded an impairment provision of $6,344 related to surplus capital spares not expected to be utilized with the Company's existing mining fleet.

For the year ended December 31, 2012, the Company recorded $15,245 of impairment charges to reduce various items of mobile equipment and construction in progress to their recoverable amounts.

17. Trade and other payables

Trade and other payables of the Company primarily consists of amounts outstanding for trade purchases relating to coal mining, development and exploration activities and mining royalties payable. The usual credit period taken for trade purchases is between 30 to 90 days.

The aging of the Company's trade and other payables is as follows:

	As at December 31,	
	2013	2012
Less than 1 month	**$ 28,786**	$ 8,999
1 to 3 months	**554**	176
3 to 6 months	**367**	–
Over 6 months	**1,534**	1,041
Total trade and other payables	**$ 31,241**	$ 10,216

Included in trade and other payables are amounts due to related parties which are further disclosed in Note 26.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

18. Line of credit facility

As at December 31, 2012, the Company had a twelve month revolving line of credit facility with Golomt Bank in Mongolia. The maximum draw-down available was $3,500 and 8.1 billion Mongolian Tugriks (approximately $5,800) and the line of credit incurred interest at 11% for any U.S. Dollar amounts outstanding and 12% for any Mongolian Tugrik amounts outstanding. The line of credit was secured by operating equipment in Mongolia to a value of not less than 150% of the total facility amount.

The line of credit facility was used by the Company's Mongolian Coal Division as part of its working capital management. The line of credit facility expired on January 19, 2013 and was not renewed.

19. Convertible debenture

19.1 Key commercial terms

On November 19, 2009, the Company issued a convertible debenture to a wholly owned subsidiary of CIC for $500,000.

The Company had the right to call for the conversion of up to $250,000 of the debenture on the earlier of twenty four months after the issue date, if the conversion price was greater than Cdn$10.66, or upon the Company achieving a public float of 25% of its common shares under certain agreed circumstances, if the conversion price was greater than Cdn$10.66. On March 29, 2010, pursuant to the debenture conversion terms, the Company exercised this conversion right and completed the conversion of $250,000 of the convertible debenture into 21,471 shares at a conversion price of $11.64 (Cdn$11.88).

The key commercial terms of the financing include:

- Interest - 8% per annum (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's common shares, where the number of shares to be issued is calculated based on the 50-day volume-weighted average price ("VWAP")).
- Term - Maximum of 30 years.
- Security - First charge over the Company's assets, including shares of its material subsidiaries. An event of default on the convertible debenture can be triggered as a result of certain encumbrances on the Company's assets (Note 29.3).
- Conversion price - The conversion price is set as the lower of Cdn$11.88 or the 50-day VWAP at the date of conversion, with a floor price of Cdn$8.88 per share.
- CIC's conversion right - CIC has the right to convert the convertible debenture, in whole or in part, into common shares twelve months after the date of issue.
- Company's normal conversion right – After sixty months from the issuance date, and when the conversion price is greater than Cdn$10.66, the Company is entitled to force conversion of the outstanding convertible debenture, in whole or in part, into common shares at the conversion price.
- Representation on the Company's Board - While the convertible debenture is outstanding, or while CIC has a minimum 15% direct or indirect stake in the Company, CIC has the right to nominate one director to the Company's Board of Directors. The Company currently has nine Board of Directors members of which none were elected by CIC.
- Voting restriction - CIC has agreed that it will not have any voting rights in the Company beyond 29.9% if CIC ever acquires ownership of such a shareholder stake.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

19. Convertible debenture continued

19.1 Key commercial terms continued

- Pre-emption rights - While the convertible debenture is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has certain pre-emption rights on a pro-rata basis to subscribe for any new shares to be allotted and issued by the Company for the period which the convertible debenture is outstanding. The pre-emption rights will not apply to new shares issued pursuant to pro-rata public equity offerings made to all shareholders, exercise of stock options and shares issued to achieve a 25% public float.

- Right of first offer - While a portion of the convertible debenture is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has the right of first offer for any direct and indirect sale of Turquoise Hill's ownership stake in the Company. At December 31, 2013, Turquoise Hill owned directly and indirectly approximately 56% of the Company's issued and outstanding shares.

- Registration rights - CIC has registration rights under applicable Canadian provincial securities laws in connection with the common shares issuable upon conversion of the convertible debenture.

19.2 Debt host and embedded derivatives

The convertible debenture is presented as a liability since it contains no equity components. The convertible debenture is a hybrid instrument, containing a debt host component and three embedded derivatives – the investor's conversion option, the issuer's conversion option and the equity based interest payment provision (the 1.6% share interest payment) (the "embedded derivatives"). The debt host component is classified as other-financial-liabilities and is measured at amortized cost using the effective interest rate method and the embedded derivatives are classified as FVTPL and all changes in fair value are recorded in profit or loss. The difference between the debt host component and the principal amount of the loan outstanding is accreted to profit or loss over the expected life of the convertible debenture.

The embedded derivatives were valued upon initial measurement and subsequent periods 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. Some of the key inputs used by the Company in its Monte Carlo simulation include: the floor and ceiling conversion prices, the Company's common share price, the risk-free rate of return, expected volatility of the Company's common share price, forward foreign exchange rate curves (between the Cdn$ and U.S. Dollar) and spot foreign exchange rates.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

19. Convertible debenture continued

19.3 Valuation assumptions

The assumptions used in the Company's valuation models are as follows:

	As at December 31, 2013	2012
Floor conversion price	**Cdn$8.88**	Cdn$8.88
Ceiling conversion price	**Cdn$11.88**	Cdn$11.88
Common share price	**Cdn$0.84**	Cdn$2.05
Historical volatility	**71%**	70%
Risk free rate of return	**3.11%**	2.26%
Foreign exchange spot rate (Cdn$ to U.S. Dollar)	**0.94**	1.01
Forward foreign exchange rate curve (Cdn$ to U.S. Dollar)	**0.92 – 0.94**	0.96 – 1.01

19.4 Presentation

Based on the Company's valuation as at December 31, 2013, the fair value of the embedded derivatives decreased by $5,481 compared to December 31, 2012. The decrease was recorded as finance income for the year ended December 31, 2013.

For the year ended December 31, 2013, the Company recorded interest expense of $20,290 related to the convertible debenture as a finance cost (2012: the Company recorded interest expenses of $20,094 related to the convertible debenture of which $9,628 was capitalized as borrowing costs and the remaining $10,466 was recorded as a finance cost). The interest expense consists of the interest at the contract rate and the accretion of the debt host component of the convertible debenture. To calculate the accretion expense, the Company uses the contract life of 30 years and an effective interest rate of 22.2%.

The movements of the amounts due under the convertible debenture are as follows:

	Year ended December 31, 2013	2012
Balance, beginning of year	**$ 105,968**	$ 145,386
Interest expense on convertible debenture	**20,290**	20,094
Decrease in fair value of embedded derivatives	**(5,481)**	(39,512)
Interest paid	**(24,174)**	(20,000)
Balance, end of year	**$ 96,603**	$ 105,968

The convertible debenture balance consists of the following amounts:

	As at December 31, 2013	2012
Current convertible debenture		
Interest payable	**$ 2,301**	6,301
Non-current convertible debenture		
Debt host	**90,907**	$ 90,791
Fair value of embedded derivatives	**3,395**	8,876
	94,302	99,667
Total convertible debenture	**$ 96,603**	$ 105,968

19. Convertible debenture continued

19.5 Convertible debenture share interest payment and application of Mongolian Foreign Investment Law

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 included 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, during the three months ended March 31, 2013, the Company settled the 1.6% share interest payment of $4,000 in cash.

Following amendments to the Foreign Strategic Sectors Law, passed in the three months ended June 30, 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.

On September 19, 2013, the Company issued 1,846 common shares to the CIC (Note 19.6). On November 21, 2013, the Company issued 3,463 common shares to settle the $4,000 November 19, 2013 share interest payment. The number of common shares was based on the 50-day volume-weighted average share price on November 19, 2013 of Cdn$1.21.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

19. Convertible debenture continued

19.6 Interest deferral and settlement

During the three months ended June 30, 2013, the Company and the CIC mutually agreed upon a three month deferral of the convertible debenture semi-annual $7,934 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 $7,934 amount, plus additional accrued interest of $173, as follows:

- the Company issued 1,846 common 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 $4,000 in cash already paid by the Company in the three months ended March 31, 2013 for the November 19, 2012 share interest payment against the amount due on September 19, 2013; and
- the Company paid the remaining $4,107 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.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

20. Decommissioning liability

At December 31, 2013, the decommissioning liability primarily relates to reclamation and closure costs of the Company's Ovoot Tolgoi Mine.

The Ovoot Tolgoi Mine decommissioning liability is calculated as the net present value of the estimated future reclamation and closure costs, which at December 31, 2013 totaled $6,286 (2012: $23,577). The estimated future reclamation and closure costs are discounted at 9.6% per annum (2012: 9.6% per annum) to determine the year end decommissioning liability. The settlement of the decommissioning liability will occur through to 2031.

The movement in the decommissioning liability during the years ended December 31, 2013 and 2012 were as follows:

	Year ended December 31, 2013	2012
Balance, beginning of year	**$ 4,104**	$ 4,156
Adjustments	**(1,910)**	(167)
Accretion	**114**	115
Balance, end of year	**$ 2,308**	$ 4,104

21. Equity

21.1 Share capital

The Company has authorized an unlimited number of common and preferred shares with no par value. At December 31, 2013, the Company had 187,309 common shares outstanding (December 31, 2012: 181,928) and no preferred shares outstanding (December 31, 2012: nil).

During the year ended December 31, 2012, the Company repurchased 148 common shares 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 shares. No additional common shares were repurchased by the Company during the year ended December 31, 2013.

The Company's volume weighted average share price for the year ended December 31, 2013 was Cdn$1.26 (2012: Cdn$5.45).

21.2 Accumulated deficit and dividends

At December 31, 2013, the Company has accumulated a deficit of $744,494 (December 31, 2012: $507,030). No dividends have been paid or declared by the Company since inception.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

22. Share-based payments

22.1 Stock option plan

The Company has a stock option plan which permits the Board of Directors of the Company to grant options to acquire common shares of the Company at the volume weighted average closing price for the five days preceding the date of grant. The Company is authorized to issue stock options for a maximum of 10% of the issued and outstanding common shares pursuant to the stock option plan. The stock option plan permits the Board of Directors of the Company to set the terms for each stock option grant; however, the general terms of stock options granted under the plan include a maximum exercise period of 5 years and a vesting period of 3 years with 33% of the grant vesting on the first anniversary of the grant, 33% vesting on the second anniversary of the grant and 34% vesting on the third anniversary of the grant.

For the year ended December 31, 2013, the Company granted 282 stock options (2012: 2,066) to officers, employees, directors and other eligible persons at exercise prices ranging from Cdn$1.16 to Cdn$2.10 (2012: exercise prices ranging from Cdn$1.92 to Cdn$6.16) and expiry dates ranging from March 27, 2018 to August 14, 2018 (2012: expiry dates ranging from March 21, 2017 to December 6, 2017). The weighted average fair value of the options granted in the year ended December 31, 2013 was estimated at $0.60 (Cdn$0.62) (2012: $2.28, Cdn$2.26) per option at the grant date using the Black-Scholes option pricing model.

The weighted average assumptions used for the Black-Scholes option pricing model were as follows:

	Year ended December 31,	
	2013	2012
Risk free interest rate	**1.56%**	1.51%
Expected life	**3.4 years**	3.4 years
Expected volatility (i)	**56%**	59%
Expected dividend per share	**$nil**	$nil

(i) Expected volatility has been calculated based on historical volatility of the Company's publicly traded shares over a period equal to the expected life of the options.

A share-based compensation expense of $151 for the options granted in the year ended December 31, 2013 (2012: $4,383) will be amortized over the vesting period, of which $58 was recognized in the year ended December 31, 2013 (2012: $1,905).

The total share-based compensation recovery for the year ended December 31, 2013 was $105 (2012: share-based compensation expense of $8,528). Share-based compensation expense of $167 (2012: $6,048) has been allocated to administration expenses and $21 (2012: $333) has been allocated to evaluation and exploration expenses. A share-based compensation recovery of $293 (2012: share-based compensation expense of $2,147) has been allocated to cost of sales.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

22. Share-based payments continued

22.2 Outstanding stock options

The option transactions under the stock option plan are as follows:

	Year ended December 31, 2013		Year ended December, 2012	
	Number of options	**Weighted average exercise price (Cdn$)**	Number of options	Weighted average exercise price (Cdn$)
Balance, beginning of year	**7,507**	**$ 9.72**	10,768	$ 10.73
Options granted	**282**	**1.37**	2,066	4.95
Options excercised	**–**	**–**	(433)	5.81
Options forfeited	**(807)**	**6.91**	(2,099)	9.92
Options expired	**(4,399)**	**10.42**	(2,795)	10.53
Balance, end of year	**2,583**	**$ 8.48**	7,507	$ 9.72

The stock options outstanding and exercisable as at December 31, 2013 are as follows:

	Options Outstanding			**Options Exercisable**		
Exercise price (Cdn$)	**Options outstanding**	**Weighted average exercise price (Cdn$)**	**Weighted average remaining contractual life (years)**	**Options outstanding and exercise**	**Weighted average exercise price (Cdn$)**	**Weighted average remaining contractual life (years)**
$1.16 – $2.10	**658**	**$ 1.68**	**4.19**	**230**	**$ 1.92**	**3.93**
$5.10 – $10.21	**840**	**8.43**	**2.63**	**651**	**8.72**	**2.52**
$11.51 – $14.25	**1,085**	**12.65**	**1.41**	**1,069**	**12.67**	**1.39**
	2,583	**$ 8.48**	**2.52**	**1,950**	**$ 10.08**	**2.07**

23. Reserves

23.1 Share option reserve

The Company's share option reserve relates to stock options granted by the Company to officers, employees, directors and other eligible persons under its stock option plan. Details about the Company's share-based payments are further disclosed in Note 22.

The share option reserve transactions for the years ended December 31, 2013 and 2012 are as follows:

	Year ended December 31,	
	2013	2012
Balance, beginning of year	**$ 51,303**	$ 44,143
Share-based compensation charged/(credited) to operations	**(105)**	8,528
Exercise of share options	**–**	(1,368)
Balance, end of year	**$ 51,198**	$ 51,303

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

23. Reserves continued

23.2 Investment revaluation reserve

The Company's investment revaluation reserve represents the cumulative gains and losses arising on the revaluation of available-for-sale financial assets that have been recognized in other comprehensive income.

The investment revaluation reserve transactions for the years ended December 31, 2013 and 2012 are as follows:

	Year ended December 31, 2013	2012
Balance, beginning of year	**$ –**	$ 16,559
Loss arising on revaluation of available-for-sale financial assets	**(2,553)**	(35,034)
Deferred income tax relating to revaluation of available-for-sale financial assets	**–**	2,366
Reclassification of impairment loss on available-for-sale financial asset	**3,067**	16,109
Balance, end of year	**$ 514**	$ –

24. Capital risk management

The Company's capital risk management objectives are to safeguard the Company's ability to continue as a going concern in order to support the Company's normal operating requirements, continue the development and exploration of its mineral properties and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk.

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may issue new shares, acquire previously issued shares, issue new debt, acquire or dispose of assets or adjust the amount of cash and cash equivalents. In order to facilitate the management of its capital requirements, the Company prepares annual expenditure budgets that are updated as necessary depending on various factors, including capital deployment, results from operations, results from the exploration and development of its properties and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

At December 31, 2013, the Company's capital structure consists of convertible debt (Note 19) and the equity of the Company (Note 21). The Company is not subject to any externally imposed capital requirements. In order to maximize ongoing development efforts, the Company does not pay dividends.

For the year ended December 31, 2013, there were no significant changes in the processes used by the Company or in the Company's objectives and policies for managing its capital. As at December 31, 2013, the Company had cash of $21,837 and working capital of $41,670.

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 (Note 1).

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

25. Financial instruments and fair value measurements

25.1 Categories of financial instruments

The Company's financial assets and financial liabilities are categorized as follows:

	As at December 31, 2013	2012
Financial assets		
Loans-and-receivables		
Cash	**$ 21,837**	$ 19,674
Trade and other receivables (Note 12)	**2,578**	3,292
Available-for-sale		
Investment in Aspire (Note 13)	**6,175**	8,727
Fair value through profit or loss		
Investment in Kangaroo (Note 13)	**222**	1,455
Money market investments (Note 13)	**–**	15,000
Total financial assets	**$ 30,812**	$ 48,148
Financial liabilities		
Fair value through profit or loss		
Convertible debenture – embedded derivatives (Note 19)	**$ 3,395**	$ 8,876
Other-financial-liabilities		
Trade and other payables (Note 17)	**31,241**	10,216
Convertible debenture – debt host (Note 19)	**93,208**	97,092
Total financial liabilities	**$ 127,844**	$ 116,184

25.2 Fair value

The fair value of financial assets and financial liabilities measured 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 measured at amortized cost approximates their fair value.

The fair values of the Company's financial instruments classified as FVTPL or available-for-sale are determined as follows:

- The fair value 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, shares of Aspire and its money market investments are determined using this methodology.

- The fair value of financial instruments that are not traded in an active market are determined using generally accepted valuation models using inputs that are directly (i.e. prices) or indirectly (i.e. derived from prices) observable. The fair value of the embedded derivatives within the convertible debenture (Note 19) is determined using a Monte Carlo simulation. None of the fair value change in the embedded derivatives for the year ended December 31, 2013 is related to a change in the credit risk of the convertible debenture. All of the change in fair value is associated with changes in market conditions.

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.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

25. Financial instruments and fair value measurements continued

25.2 Fair value continued

The following table provides an analysis of the Company's financial instruments that are measured subsequent to initial recognition at fair value, grouped into Level 1 to 3 based on the degree to which the inputs used to determine the fair value are observable.

- Level 1 fair value measurements are those derived from quoted prices in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1, that are observable either directly or indirectly.
- Level 3 fair value measurements are those derived from valuation techniques that include inputs that are not based on observable market data. As at December 31, 2013 and 2012, the Company did not have any Level 3 financial instruments.

	As at December 31, 2013			
Recurring measurements	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets at fair value				
Investment in Aspire	**$ 6,175**	**$ –**	**$ –**	**$ 6,175**
Investment in Kangaroo	**222**	**–**	**–**	**222**
Total financial assets at fair value	**$ 6,397**	**$ –**	**$ –**	**$ 6,397**
Financial liabilities at fair value				
Convertible debenture - embedded derivatives	**$ –**	**$ 3,395**	**$ –**	**$ 3,395**
Total financial liabilities at fair value	**$ –**	**$ 3,395**	**$ –**	**$ 3,395**
Non-recurring measurements				
Assets at fair value				
Inventories	**$ –**	**$ –**	**$ 4,853**	**$ 4,853**
Total assets at fair value	**$ –**	**$ –**	**$ 4,853**	**$ 4,853**

	As at December 31, 2012			
Recurring measurements	Level 1	Level 2	Level 3	Total
Financial assets at fair value				
Investment in Aspire	$ 8,727	$ –	$ –	$ 8,727
Investment in Kangaroo	1,455	–	–	1,455
Money market investments	15,000	–	–	15,000
Total financial assets at fair value	$ 25,182	$ –	$ –	$ 25,182
Financial liabilities at fair value				
Convertible debenture - embedded derivatives	$ –	$ 8,876	$ –	$ 8,876
Total financial liabilities at fair value	$ –	$ 8,876	$ –	$ 8,876
Non-recurring measurements				
Assets at fair value				
Inventories	$ –	$ –	$ 7,858	$ 7,858
Total assets at fair value	$ –	$ –	$ 7,858	$ 7,858

At December 31, 2013, certain coal stockpile inventories were written down to their net realizable value of $4,853 (December 31, 2012: $7,858). The net realizable value has become the carrying value and will not be revalued. Certain assumptions used in the calculation of the net realizable value are categorized as Level 3 in the fair value hierarchy.

There were no transfers between Level 1, 2 and 3 for the year ended December 31, 2013.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

25. Financial instruments and fair value measurements continued

25.3 Financial risk management objectives and policies

The financial risk arising from the Company's operations are currency risk, interest rate risk, credit risk, liquidity risk and commodity price risk. These risks arise from the normal course of operations and all transactions undertaken are to support the Company's ability to continue as a going concern. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. Management of the Company manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

Currency risk

The Company is exposed to foreign currency risk on its sales or purchases in currencies other than the U.S. Dollar. The Company manages this risk by matching receipts and payments in the same currency and through monitoring.

The sensitivity of the Company's comprehensive income due to changes in the carrying values of monetary assets and liabilities denominated in foreign currencies is as follows. A positive number indicates an increase in comprehensive income, whereas a negative number indicates a decrease in comprehensive income.

	As at December 31,	
	2013	2012
Increase/decrease in foreign exchange rate		
+5%	**$ 59**	$ 177
–5%	**$ (59)**	$ (177)

Interest rate risk

The Company is exposed to interest rate risk on the variable rate of interest earned on its cash. However, the rate of interest earned on these instruments is below 3%; therefore, the interest rate risk is not significant.

The Company's convertible debenture (Note 19) accrues interest at fixed rates; therefore the Company is not exposed to interest rate risk on this instrument.

Credit risk

The Company is exposed to credit risk associated with its cash and trade and other receivables. The Company's maximum exposure to credit risk is equal to the carrying amount of these instruments.

The Company's credit risk on cash arises from default of the counterparty. The Company limits its exposure to counterparty credit risk on cash by only dealing with financial institutions with high credit ratings.

The Company seeks to manage its credit risk on trade and other receivables by trading with third party customers it considers to be creditworthy. It is the Company's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, the trade and other receivables balances are monitored on an ongoing basis and, if appropriate, the Company records provisions for uncollectible trade and other receivables.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

25. Financial instruments and fair value measurements continued

25.3 Financial risk management objectives and policies continued

Liquidity risk

Liquidity risk is the risk that the Company will not be able to settle or manage its obligations associated with financial liabilities. 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 (Note 1).

The Company's current and expected remaining contractual maturities for its financial liabilities with agreed repayment periods are as follows. The table includes the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to satisfy the liabilities.

	0 to 6 months	6 to 12 months	Total
As at December 31, 2013			
Trade and other payables	**$ 31,241**	**$ –**	**$ 31,241**
Convertible debenture - cash interest (Note 19) [(i)]	**8,000**	**8,000**	**16,000**
	$ 39,241	**$ 8,000**	**$ 47,241**
As at December 31, 2012			
Trade and other payables	$ 10,216	$ –	$ 10,216
Convertible debenture - cash interest (Note 19)	8,000	8,000	16,000
	$ 18,216	$ 8,000	$ 26,216

(i) The expected undiscounted cash flows of the above noted financial liabilities include the cash interest payment on the convertible debenture for the year ended December 31, 2014. Refer to Note 19 for the terms of the convertible debenture.

Commodity price risk

The Company is exposed to the risk of fluctuations in prevailing market prices for its coal products. Coal prices are affected by numerous factors such as interest rates, exchange rates, inflation or deflation and global and regional supply and demand.

The Company enters into sales contracts with its customers to manage the risk of off-take of coal at prevailing market prices by, in most cases, entering into short term coal contracts which fix the quantity and price of the Company's coal. The Company has not entered into any coal hedging instruments to manage its exposure to fluctuations in coal prices. As coal sales are the only source of revenue for the Company, a 5% increase or decrease in coal prices will result in a corresponding increase or decrease in revenue.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

26. Related party transactions

The consolidated financial statements include the financial statements of SouthGobi Resources Ltd. and its significant subsidiaries listed in the following table:

Name	Country of incorporation	% equity interest As at December 31, 2013	2012
SouthGobi Resources (Hong Kong) Limited	Hong Kong	**100%**	100%
SouthGobi Sands LLC	Mongolia	**100%**	100%
SGQ Coal Investment Pte. Ltd.	Singapore	**100%**	100%

During the year ended December 31, 2013 and 2012, 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.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

26. Related party transactions continued

26.1 Related party expenses

The Company's related party expenses consist of the following amounts:

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

The Company's related party expenses relate to the following related parties:

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

26.2 Related party expense recoveries

The Company's expenses recovered from related parties consist of the following amounts:

	Year ended December 31, 2013	2012
Corporate administration	$ 17	$ 589

The Company's related party expense recoveries relate to the following related parties:

	Year ended December 31, 2013	2012
Turquoise Hill	$ –	$ 479
Ivanhoe Energy	–	77
Rio Tinto	17	33
Related party expense recoveries	$ 17	$ 589

26.3 Related party assets

The assets of the Company include the following amounts due from related parties:

	As at December 31, 2013	2012
Amounts due from GMM	$ 74	$ 420
Amounts due from Turquoise Hill	–	317
Amounts due from Turquoise Hill Singapore	–	2
Total assets due from related parties	$ 74	$ 739

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

26. Related party transactions continued

26.4 Related party liabilities

The liabilities of the Company include the following amounts due to related parties:

	As at December 31, 2013	2012
Amounts payable to Rio Tinto	**$ 1,375**	$ 35
Accounts payable to Turquoise Hill	**34**	–
Total liabilities due to related parties	**$ 1,409**	$ 35

26.5 Key management personnel compensation

The remuneration of the Company's directors and other members of key management, who have the authority and responsibility for planning, directing and controlling the activities of the Company, consists of the following amounts:

	Year ended December 31, 2013	2012
Salaries, fees and other benefits	**$ 2,635**	$ 3,788
Share-based compensation	**170**	2,132
Total remuneration	**$ 2,805**	$ 5,920

27. Supplemental cash flow information

27.1 Non-cash financing and investing activities

The Company's non-cash investing and financing transactions are as follows:

	Year ended December 31, 2013	2012
Convertible debenture interest settlement in shares	**$ 8,000**	$ 4,000
Transfer of share option reserve upon exercise of stock options	**–**	1,368

27.2 Net change in non-cash working capital items

The net change in the Company's non-cash working capital items is as follows:

	Year ended December, 31 2013	2012
Decrease/(increase) in inventories	**$ (4,759)**	$ 45,339
Decrease in trade and other receivables	**2,513**	12,942
Decrease/(increase) in prepaid expenses and deposits	**22,552**	(11,061)
Increase/(decrease) in trade and other payables	**19,858**	(33,336)
Decrease in deferred revenue	**(7,184)**	(9,472)
Net change in non-cash working capital items	**$ 32,980**	$ 4,412

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

28. Commitments for expenditure

As at December 31, 2013, the Company's commitments for expenditure that have not been disclosed elsewhere in the consolidated financial statements are as follows:

	As at December 31, 2013			
	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 $18,481 of fees related to the Company's toll wash plant agreement with Ejin Jinda. This amount reflects the minimum expenditure due under this agreement.

29. Contingencies

29.1 Governmental and regulatory investigations

The Company is subject to investigations by Mongolia's Independent Authority against Corruption (the "IAAC") and the Mongolian State Investigation Office (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.

29. Contingencies continued

29.1 Governmental and regulatory investigations continued

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.

In the opinion of management of the Company, at December 31, 2013 a provision for this matter is not required.

29.2 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.

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.

In the opinion of management of the Company, at December 31, 2013 a provision for this matter is not required.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

29. Contingencies continued

29.3 Mongolian IAAC investigation

In the first quarter of 2013, the IAAC informed the Company that orders placing restrictions on certain of its Mongolian assets had been imposed in connection with its continuing investigation. The orders were imposed on the Company in connection with the IAAC's investigation of the Company. 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 Company's 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.

29.4 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, former Chief Financial Officers and the members of its Audit Committee.

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.

Appendix to the consolidated financial statements

December 31, 2013

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

Additional stock exchange information

Additional information required by the Hong Kong Stock Exchange and not shown elsewhere in this report is as follows:

A1. Loss for the year

Loss for the year has been arrived at after charging the following items:

	Year ended December, 31	
	2013	2012
Auditor's remuneration	**$ 406**	$ 430
Loss on disposal of property, plant and equipment	**$ 895**	$ 720
Depreciation and depletion		
Depreciation included in administration expenses	**$ 193**	$ 212
Depreciation included in evaluation and exploration expenses	**5**	40
Depreciation and depletion included in cost of sales	**45,055**	46,243
Total depreciation and depletion	**$ 45,253**	$ 46,495
Staff costs		
Directors' emoluments - executive directors (Note A2)	**$ 1,103**	$ 1,183
Directors' emoluments - non-executive directors (Note A2)	**827**	1,366
Other staff costs	**1,985**	9,055
Staff costs included in administration expenses	**3,915**	11,604
Staff costs included in evaluation and exploration expenses	**46**	437
Total staff costs	**$ 3,961**	$ 12,041

A2. Director and employee emoluments

Directors' emoluments

The Company's directors' emoluments consist of the following amounts:

	Year ended December, 31	
	2013	2012
Directors' fees	**$ 721**	$ 719
Other emoluments for executive and non-executive directors		
Salaries and other benefits	**1,162**	799
Share-based compensation	**47**	1,031
Directors' emoluments	**$ 1,930**	$ 2,549

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

A2. Director and employee emoluments continued

Directors' emoluments continued

Year ended December 31, 2013

Name of director	Directors' fees	Salaries and other benefits	Share-based compensation	Total
Executive director				
K. Ross Tromans	$ –	$ 1,103	$ –	$ 1,103
Non-executive directors				
Kay Priestly	$ 126	$ –	$ –	$ 126
Sean Hinton	83	59	47	189
Kelly Sanders	64	–	–	64
Brett Salt (i)	26	–	–	26
Lindsay Dove	81	–	–	81
Pierre Lebel	126	–	–	126
André Deepwell	114	–	–	114
W. Gordon Lancaster	89	–	–	89
Bold Baatar	12	–	–	12
	$ 721	$ 59	$ 47	$ 827
Directors' emoluments	$ 721	$ 1,162	$ 47	$ 1,930

(i) Resigned from the Board of Directors during the year ended December 31, 2013.

Year ended December 31, 2012

Name of director	Directors' fees	Salaries and other benefits	Share-based compensation	Total
Executive directors				
K. Ross Tromans	$ –	$ 124	$ –	$ 124
Alexander Molyneux (i)	–	473	586	1,059
	$ –	$ 597	$ 586	$ 1,183
Non-executive directors				
Kay Priestly	$ 39	$ –	$ –	$ 39
Sean Hinton	29	202	37	268
Kelly Sanders	17	-	-	17
Brett Salt	13	-	-	13
Lindsay Dove	23	-	37	60
Peter Meredith (i)	18	-	70	88
John Macken (i)	-	-	41	41
Pierre Lebel	153	-	62	215
André Deepwell	128	-	62	190
R. Edward Flood (i)	69	-	41	110
R. Stuart (Tookie) Angus (i)	22	-	-	22
Robert Hanson (i)	100	-	41	141
W. Gordon Lancaster	108	-	54	162
	$ 719	$ 202	$ 445	$ 1,366
Directors' emoluments	$ 719	$ 799	$ 1,031	$ 2,549

(i) Resigned from the Board of Directors during the year ended December 31, 2012.

Salaries and other benefits paid to Ross Tromans during the year ended December 31, 2013 includes a bonus of $193 paid in accordance with the Company's annual incentive plans. Salaries and other benefits paid to Alexander Molyneux include $2 of contributions to the Mandatory Provident Fund Scheme under the Hong Kong Mandatory Provident Fund Schemes Ordinance.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

A2. Director and employee emoluments continued

Five highest paid individuals

The five highest paid individuals included one director of the Company for the years ended December 31, 2013 and 2012. The emoluments of the five highest paid individuals are as follows:

	Year ended December, 31	
	2013	2012
Salaries and other benefits	**$ 2,138**	$ 2,571
Share-based compensation	**-**	1,743
Compensation for loss of office	**344**	424
Total emoluments	**$ 2,482**	$ 4,738

The emoluments for the five highest paid individuals were within the following bands:

	Year ended December, 31	
	2013	2012
HK$ 1,500,001 to HK$ 2,000,000	**1**	-
HK$ 2,000,001 to HK$ 2,500,000	**1**	-
HK$ 2,500,001 to HK$ 3,000,000	**1**	-
HK$ 4,000,001 to HK$ 4,500,000	**1**	-
HK$ 4,500,001 to HK$ 5,000,000	**-**	1
HK$ 6,500,001 to HK$ 7,000,000	**-**	1
HK$ 7,000,001 to HK$ 7,500,000	**-**	1
HK$ 8,000,001 to HK$ 8,500,000	**-**	1
HK$ 8,500,001 to HK$ 9,000,000	**1**	-
HK$ 9,500,001 to HK$ 10,000,000	**-**	1
	5	5

Salaries and other benefits of the five highest paid individuals during the year ended December 31, 2013 includes $2 of contributions to the Mandatory Provident Fund Scheme under the Hong Kong Mandatory Provident Fund Schemes Ordinance (2012: $7).

A3. Five year summary

The following table contains a five year summary of the Company's results, assets and liabilities:

	As at December 31,				
	2013	2012	2011	2010	2009
Revenue	**$ 58,636**	$ 78,061	$ 130,756	$ 60,412	$ 36,038
Gross profit/(loss)	**(53,991)**	(49,346)	38,578	7,761	6,613
Net comprehensive income/(loss) attributable to equity holders of the Company	**$ (236,950)**	$ (114,061)	$ 37,350	$ (89,855)	$ (110,805)
Basic income/(loss) per share from continuing and discontinued operations	**$ (1.30)**	$ (0.54)	$ 0.27	$ (0.67)	$ (0.83)
Diluted loss per share from continuing and discontinued operations	**$ (1.30)**	$ (0.60)	$ (0.24)	$ (0.67)	$ (0.83)

	As at December 31,				
	2013	2012	2011	2010	2009
Total assets	**$ 506,206**	$ 732,452	$ 918,680	$ 968,682	$ 560,684
Less: total liabilities	**(131,149)**	(128,469)	(213,113)	(291,212)	(563,476)
Total net assets/(liabilities)	**$ 375,057**	$ 603,983	$ 705,567	$ 677,470	$ (2,792)

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

A4. Cash

The Company's cash is denominated in the following currencies:

	As at December 31, 2013	2012
Denominated in U.S. Dollars	**$ 15,912**	$ 18,107
Denominated in Chinese Renminbi	**4,888**	-
Denominated in Mongolian Tugriks	**632**	911
Denominated in Canadian Dollars	**200**	260
Denominated in Hong Kong Dollars	**182**	396
Others	**23**	-
Total Cash	**$ 21,837**	$ 19,674

Corporate information

Directors

Executive Director:

Mr. K. Ross Tromans

Non-Executive Directors:

Ms. Kay Priestly (Chairman)
Mr. Sean Hinton (Deputy Chairman)
Mr. Lindsay Dove
Mr. Kelly Sanders
Mr. Bold Baatar

Independent Non-Executive Directors:

Mr. Pierre Lebel (Lead Director)
Mr. André Deepwell
Mr. W. Gordon Lancaster

Audit Committee

Mr. André Deepwell (Chair)
Mr. Pierre Lebel
Mr. W. Gordon Lancaster

Nominating and Corporate Governance Committee

Mr. Pierre Lebel (Chair)
Mr. André Deepwell
Mr. Sean Hinton
Mr. W. Gordon Lancaster
Ms. Kay Priestly

Compensation and Benefits Committee

Mr. W. Gordon Lancaster (Chair)
Mr. André Deepwell
Mr. Lindsay Dove
Mr. Pierre Lebel

Health, Environment, Safety and Social Responsibility Committee

Mr. Kelly Sanders (Chair)
Mr. Lindsay Dove
Mr. Bold Baatar
Mr. K. Ross Tromans

Mergers and Acquisitions Committee

Mr. Lindsay Dove (Chair)
Mr. Bold Baatar
Mr. Pierre Lebel
Mr. K. Ross Tromans

Company Secretary

Ms. Allison Snetsinger

Registered Office

Suite 354 – 200 Granville Street, Vancouver, British Columbia, Canada V6C 1S4

Principal Place of Business in Mongolia

8th Floor, Monnis Building, Orgil Stadium 22, Great Mongolian State Street,15th Khoroo, Khan-Uul District, Ulaanbaatar, Mongolia 17011

Principal Place of Business in Hong Kong

Suite 1501, The Center, 99 Queen's Road Central, Hong Kong

Principal Bankers

Canada:

BMO Bank of Montreal

Hong Kong:

Standard Chartered Bank (Hong Kong) Limited
The Hongkong and Shanghai Banking Corporation Limited

Principal Share Registrar

CST Trust Company
Suite 1600 – 1066 West Hastings Street, Vancouver, British Columbia, Canada V6E 3X1

Branch Share Registrar

Computershare Hong Kong Investor Services Limited
Shops 1712 – 1716, 17/F, Hopewell Centre 183 Queen's Road East, Wan Chai, Hong Kong

Independent Auditor

PricewaterhouseCoopers LLP

Website Address

www.southgobi.com

MIX
Paper from
responsible sources
FSC® C008061
www.fsc.org

www.southgobi.com