SouthGobi Resources Ltd.
Consolidated Financial Statements

December 31, 2014
(Expressed in U.S. Dollars)

Independent Auditor's Report

To the Shareholders of SouthGobi Resources Ltd.

We have audited the accompanying consolidated financial statements of SouthGobi Resources Ltd., which comprise the consolidated statements of financial position as at December 31, 2014 and December 31, 2013 and the consolidated statements of comprehensive income, changes in equity and cash flows 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 SouthGobi Resources Ltd. as at December 31, 2014 and December 31, 2013 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 consolidated financial statements which describes matters and conditions that indicate the existence of a material uncertainty that casts significant doubt about the Company's ability to continue as a going concern.

signed "PricewaterhouseCoopers LLP"

Chartered Accountants
Vancouver, Canada
March 30, 2015

TABLE OF CONTENTS

CONSOLIDATED FINANCIAL STATEMENTS

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Additional stock exchange information

SOUTHGOBI RESOURCES LTD.

Consolidated Statements of Comprehensive Income

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

	Notes	Year ended December 31, 2014	2013
Revenue		**$ 24,494**	$ 58,636
Cost of sales	5	**(82,132)**	(112,627)
Gross loss		**(57,638)**	(53,991)
Other operating expenses	6	**(14,840)**	(126,040)
Administration expenses	7	**(8,944)**	(15,629)
Evaluation and exploration expenses	8	**(1,312)**	(1,169)
Loss from operations		**(82,734)**	(196,829)
Finance costs	9	**(21,848)**	(21,162)
Finance income	9	**1,586**	5,566
Share of losses of joint venture	16	**(101)**	(53)
Loss before tax		**(103,097)**	(212,478)
Current income tax expense	10	**(586)**	(3)
Deferred income tax recovery/(expense)	10	**-**	(24,983)
Net loss attributable to equity holders of the Company		**(103,683)**	(237,464)
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)**	514
Net comprehensive loss attributable to equity holders of the Company		**$ (104,197)**	$ (236,950)
Basic loss per share	11	**$ (0.55)**	$ (1.30)
Diluted loss per share	11	**$ (0.55)**	$ (1.30)

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

SOUTHGOBI RESOURCES LTD.

Consolidated Statements of Financial Position

(Expressed in thousands of U.S. Dollars)

	Notes	As at December 31, 2014	2013
Assets			
Current assets			
Cash and cash equivalents		**$ 3,789**	$ 21,837
Trade and other receivables	12	**462**	2,578
Inventories	13	**31,255**	40,288
Prepaid expenses and deposits	14	**4,192**	11,506
Total current assets		**39,698**	76,209
Non-current assets			
Property, plant and equipment	15	**349,867**	399,395
Long term investments	16	**26,574**	30,602
Total non-current assets		**376,441**	429,997
Total assets		**$ 416,139**	$ 506,206
Equity and liabilities			
Current liabilities			
Trade and other payables	17	**$ 18,124**	$ 31,241
Deferred revenue	18	**11,898**	997
Interest-bearing borrowings	19	**3,945**	-
Current portion of convertible debenture	20	**2,301**	2,301
Total current liabilities		**36,268**	34,539
Non-current liabilities			
Convertible debenture	20	**92,886**	94,302
Decommissioning liability	21	**2,704**	2,308
Total non-current liabilities		**95,590**	96,610
Total liabilities		**131,858**	131,149
Equity			
Common shares		**1,080,417**	1,067,839
Share option reserve	24	**52,041**	51,198
Investment revaluation reserve	24	**-**	514
Accumulated deficit	22	**(848,177)**	(744,494)
Total equity		**284,281**	375,057
Total equity and liabilities		**$ 416,139**	$ 506,206
Net current assets		**$ 3,430**	$ 41,670
Total assets less current liabilities		**$ 379,871**	$ 471,667

Corporate information and going concern (Note 1), commitments for expenditure (Note 29) and contingencies (Note 30)

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

APPROVED BY THE BOARD:

"Andre Deepwell"	***"Pierre Lebel"***
Director	Director

SOUTHGOBI RESOURCES LTD.

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, 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 charged to operations	-	-	(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
Balances, January 1, 2014	**187,309**	**$ 1,067,839**	**$ 51,198**	**$ 514**	**$ (744,494)**	**$ 375,057**
Shares issued for:						
Interest settlement on convertible debenture	**7,068**	**4,000**	**-**	**-**	**-**	**4,000**
Private placement (net proceeds)	**24,361**	**8,568**				**8,568**
Employee share purchase plan	**14**	**10**	**-**	**-**	**-**	**10**
Share-based compensation charged to operations	**-**	**-**	**843**	**-**	**-**	**843**
Net loss for the year	**-**	**-**	**-**	**-**	**(103,683)**	**(103,683)**
Change in value of available-for-sale financial asset, net of tax	**-**	**-**	**-**	**(514)**	**-**	**(514)**
Balances, December 31, 2014	**218,752**	**$ 1,080,417**	**$ 52,041**	**$ -**	**$ (848,177)**	**$ 284,281**

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

SOUTHGOBI RESOURCES LTD.

Consolidated Statements of Cash Flows

(Expressed in thousands of U.S. Dollars)

	Notes	Year ended December 31, 2014	2013
Operating activities			
Loss before tax		**$ (103,097)**	$ (212,478)
Adjustments for:			
Depreciation and depletion		**38,512**	45,253
Share-based compensation	23	**843**	(105)
Finance costs	9	**21,848**	21,162
Finance income	9	**(1,586)**	(5,566)
Share of losses of joint venture	16	**101**	53
Interest paid		**(16,262)**	(16,184)
Commitment fee and front end fee		**(187)**	-
Income tax paid		**(49)**	-
Unrealized foreign exchange gain		**(604)**	(236)
Loss on disposal of property, plant and equipment		**-**	895
Provision for doubtful trade and other receivables	12	**567**	200
Impairment loss on available-for-sale financial asset	16	**1,766**	3,067
Impairment of inventories	13	**19,237**	35,697
Impairment of prepaid expenses and deposits	14	**3,780**	30,152
Impairment of property, plant and equipment	15	**7,993**	72,669
Net proceeds from disposal of mining license		**(1,689)**	-
Operating cash flows before changes in non-cash working capital items		**(28,827)**	(25,421)
Net change in non-cash working capital items	28	**(846)**	32,980
Cash generated from/(used in) operating activities		**(29,673)**	7,559
Investing activities			
Expenditures on property, plant and equipment		**(2,809)**	(11,819)
Proceeds from disposal of property, plant and equipment		**-**	1,703
Interest received		**8**	94
Net proceeds from maturity or disposal of short and long term investments		**2,957**	15,486
Net proceeds from disposal of mining license		**1,689**	-
Investment in joint venture		**(2,470)**	(10,356)
Cash used in investing activities		**(625)**	(4,892)
Financing activities			
Proceeds from issuance of common shares, net of issue costs		**8,578**	129
Drawings under borrowing from immediate parent company		**3,800**	-
Cash generated from financing activities		**12,378**	129
Effect of foreign exchange rate changes on cash		**(128)**	(633)
Increase/(decrease) in cash		**(18,048)**	2,163
Cash, beginning of year		**21,837**	19,674
Cash, end of year		**$ 3,789**	$ 21,837

Supplemental cash flow information (Note 28)

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

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. At December 31, 2014, Turquoise Hill Resources Ltd. ("Turquoise Hill") owned approximately 48% of the outstanding common shares of the Company (Note 27). 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.

<u>Going concern assumption</u>

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had limited cash of $3,789 at December 31, 2014 and anticipates that coal prices in the People's Republic of China ("China") will remain under pressure in 2015, which will continue to impact the Company's margins and liquidity. Therefore, the Company is actively seeking prepaid coal offtake agreements and other additional sources of financing to continue operating and meet its business objectives, while remaining focused on minimizing uncommitted capital expenditures and preserving the Company's growth options. The Company, together with its new strategic partner, Novel Sunrise Investments Ltd., has developed a funding plan in order to pay the interest due under the CIC convertible debenture, meet its obligations as they fall due and achieve its business objectives in 2015. These obligations may include potential penalties incurred as a consequence of the tax case in Mongolia (Refer to Note 30.1 for details). However, there is no guarantee that the Company will be able to implement this funding plan or secure other sources of financing. If it fails to do so, or is unable to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through December 31, 2015, then the Company is unlikely to have sufficient capital resources or 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 (approximately $7,900 on May 19, 2015 and approximately $8,000 on November 19, 2015). As a result, the Company may not be able to continue as a going concern.

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, 2015 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. However, in order to continue as a going concern, the Company must generate sufficient operating cash flows, secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transaction to provide it with additional liquidity. If it fails to do so, or is unable to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through December 31, 2015, then the Company is unlikely to have sufficient capital resources or 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. As a result, it may not be able to continue as a going concern.

1. CORPORATE INFORMATION AND GOING CONCERN (CONTINUED)

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.

The Company is also subject to a remedial delisting review by the TSX in connection with its reliance on the financial hardship exemption from approval by its shareholders of the private placement with Novel Sunrise as announced on February 24, 2015. The TSX has advised that the Company's financial and operating results may not warrant that its securities continue to be listed on the TSX. A meeting of the TSX Continued Listing Committee to consider this matter has been scheduled for May 19, 2015. The failure by the Company to clear the TSX delisting review within 90 days from February 25, 2015 may result in the Company's delisting which would result in an event of default under the CIC convertible debenture. An event of default may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

2. 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, 2014 were approved and authorized for issue by the Board of Directors of the Company on March 30, 2015.

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 26.

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, 2014. These changes were made in accordance with the transitional provisions outlined in the respective standards and interpretations.

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

2. BASIS OF PREPARATION (CONTINUED)

IFRIC 21 Levies

IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. Retrospective application is required for IFRIC 21. This interpretation has no impact on the Company.

Annual Improvements 2010-2012 Cycle

In the 2010-2012 annual improvements cycle, the IASB issued seven amendments to six standards, which included an amendment to IFRS 13 Fair Value Measurement. The amendment to IFRS 13 is effective immediately and, thus, for periods beginning at 1 January 2014, and it clarifies in the basis for conclusions that short-term receivables and payables with no stated interest rates can be measured at invoice amounts when the effect of discounting is immaterial. This amendment to IFRS 13 has no impact on the Company.

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, 2014, are disclosed below. The Company intends to adopt these standards, if applicable, when they become effective.

IFRS 9	Financial Instruments(iv)
IFRS 14	Regulatory Deferral Accounts(iv)
IFRS 15	Revenue from Contracts with Customers(iii)
Amendments to IAS 19	Defined Benefit Plans: Employee Contributions(i)
Amendments to IAS 27	Equity Method in Separate Financial Statements(ii)
Amendments to IFRS 11	Accounting for Acquisitions of Interests in Joint Operations(ii)
Amendments to IFRS 16 and IAS 38	Clarification of Acceptable Methods of Depreciation and Amortisation(ii)
Amendments to IFRS 16 and IAS 41	Agriculture: Bearer Plants(ii)
Annual improvements 2010-2012 Cycle	Amendments to a number of IFRSs(i)
Annual improvements 2011-2013 Cycle	Amendments to a number of IFRSs(i)

(i) Effective for annual periods beginning on or after July 1, 2014.
(ii) Effective for annual periods beginning on or after January 1, 2016
(iii) Effective for annual periods beginning on or after January 1, 2017
(iv) Effective for an entity that first adopts IFRSs for its annual financial statements beginning on or after January 1, 2016 and therefore is not applicable to the Company

2. BASIS OF PREPARATION (CONTINUED)

None of these is expected to have a significant effect on the consolidated financial statements of the Company, except the following set out below:

IFRS 9 Financial instruments
IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through OCI and fair value through P&L. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted. The Company has yet to assess IFRS 9's full impact.

IFRS 15 Revenue from Contracts with Customers
IFRS 15 deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognized when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18, Revenue, and IAS 11, Construction Contracts, and related interpretations. The standard is effective for annual periods beginning on or after January 1, 2017 and earlier application is permitted. Management is in the process of assessing the impact of IFRS 15.

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.

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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

<u>Depreciation and depletion</u>

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

<u>Evaluation and exploration expenses</u>

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.

<u>Commencement of commercial production</u>

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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

3.11 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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

3.21 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 the 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. The Company had limited cash of $3,789 at December 31, 2014 and anticipates that coal prices in China will remain under pressure in 2015, which will continue to impact the Company's margins and liquidity. Therefore the Company is actively seeking prepaid coal offtake agreements and other additional sources of financing to continue operating and meet its business objectives, while remaining focused on minimizing uncommitted capital expenditures and preserving the Company's growth options. The Company, together with its new strategic partner, Novel Sunrise Investments Ltd., has developed a funding plan in order to pay the interest due under the CIC convertible debenture, meet its obligations as they fall due and achieve its business objectives in 2015. These obligations may include potential penalties incurred as a consequence of the tax case in Mongolia (Refer to Note 30.1 for details). However, there is no guarantee that the Company will be able to implement this funding plan or secure other sources of financing. If it fails to do so, or is unable to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through December 31, 2015, then the Company is unlikely to have sufficient capital resources or 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 (approximately $7,900 on May 19, 2015 and approximately $8,000 on November 19, 2015). As a result, the Company may not be able to continue as a going concern.

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, 2015 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due; however, in order to continue as a going concern, the Company must generate sufficient operating cash flows, secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transaction to provide it with additional liquidity. If it fails to do so, or is unable to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through December 31, 2015, then the Company is unlikely to have sufficient capital resources or 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. As a result, it may not be able to continue as a going concern.

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.

The Company is also subject to a remedial delisting review by the TSX in connection with its reliance on the financial hardship exemption from approval by its shareholders of the private placement with Novel Sunrise as announced on February 24, 2015. The TSX has advised that the Company’s financial and operating results may not warrant that its securities continue to be listed on the TSX. A meeting of the TSX Continued Listing Committee to consider this matter has been scheduled for May 19, 2015. The failure by the Company to clear the TSX delisting review within 90 days from February 25, 2015 may result in the Company’s delisting which would result in an event of default under the CIC convertible debenture. An event of default 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 20.2 and Note 20.3. 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, 2014 was a liability of $1,834 (December 31, 2013: $3,395).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (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.

Prepaid toll washing fees

Refer to Note 14 and Note 30.5 for further analysis of the $3,405 impairment loss recorded in 2014 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, 2014. The impairment indicator was the continued weakness in the Company's share price during the year ended December 31, 2014 and the fact that the market capitalization of the Company, as at December 31, 2014, 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 cash flow valuation model has been updated to take into consideration the latest available information to the Company, including but not limited to, sales price, sales volumes and washing assumptions, operating cost assumptions and life of mine coal production assumptions as at December 31, 2014. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was $358,600 as at December 31, 2014.

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

- Long term price estimates from an independent market consulting firm;
- Forecasted sales volumes in line with production levels as per the updated mine plan;
- Updated life-of-mine coal production, strip ratio, capital costs and operating costs;
- A pre-tax discount rate of 16.0% based on an analysis of market, country and the Company specific factors; and
- Coal processing yield of 75%.

Key sensitivities in the valuation model are as follows:

- For each 1% increase/(decrease) in the long term price estimates, the calculated fair value of the cash generating unit increases/(decreases) by approximately $19,300/($19,300);
- For each 1% increase/(decrease) in the discount rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately ($25,000)/$27,500; and
- For each 1% increase/(decrease) in the cash mining cost estimates, the calculated fair value of the cash generating unit (decreases)/increases by approximately ($10,800)/$10,800.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at December 31, 2014. A decline of more than 1% in the long term price estimates, an increase of more than 1% in the pre-tax discount rate or an increase of more than 2% in the cash mining cost estimates may trigger an impairment charge on the cash generating unit. 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.

The Company is currently still reviewing its mine plan for the Ovoot Tolgoi project. Changes to the mine plan may have an impact on the quantities of measured and/or indicated resources and reserves of the Ovoot Tolgoi project.

Investment in RDCC LLC

The Company determined that an indicator of impairment existed for its investment in RDCC LLC as at December 31, 2014. The impairment indicator was the continued delay in the commencement of operation of the paved highway from the Company's Ovoot Tolgoi Mine to the Mongolia-China border. Refer to Note 16.3 for details.

Therefore, the Company conducted an impairment test whereby the carrying value of the Company's investment in RDCC LLC compared to its "value in use" using a discounted future cash flow valuation model. The carrying value was $26,574 as at December 31, 2014.

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

- Toll fee estimates reference to the concession agreement;
- Traffic volume;
- Repair, maintenance and operating cost; and
- A pre-tax discount rate of 15.9% based on a weighted average cost of capital of the Company.

Key sensitivities in the valuation model are as follows:

- For each 1% increase/(decrease) in the toll fee estimates or traffic volume, the calculated fair value of the carrying unit increases/(decreases) by approximately $265/($265); and
- For each 1% increase/(decrease) in the discount rate, the calculated fair value of the carrying unit (decreases)/increases by approximately ($1,546)/$1,691.

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at December 31, 2014. 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (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.

The Company is currently reviewing the geology and mine plan for Ovoot Tolgoi and changes thereto may impact the quantities of measured and/or indicated resources and reserves of Ovoot Tolgoi. The classification of the geology type of the coal deposits at the Ovoot Tolgoi Complex is currently under review. The results of this review are not yet known and may have a material impact on production levels from the Ovoot Tolgoi Complex.

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, 2014 was nil (December 31, 2013: nil).

(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 Executive Director (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, 2014, the Mongolian Coal Division had 6 active customers with the largest customer accounting for 34% of revenues, the second largest customer accounting for 29% of revenue, the third largest customer accounting for 27% of revenue and the other customers accounting for the remaining 10% 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, 2014	**$ 411,816**	**$ 4,323**	**$ 416,139**
As at December 31, 2013	490,949	15,257	506,206
Segment liabilities			
As at December 31, 2014	**$ 22,770**	**$ 109,088**	**$ 131,858**
As at December 31, 2013	25,393	105,756	131,149
Segment loss			
For the year ended December 31, 2014	**$ (76,515)**	**$ (27,168)**	**$ (103,683)**
For the year ended December 31, 2013	(199,248)	(38,216)	(237,464)
Segment revenues			
For the year ended December 31, 2014	**$ 24,494**	**$ -**	**$ 24,494**
For the year ended December 31, 2013	58,636	-	58,636
Impairment charge on assets (ii)			
For the year ended December 31, 2014	**$ 32,464**	**$ 1,766**	**$ 34,230**
For the year ended December 31, 2013	138,718	3,067	141,785

(i) The unallocated amount contains all amounts associated with the Corporate Division.
(ii) The impairment charge on assets for the year ended December 31, 2014 and year ended December 31, 2013 relates to trade and other receivables (Note 12), inventories (Note 13), prepaid expenses and deposits (Note 14), property, plant and equipment (Note 15) and investments (Note 16).

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, 2014	**$ 24,494**	**$ -**	**$ -**	**$ 24,494**
For the year ended December 31, 2013	58,636	-	-	58,636
Non-current assets				
As at December 31, 2014	**$ 375,588**	**$ 13**	**$ 840**	**$ 376,441**
As at December 31, 2013	422,679	81	7,237	429,997

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

5. COST OF SALES

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

	Year ended December 31, 2014	2013
Operating expenses	**$ 22,472**	$ 41,746
Share-based compensation expense/(recovery) (Note 23)	**230**	(293)
Depreciation and depletion	**7,235**	20,000
Impairment of coal stockpile inventories (Note 13)	**16,256**	20,735
Cost of sales from mine operations	**46,193**	82,188
Cost of sales related to idled mine assets [(i)]	**35,939**	30,439
Cost of sales	**$ 82,132**	$ 112,627

(i) Cost of sales related to idled mine assets for the year ended December 31, 2014 includes $30,305 of depreciation expense (2013: includes $25,053 of depreciation expenses). The depreciation expense relates to the Company's idled plant and equipment.

The Company's mining activities remained fully curtailed from January 1, 2013 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 during the curtailment of its mining activities. The 2014 idled mine asset depreciation expense relates to the Company's idled plant and equipment as the production plan during the year ended December 31, 2014 did not fully utilize the Company's existing mining fleet. In Mid-June, the Company placed approximately half of its workforce on furlough and reduced its mining activities accordingly. The furlough is anticipated to remain in place subject to market conditions.

6. OTHER OPERATING EXPENSES

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

	Year ended December 31, 2014	2013
Public infrastructure	**$ -**	$ 7
Sustainability and community relations	**252**	235
Foreign exchange loss/(gain)	**(1,151)**	1,659
Provision for doubtful trade and other receivables (Note 12)	**567**	200
Mark-to-market loss on available-for-sale financial asset	**1,766**	3,067
Loss on disposal of property, plant and equipment (Note 15)	**-**	895
Impairment of property, plant and equipment (Note 15)	**8,880**	72,669
Impairment of prepaid expenses and deposits (Note 14)	**3,780**	30,152
Impairment of materials and supplies inventories (Note 13)	**2,981**	14,962
Gain on disposal of mining licenses	**(2,235)**	-
Other	**-**	2,194
Other operating expenses	**$ 14,840**	$ 126,040

(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,	
	2014	**2013**
Corporate administration	**$ 2,591**	$ 3,269
Professional fees	**2,680**	8,252
Salaries and benefits	**2,955**	3,748
Share-based compensation expense (Note 23)	**590**	167
Depreciation	**128**	193
Administration expenses	**$ 8,944**	$ 15,629

8. EVALUATION AND EXPLORATION EXPENSES

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

	Year ended December 31,	
	2014	**2013**
Drilling and trenching	**$ 621**	$ 243
Other direct expenses	**197**	84
License fees	**6**	657
Share-based compensation expense (Note 23)	**23**	21
Overhead and other	**465**	164
Evaluation and exploration expenses	**$ 1,312**	$ 1,169

9. FINANCE COSTS AND INCOME

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

	Year ended December 31,	
	2014	**2013**
Interest expense on convertible debenture (Note 20)	**$ 20,165**	$ 20,290
Unrealized loss on FVTPL investments	**-**	656
Interest expense on line of credit facility	**-**	11
Interest expense on borrowing (Note 19)	**242**	-
Commitment fee and front end fee (Note 19)	**187**	-
Realized loss on disposal of AFS investments (Note 16)	**1,104**	-
Realized loss on disposal of FVTPL investments (Note 16)	**55**	91
Accretion of decommissioning liability (Note 21)	**95**	114
Finance costs	**$ 21,848**	$ 21,162

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

	Year ended December 31,	
	2014	**2013**
Unrealized gain on embedded derivatives in convertible debenture (Note 20)	**$ 1,560**	$ 5,481
Interest income	**26**	85
Finance income	**$ 1,586**	$ 5,566

(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

The Canadian statutory tax rate increased to 26% due to legislative changes relating to British Columbia provincial tax (2013: 25.75%). A reconciliation between the Company's tax expense 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, 2014	Year ended December 31, 2013
Loss before tax	**$ (103,097)**	$ 212,478
Statutory tax rate	**26.00%**	25.75%
Income tax recovery based on combined Canadian federal and provincial statutory rates	**(26,805)**	(54,713)
Deduct:		
Lower effective tax rate in foreign jurisdictions	**920**	1,467
Tax effect of tax losses and temporary differences not recognized	**18,199**	59,878
Non-deductible expenses	**8,272**	18,354
Income tax expenses	**$ 586**	$ 24,986

10.2 Deferred tax balances

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

	As at December 31, 2014	As at December 31, 2013
Tax loss carryforwards	**$ 11,860**	$ 332
Property, plant and equipment and other assets	**(11,860)**	(332)
Total deferred tax balances	**$ -**	$ -

(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.

10.3 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, 2014	As at December 31, 2013
Non-capital losses	**$ 140,694**	$ 136,185
Capital losses	**50,964**	2,676
Deductible temporary differences	**276,791**	257,016
Total unrecognized amounts	**$ 468,449**	$ 395,877

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

10. TAXES (CONTINUED)

10.4 Expiry dates

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

	As at December 31, 2014	
	U.S. Dollar Equivalent	Expiry dates
Non-capital losses		
Canada	**$ 93,242**	2032 - 2034
Mongolia	**79,004**	2016 - 2018
Hong Kong	**15,730**	indefinite
Singapore	**167**	indefinite
	$ 188,143	
Capital losses		
Canada	**$ 50,964**	indefinite

11. LOSS PER SHARE

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

	Year ended December 31,	
	2014	2013
Net loss	**$ (103,683)**	$ (237,464)
Weighted average number of shares	**190,132**	182,883
Basic and diluted loss per share	**$ (0.55)**	$ (1.30)

Potentially dilutive items not included in the calculation of diluted loss per share for the year ended December 31, 2014 include the convertible debenture (Note 20) and stock options (Note 23) 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,	
	2014	2013
Trade receivables	**$ -**	$ 1,818
Other receivables	**462**	760
Total trade and other receivables	**$ 462**	$ 2,578

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

12. TRADE AND OTHER RECEIVABLES (CONTINUED)

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

	As at December 31,	
	2014	2013
Less than 1 month	$ 305	$ 396
1 to 3 months	123	1,321
3 to 6 months	34	141
Over 6 months	-	720
Total trade and other receivables	**$ 462**	$ 2,578

Included in trade and other receivables are amounts due from related parties which are further disclosed in Note 27. 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, 2014, the Company recorded a $567 loss provision on its trade and other receivables in other operating expenses (2013: $200). 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.

13. INVENTORIES

The Company's inventories consist of the following amounts:

	As at December 31,	
	2014	2013
Coal stockpiles	$ 3,765	$ 8,305
Materials and supplies	27,490	31,983
Total inventories	**$ 31,255**	$ 40,288

Cost of sales for the year ended December 31, 2014 includes an impairment loss of $16,256 related to the Company's coal stockpile inventories (2013: $20,735). As at December 31, 2014, $1,220 of the Company's coal stockpile inventories are carried at their net realizable value (2013: $4,853).

Other operating expenses for the year ended December 31, 2014 includes an impairment loss of $2,981 related to surplus materials and supplies inventories (2013: $14,962). These items are not expected to be utilized with the Company's existing mining fleet and, therefore, were adjusted to their net realizable value.

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

14. PREPAID EXPENSES AND DEPOSITS

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

	As at December 31, 2014	As at December 31, 2013
Vendor prepayments	**$ 900**	$ 6,044
Ejin Jinda toll coal washing prepayment	**-**	3,405
Restricted cash balance	**1,239**	-
Other prepaid expenses and deposits	**2,053**	2,057
Total short and long term prepaid expenses and deposits	**$ 4,192**	$ 11,506

14.1 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 covered a period of 5-years from commencement of coal washing and provided for an annual wet washing capacity and usage by the Company 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 further impairment loss of $3,405 was recorded in other operating expenses during the year ended December 31, 2014 (2013: $30,151) to fully provide against the initial prepayment of $33,556.

15. 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, 2013	$ 363,689	$ 28,350	$ 72,214	$ 127,068	$ 6,276	$ 597,597
Additions	**3,564**	**326**	**14**	**6,418**	**-**	**10,322**
Disposals	**(826)**	**(61)**	**-**	**-**	**(42)**	**(929)**
Reclassifications	**-**	**-**	**(34)**	**-**	**34**	**-**
As at December 31, 2014	**$ 366,427**	**$ 28,615**	**$ 72,194**	**$ 133,486**	**$ 6,268**	**$ 606,990**
Accumulated depreciation and impairment charges						
As at December 31, 2013	$ (138,627)	$ (17,231)	$ (27,454)	$ (14,890)	$ -	$ (198,202)
Charge for the year	**(41,771)**	**(2,659)**	**(5,598)**	**(895)**	**-**	**(50,923)**
Impairment charges	**(8,603)**	**-**	**-**	**-**	**(277)**	**(8,880)**
Eliminated on disposals	**826**	**56**	**-**	**-**	**-**	**882**
As at December 31, 2014	**$ (188,175)**	**$ (19,834)**	**$ (33,052)**	**$ (15,785)**	**$ (277)**	**$ (257,123)**
Carrying amount						
As at December 31, 2013	$ 225,062	$ 11,119	$ 44,760	$ 112,178	$ 6,276	$ 399,395
As at December 31, 2014	**$ 178,252**	**$ 8,781**	**$ 39,142**	**$ 117,701**	**$ 5,991**	**$ 349,867**

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

15. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

	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

15.1 Prepayments on property, plant and equipment

As at December 31, 2014, the cost of the Company’s property, plant and equipment includes $28,232 of prepayments to vendors (December 31, 2013: $41,240). 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.

15.2 Impairment charges

Given the difficult market conditions and associated delays in projects and commissioning of equipment, the Company recorded $8,880 of impairment charges to reduce various items of property, plant and equipment to their recoverable amounts for the year ended December 31, 2014 (2013: $72,669).

16. INVESTMENTS

The Company’s investments consist of the following amounts:

	As at December 31, 2014	As at December 31, 2013
Non-current investment in joint venture		
Investment in RDCC LLC	**$ 26,574**	$ 24,205
Non-current investments at fair value		
Investment in Kangaroo Resources Limited	**-**	222
Investment in Aspire Mining Limited	**-**	6,175
Total investments	**$ 26,574**	$ 30,602

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

16. INVESTMENTS (CONTINUED)

16.1 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 classified 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, 2014, the Company disposed of its remaining 17,764 shares of Kangaroo for gross proceeds of $166 and realized a loss of $55 (2013: disposed of 22,236 shares for gross proceeds of $486 and realized a loss of $91).

16.2 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 classified its investment in Aspire as an available-for-sale financial asset. During the year ended December 31, 2014, the Company disposed of all 123,498 shares it held in Aspire for gross proceeds of $2,791 and realized a loss of $1,104 (2013: nil).

16.3 Investment in RDCC LLC

The Company has a 40% interest in RDCC LLC, a joint venture. RDCC LLC has 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. The construction was completed in 2014 and the operation is expected to commence in the second quarter of 2015.

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,	
	2014	**2013**
Balance, beginning of period	**$ 24,205**	$ 13,902
Funds advanced	**2,470**	10,356
Share of losses of joint venture	**(101)**	(53)
Balance, end of period	**$ 26,574**	$ 24,205

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

16. INVESTMENTS (CONTINUED)

Summarized financial statement information of RDCC LLC is as follows (presented on a 100% basis of RDCC LLC in which the Company has a 40% investment):

	As at December 31, 2014	As at December 31, 2013
Current assets	**$ 4,136**	$ 3,254
Non-current assets	**48,776**	37,292
Total assets	**$ 52,912**	$ 40,546
Current liabilities	**$ 19**	$ 1
Total liabilities	**$ 19**	$ 1

	Year ended December 31, 2014	Year ended December 31, 2013
Construction revenue	**$ 16,544**	$ 21,219
Gross profit margin	**11**	12
Other operating and finance costs	**(264)**	(144)
Loss before tax	**(253)**	(133)
Net loss	**(253)**	(133)

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, 2014	As at December 31, 2013
Less than 1 month	**$ 6,706**	$ 28,786
1 to 3 months	**1,703**	554
3 to 6 months	**2,705**	367
Over 6 months	**7,010**	1,534
Total trade and other payables	**$ 18,124**	$ 31,241

Included in trade and other payables are amounts due to related parties which are further disclosed in Note 27, the aging analysis of the trade and other payables due to related parties is as follows:

	As at December 31, 2014	As at December 31, 2013
Less than 1 month	**$ 412**	$ 1,375
1 to 3 months	**142**	-
3 to 6 months	**2,140**	-
Over 6 months	**5,838**	34
Total trade and other payables	**$ 8,532**	$ 1,409

18. DEFERRED REVENUE

At December 31, 2014, the Company has deferred revenue of $11,898, which represents prepayments for coal sales from customers (December 31, 2013: $997).

19. INTEREST-BEARING BORROWING

On May 25, 2014, the Company announced it has obtained a $10,000 revolving credit facility from Turquoise Hill to meet its short term working capital requirements (the “Turquoise Hill Loan Facility”). The key commercial terms of the facility were as follows:

- original maturity date of August 30, 2014 (subsequently extended);
- interest rate of one month US dollar LIBOR Rate in effect plus 11% margin per annum;
- commitment fee of 35% of interest rate payable quarterly in arrears on undrawn principal amount of facility;
- front end fee of $100;
- draws subject to customary closing conditions and the Company’s cash requirements in the ordinary course of business;
- facility is subject to certain mandatory prepayment and termination provisions; and
- the Company to continue to seek other funding alternatives.

On August 30, 2014, subject to certain conditions and limitations, Turquoise Hill agreed to grant a deferral of payment of $3,800 plus accrued interest thereon owing by the Company under the Turquoise Hill Loan Facility and reduced the revolving credit facility to the same $3,800. This deferral of payment and repayment was granted to the Company without prejudice to Turquoise Hill’s right and ability to assert and re-assert at any point in time to demand payment and repayment of all amounts owing to Turquoise Hill under the Turquoise Hill Loan Facility.

Subsequently, on December 4, 2014 as a result of unavoidable delays in closing the NUR SPA, Turquoise Hill agreed to a further limited deferral of repayment on the $3,800 principal and accrued interest owing on the Turquoise Hill Loan Facility as follows:

(i) $1,900 in principal and all interest that has accrued on and under the Turquoise Hill Loan Facility up to and including May 30, 2015 shall become due and payable on May 30, 2015; and

(ii) $1,900 in principal and all interest that has accrued on and under the Turquoise Hill Loan Facility from June 1, 2015 up to and including August 31, 2015 shall become due and payable on August 31, 2015.

This limited deferral is subject to certain conditions and limitations, including the completion by April 30, 2015 of the transaction contemplated by the NUR SPA, as amended by an agreement dated December 2, 2014.

As at December 31, 2014 the Company had drawn $3,800 and owed accrued interest of $145 under this facility (December 31, 2013: nil). The amounts owing are included in the interest-bearing borrowing amounts due to related parties which are further disclosed in Note 27.

20. CONVERTIBLE DEBENTURE

20.1 Key commercial terms

On November 19, 2009, the Company issued a convertible debenture to a wholly owned subsidiary of CIC for $500,000. The convertible debenture bears interest at 8.0% per annum (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's shares) and has a maximum term of 30 years. The convertible debenture is secured by a 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 (refer to Note 30.3). During 2010, the Company exercised a right within the debenture to call and convert $250,000 of the debenture for 21,471 common shares. Following the conversion the outstanding principal balance was $250,000 and has remained unchanged at that balance to December 31, 2014.

Under certain conditions, including the non-payment of interest amounts as the same become due, amounts outstanding under the CIC convertible debenture may be accelerated. Bankruptcy and insolvency events with respect to the Company or its material subsidiaries will result in an automatic acceleration of the indebtedness under the CIC convertible debenture. Subject to notice and cure periods, certain events of default under the CIC convertible debenture will result in acceleration of the indebtedness under such debenture at the option of CIC. Such other events of default include, but are not limited to, non-payment, breach of warranty, non-performance of obligations under the convertible debenture, default on other indebtedness and certain adverse judgments.
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 30.3).
- 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.
- 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.

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

20. CONVERTIBLE DEBENTURE (CONTINUED)

- 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, 2014, Turquoise Hill owned directly and indirectly approximately 48% 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.

20.2 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.

20.3 Valuation assumptions

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

	As at December 31,	
	2014	**2013**
Floor conversion price	**Cdn$8.88**	Cdn$8.88
Ceiling conversion price	**Cdn$11.88**	Cdn$11.88
Common share price	**Cdn$0.50**	Cdn$0.84
Historical volatility	**69%**	71%
Risk free rate of return	**2.24%**	3.11%
Foreign exchange spot rate (Cdn$ to U.S. Dollar)	**0.86**	0.94
Forward foreign exchange rate curve (Cdn$ to U.S. Dollar)	**0.85 - 0.86**	0.92 - 0.94

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

20. CONVERTIBLE DEBENTURE (CONTINUED)

20.4 Presentation

Based on the Company's valuation as at December 31, 2014, the fair value of the embedded derivatives decreased by $1,560 compared to December 31, 2013. The decrease was recorded as finance income for the year ended December 31, 2014.

For the year ended December 31, 2014, the Company recorded interest expense of $20,165 related to the convertible debenture as a finance cost (2013: $20,290). 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, 2014	Year ended December 31, 2013
Balance, beginning of year	**$ 96,603**	$ 105,968
Interest expense on convertible debenture	**20,165**	20,290
Decrease in fair value of embedded derivatives	**(1,560)**	(5,481)
Interest paid	**(20,021)**	(24,174)
Balance, end of year	**$ 95,187**	$ 96,603

The convertible debenture balance consists of the following amounts:

	As at December 31, 2014	As at December 31, 2013
Current convertible debenture		
Interest payable	**$ 2,301**	$ 2,301
Non-current convertible debenture		
Debt host	**91,052**	90,907
Fair value of embedded derivatives	**1,834**	3,395
	92,886	94,302
Total convertible debenture	**$ 95,187**	$ 96,603

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

On October 3, 2013, the Parliament of Mongolia passed the Investment Law to repeal and replace the Law on Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance ("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.

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

20. CONVERTIBLE DEBENTURE (CONTINUED)

On November 20, 2014, the Company issued 7,068 common shares to settle the $4,000 November 19, 2014 share interest payment. The number of common shares was based on the 50-day volume-weighted average share price on November 19, 2014 of Cdn$0.64.

20.6 Interest deferral and settlement

During the three months ended December 31, 2014, the Company and the CIC mutually agreed upon to defer of the convertible debenture semi-annual $8,066 cash interest payment due on November 19, 2014 (“November 2014 Cash Interest Payment”) to December 1, 2014. The Company and the CIC subsequently agreed that the cure period with respect of the November 2014 Cash Interest Payment would continue until December 4, 2014.

On December 3, 2014, the Company settled the $8,066 amount, plus additional accrued interest of $20.

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

21. DECOMMISSIONING LIABILITY

At December 31, 2014, 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, 2014 totaled $7,158 (2013: $6,286). The estimated future reclamation and closure costs are discounted at 9.9% per annum (2013: 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, 2014 and 2013 were as follows:

	Year ended December 31, 2014	2013
Balance, beginning of year	**$ 2,308**	$ 4,104
Adjustments	**301**	(1,910)
Accretion	**95**	114
Balance, end of year	**$ 2,704**	$ 2,308

The increase in balance from December 31, 2013 to December 31, 2014 is mainly related to revised cost estimates in respect of re-vegetation of the Ovoot Tolgoi site.

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

22. EQUITY

22.1 Share capital

The Company has authorized an unlimited number of common and preferred shares with no par value. At December 31, 2014, the Company had 218,752 common shares outstanding (December 31, 2013: 187,309) and no preferred shares outstanding (December 31, 2013: nil).

During December 2014, the Company completed the private placements for the issue of new common shares for net proceeds of $8,568.

The Company's volume weighted average share price for the year ended December 31, 2014 was Cdn$0.64 (2013: Cdn$1.26).

22.2 Accumulated deficit and dividends

At December 31, 2014, the Company has accumulated a deficit of $848,177 (December 31, 2013: $744,494). No dividends have been paid or declared by the Company since inception.

23. SHARE-BASED PAYMENTS

23.1 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, 2014, the Company granted 1,924 stock options (2013: 282) to officers, employees, directors and other eligible persons at exercise prices ranging from Cdn$0.58 to Cdn$0.84 (2013: exercise prices ranging from Cdn$1.16 to Cdn$2.10) and expiry dates ranging from January 13, 2019 to August 13, 2019 (2013: expiry dates ranging from March 27, 2018 to August 14, 2018). The weighted average fair value of the options granted in the year ended December 31, 2014 was estimated at $0.22 (Cdn$0.25) (2013: $0.60, Cdn$0.62) 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,	
	2014	**2013**
Risk free interest rate	**1.36%**	1.56%
Expected life	**3.3 years**	3.4 years
Expected volatility (i)	**56%**	56%
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.

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

23. SHARE-BASED PAYMENTS (CONTINUED)

A share-based compensation expense of $373 for the options granted in the year ended December 31, 2014 (2013: $151) will be amortized over the vesting period, of which $136 was recognized in the year ended December 31, 2014 (2013: $58).

The total share-based compensation expenses for the year ended December 31, 2014 was $843 (2013: share-based compensation recovery of $105). Share-based compensation expense of $590 (2013: $167) has been allocated to administration expenses, $23 (2013: $21) has been allocated to evaluation and exploration expenses and $230 (2013: share-based compensation recovery of $293) has been allocated to cost of sales.

23.2 Outstanding stock options

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

	Year ended December 31, 2014			Year ended December 31, 2013		
	Number of options		Weighted average exercise price (Cdn$)	Number of options		Weighted average exercise price (Cdn$)
Balance, beginning of year	**2,583**	**$**	**8.48**	7,507	$	9.72
Options granted	**1,924**		**0.60**	282		1.37
Options excercised	**-**		**-**	-		-
Options forfeited	**(280)**		**1.93**	(807)		6.91
Options expired	**(1,174)**		**9.77**	(4,399)		10.42
Balance, end of year	**3,053**	**$**	**3.63**	2,583	$	8.48

The stock options outstanding and exercisable as at December 31, 2014 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 exercisable		Weighted average exercise price (Cdn$)	Weighted average remaining contractual life (years)
$0.58 - $1.92	**2,151**	**$**	**0.76**	**4.32**	**207**	**$**	**1.65**	**3.18**
$6.16 - $9.43	**442**		**8.25**	**1.84**	**408**		**8.42**	**1.81**
$12.58	**460**		**12.58**	**0.62**	**460**		**12.58**	**0.62**
	3,053	**$**	**3.63**	**3.40**	**1,075**	**$**	**8.90**	**1.56**

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

24. RESERVES

24.1 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 23.

The share option reserve transactions for the years ended December 31, 2014 and 2013 are as follows:

	Year ended December 31,	
	2014	**2013**
Balance, beginning of year	**$ 51,198**	$ 51,303
Share-based compensation charged/(credited) to operations	**843**	(105)
Balance, end of year	**$ 52,041**	$ 51,198

24.2 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, 2014 and 2013 are as follows:

	Year ended December 31,	
	2014	**2013**
Balance, beginning of year	**$ 514**	$ -
Loss arising on revaluation of available-for-sale financial assets	**-**	(2,553)
Reclassification upon disposal of available-for-sale financial asset	**(514)**	-
Reclassification of impairment loss on available-for-sale financial asset	**-**	3,067
Balance, end of year	**$ -**	$ 514

25. 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, 2014, the Company's capital structure consists of convertible debt (Note 20), interest-bearing borrowing (Note 19) and the equity of the Company (Note 22). 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, 2014, 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, 2014, the Company had limited cash of $3,789.

Based on the Company's forecasts for the year ending December 31, 2015, 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)

26. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

26.1 Categories of financial instruments

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

	As at December 31,	
	2014	**2013**
Financial assets		
Loans-and-receivables		
Cash	**$ 3,789**	$ 21,837
Trade and other receivables (Note 12)	**462**	2,578
Available-for-sale		
Investment in Aspire (Note 13)	**-**	6,175
Fair value through profit or loss		
Investment in Kangaroo (Note 13)	**-**	222
Total financial assets	**$ 4,251**	$ 30,812
Financial liabilities		
Fair value through profit or loss		
Convertible debenture - embedded derivatives (Note 20)	**$ 1,834**	$ 3,395
Other-financial-liabilities		
Trade and other payables (Note 17)	**18,124**	31,241
Interest-bearing borrowings (Note 19)	**3,945**	-
Convertible debenture - debt host (Note 20)	**93,353**	93,208
Total financial liabilities	**$ 117,256**	$ 127,844

26.2 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 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 20) is determined using a Monte Carlo simulation. None of the fair value change in the embedded derivatives for the year ended December 31, 2014 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.

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

26. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (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.

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, 2014			
Recurring measurements	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial iabilities at fair value				
Convertible debenture - embedded derivatives	**$ -**	**$ 1,834**	**$ -**	**$ 1,834**
Total financial liabilities at fair value	**$ -**	**$ 1,834**	**$ -**	**$ 1,834**
Non-recurring measurements				
Assets at fair value				
Inventories	**$ -**	**$ -**	**$ 1,220**	**$ 1,220**
Total assets at fair value	**$ -**	**$ -**	**$ 1,220**	**$ 1,220**

	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

At December 31, 2014, certain coal stockpile inventories were written down to their net realizable value of $1,220 (December 31, 2013: $4,853). 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, 2014.

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

26. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (CONTINUED)

26.3 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,	
	2014	2013
Increase / decrease in foreign exchange rate		
+5%	**$ 66**	$ 59
–5%	**$ (66)**	$ (59)

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)

26. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (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, 2015, 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, 2014			
Trade and other payables	**$ 18,124**	**$ -**	**$ 18,124**
Interest-bearing borrowing (Note 18)	**1,972**	**1,973**	**3,945**
Convertible debenture - cash interest (Note 20) (i)	**8,000**	**8,000**	**16,000**
	$ 28,096	**$ 9,973**	**$ 38,069**
As at December 31, 2013			
Trade and other payables	$ 31,241	$ -	$ 31,241
Convertible debenture - cash interest (Note 20)	8,000	8,000	16,000
	$ 39,241	$ 8,000	$ 47,241

(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, 2015. Refer to Note 20 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)

27. 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, 2014	2013
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, 2014 and 2013, 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, 2014 owned approximately 48% of the outstanding common shares of the Company. Turquoise Hill provides various administrative services to the Company on a cost-recovery basis.
- Rio Tinto – Rio Tinto is the Company's ultimate parent company and at December 31, 2014 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 and recovers legal and professional fees from the Company in respect of the internal and tripartite committees referred to in Note 24.3.
- 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.
- Global Mining Management ("GMM") – On October 31, 2013, the Company and Turquoise Hill ceased being shareholders of GMM, a private company. GMM was owned equally by seven companies, two of which included the Company and Turquoise Hill. GMM provided administration, accounting and other office services to the Company on a cost-recovery basis. The provision of these services ceased on October 31, 2013.

27.1 Related party expenses

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

	Year ended December 31, 2014	2013
Corporate administration	**$ 711**	$ 781
Salaries and benefits	**1,392**	1,505
Finance cost	**415**	-
Related party expenses	**$ 2,518**	$ 2,286

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

27. RELATED PARTY TRANSACTIONS (CONTINUED)

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

	Year ended December 31,	
	2014	**2013**
GMM	**$ -**	$ 40
Turquoise Hill	**513**	205
Rio Tinto	**1,391**	1,353
Turquoise Hill Singapore	**614**	688
Related party expenses	**$ 2,518**	$ 2,286

27.2 Related party expense recoveries

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

	Year ended December 31,	
	2014	**2013**
Corporate administration	**$ 62**	$ 17

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

	Year ended December 31,	
	2014	**2013**
Turquoise Hill	**$ 62**	$ -
Rio Tinto	**-**	17
Related party expense recovery	**$ 62**	$ 17

27.3 Related party assets

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

	As at December 31,	
	2014	**2013**
Amounts due from GMM	**$ -**	$ 74

27.4 Related party liabilities

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

	As at December 31,	
	2014	**2013**
Amounts payable to Rio Tinto	**$ 8,047**	$ 1,375
Accounts payable to Turquoise Hill Singapore	**278**	-
Accounts payable to Turquoise Hill	**4,151**	34
Total liabilities due to related parties	**$ 12,476**	$ 1,409

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

27. RELATED PARTY TRANSACTIONS (CONTINUED)

27.5 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,			
	2014		2013	
Salaries, fees and other benefits	**$**	**2,695**	$	2,635
Share-based compensation		**232**		170
Total remuneration	**$**	**2,927**	$	2,805

28. SUPPLEMENTAL CASH FLOW INFORMATION

28.1 Non-cash financing and investing activities

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

	Year ended December 31,			
	2014		2013	
Convertible debenture interest settlement in shares	**$**	**4,000**	$	8,000

28.2 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			
	2014		2013	
Increase in inventories	**$**	**(871)**	$	(4,759)
Decrease in trade and other receivables		**1,741**		2,513
Decrease in prepaid expenses and deposits		**863**		22,552
Increase/(decrease) in trade and other payables		**(13,479)**		19,858
Increase/(decrease) in deferred revenue		**10,900**		(7,184)
Net change in non-cash working capital items	**$**	**(846)**	$	32,980

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

29. COMMITMENTS FOR EXPENDITURE

As at December 31, 2014, the Company's commitments for expenditure that have not been disclosed elsewhere in the consolidated financial statements are as follows:

	As at December 31, 2014			
	Within 1 year	2-3 years	Over 3 years	Total
Capital expenditure commitments	$ 2,519	$ 16,691	$ -	$ 19,210
Operating expenditure commitments	12,221	355	355	12,931
Commitments	**$ 14,740**	**$ 17,046**	**$ 355**	**$ 32,141**

30. CONTINGENCIES

30.1 Governmental and regulatory investigations

The Company was subject to investigations by IAAC regarding allegations of breaches of Mongolia's anti-corruption laws (the "Anti-Corruption Case"), and tax evasion and money laundering (the "Tax Evasion Case"). On March 18, 2013 the Prosecutor's Office decided to split the Tax Evasion Case from the Anti-Corruption Case and on April 12, 2013, the Public Prosecutor of Capital city Prosecutor's Office issued a resolution that the jurisdiction to conduct the investigation on Tax Evasion Case was with the SIA and not the IAAC, and the Tax Evasion Case was transferred to SIA.

While the IAAC has not made any formal accusations against any current or former employee of the Company or the Company under the Anti-Corruption Case, administrative penalties were imposed on certain of the Company's Mongolian assets in connection with the investigation, including a restriction of the use of US$1,200 (the "Restricted Funds") held in bank accounts in Mongolia to spending in Mongolia. The Company has been informed that the Anti-Corruption Case has been suspended; however, it has not received formal notice that the investigation is completed and the restriction on the Restricted Funds remains in place. The Restricted Funds are included within the prepaid expenses and deposits balance in the Company's financial statements. This restriction may have a material impact on the Company's activities in light of the Tax Penalty.

Investigations under the Tax Evasion Case included investigations of three of the Company's former employees (the "Former Employees"). On December 30, 2014, the Capital City Prosecutor's Office (Ulaanbaatar, Mongolia) dismissed the allegations of money laundering as not having been proven during the investigation. The Former Employees were indicted for tax evasion by the Prosecutor General on March 14, 2014. The case was sent to the First Instance Second District Criminal Court of Justice (the "District Court"). The Company was advised on May 12, 2014 that the appointed judge of the District Court concluded that the investigation of the Tax Evasion Case initiated by IAAC and continued by SIA was incomplete and ordered the case to be returned to the Prosecutor General for additional investigation. The additional investigation was subsequently completed and the case was sent to the District Court again on June 4, 2014. The trial took place on August 25 and 26, 2014. A panel of three judges appointed to the case returned the case to the Prosecutor General once again for further investigation due to insufficient evidence presented by the prosecutor.

On October 7, 2014, based on the District Court verdict, the SIA ordered a re-investigation (the "Fourth Investigation") into allegations of violations of Mongolian tax laws by the Former Employees. Following the completion of the Fourth Investigation, the Former Employees were indicted again and on December 31, 2014 the Former Employees were tried in the District Court. On January 30, 2015, the panel of appointed judges from the District Court found the Former Employees guilty of tax evasion and imposed sentences on the Former Employees ranging from 5 years and 6 months to 5 years and 10 months of imprisonment in the correctional facilities of strict regimen in Mongolia. The Former Employees were immediately imprisoned. The Company was informed that, following the receipt of the written verdict (the "Tax Verdict"), the Former Employees requested pardons from the President of Mongolia and waived their right of appeal. On February 26, 2015 the President of Mongolia issued a decree to pardon to the Former Employees. The Former Employees were released from imprisonment following the decree and departed Mongolia.

The Tax Verdict declared SGS to be financially liable as a "civil defendant" for a penalty (the "Tax Penalty") of MNT35,300,000 (approximately US$18,200 on February 1, 2015). The Company firmly rejects this conclusion. On February 18, 2015, the Company appealed the Tax Verdict (the "Tax Verdict Appeal") on the grounds that it has prepared its financial statements, including those of SGS, in compliance with IFRS, and lodged all its tax returns in the required format under Mongolian tax law. The hearing of the Tax Penalty Appeal took place on March 25, 2015 at the 10th Appeal Court for Criminal Case of Mongolia (the "Court of Appeal") and a panel of three appointed judges decided to uphold the Tax Verdict and dismissed the Tax Verdict Appeal by the Company. As of the date of this Consolidated Financial Statement, the Court of Appeal has not provided any explanation of its reasoning to uphold the Tax Verdict and the Company is awaiting a written version of the Appeal Court's verdict ("Appeal Verdict"). It is the view of the Company that there is a lack of evidence to support both the Tax Verdict and the Appeal Verdict.

The Company has been advised that it can appeal further to the Supreme Court of Mongolia. However there is no assurance that the Supreme Court of Mongolia will agree to hear the appeal. The Tax Penalty would only be payable after a final appeal. The Company will continue to defend itself through all available legal means including a final appeal.

The consequences for the Company of the Tax Verdict and the Appeal Verdict are uncertain. If the Tax Verdict is not reversed on final appeal, or if the amount of the Tax Penalty is not reduced upon exhaustion of the foregoing appeal process, the Company may not be able to pay the Tax Penalty or the final assessed amount, which could result in voluntary or involuntary insolvency proceedings involving the Company.

In the opinion of management of the Company, at December 31, 2014 a provision for this matter is not required.

30. CONTINGENCIES (CONTINUED)

30.2 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 through the investigations in Mongolia. 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. The tripartite committee substantially completed the investigative phase of its activities during the third quarter of 2013. There have been no significant developments in respect of the internal investigations since the completion of the investigative phase during the third quarter of 2013.

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.

In the opinion of management of the Company, at December 31, 2014 a provision for this matter is not required.

30.3 Mongolian IAAC investigation

In the first quarter of 2013, the Company was subject to orders imposed by the IAAC 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 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.

30. CONTINGENCIES (CONTINUED)

30.4 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.
There have been no significant developments in respect of the class action lawsuit since the first quarter ended March 31, 2014. For more details, refer to the Company’s Management Discussion and Analysis for the quarter ended March 31, 2014 available on SEDAR at www.sedar.com, and, in particular, the sub-section on “Contingencies – Class Action Lawsuit of the section 6 on “Regulatory Issues and Contingencies”.

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, the Company has judged a provision for this matter at December 31, 2014 is not required.

30.5 Toll wash plant agreement with Ejin Jinda

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. To date, commercial operations at the wet washing facility have not commenced.

In 2011, the Company made an initial payment of $33,556 in respect of prepaid toll washing fees. The Company recorded a $30,152 impairment loss on the $33,556 of prepaid toll washing fees during the year ended December 31, 2013 and in the quarter ended June 30, 2014, the Company recorded an additional impairment of $3,405 to fully impair the deposit. As at December 31, 2014 the Company has reassessed the carrying value of this prepayment and continues to believe it is appropriate for the balance to be fully impaired. This impairment continues to be recognized due to the continued delay in starting the commercial operations at the wet washing facility and the continued soft coal market in China.

Under the original agreement with Ejin Jinda, which required the commercial operation of the wet washing facility to commence on October 1, 2011, the additional fees payable by the Company under the wet washing contract would have been $18,500. The Company assesses on a continuous basis the agreement with Ejin Jinda and has determined it is not probable that these $18,500 will be required to be paid as part of the initial contract.

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.

30.6 Tax legislation

Mongolian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management’s interpretation of such legislation as applied to the transactions and

30. CONTINGENCIES (CONTINUED)

activity of the Company may be challenged by the relevant authorities. The Mongolian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged by tax authorities. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for five calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

The Mongolian tax legislation does not provide definitive guidance in certain areas, specifically in areas such as VAT, withholding tax, corporate income tax, personal income tax, transfer pricing and other areas. From time to time, the Company adopts interpretations of such uncertain areas that reduce the overall tax rate of the Company. As noted above, such tax positions may come under heightened scrutiny as a result of recent developments in administrative and court practices. The impact of any challenge by the tax authorities cannot be reliably estimated; however, it may be significant to the financial position and/or the overall operations of the entity.

Management believes that its interpretation of the relevant legislation is appropriate and the Company's positions related to tax and other legislation will be sustained. Management believes that tax and legal risks are remote at present. The management performs regular re-assessment of tax risk and its position may change in the future as a result of the change in conditions that cannot be anticipated with sufficient certainty at present.

As of December 31, 2014 and 2013, management has assessed that recognition of a provision for uncertain tax position is not necessary.

31. SUBSEQUENT EVENTS

31.1 Private placement

On February 24, 2015, the Company entered into a private placement agreement with Novel Sunrise Investments Limited ("Novel Sunrise") as a proposed new significant investor and strategic partner for the issue of a combination of Mandatory Convertible Units and Common Shares. The closing of the private placement tranches are subject to regulatory and other closing conditions including the closing of a sale and purchase agreement between Novel Sunrise and Turquoise Hill for Novel Sunrise to purchase 48,705 Common Shares. Novel Sunrise has agreed to subscribe for an initial tranche of 10,131,113 Mandatory Convertible Units in consideration of subscription funds of approximately $3,500. The Mandatory Convertible Units are convertible on a one for one basis into Common Shares and, in combination with the common shares issuable under the additional private placement tranches, up to 21,750 new common shares in the Company are issuable, for aggregate gross proceeds of up to approximately $7,500. Prior to conversion into Common Shares, the Mandatory Convertible Units will not carry any right to vote at a general meeting of shareholders of the Company.

On March 3, 2015 the Company successfully closed the initial tranche of a two tranche private placement with Novel Sunrise. The private placement was approved by the Toronto Stock Exchange (the "TSX") pursuant to the financial hardship provisions of the TSX Company Manual on March 2, 2015 and the TSX has informed the Company that it has been placed on remedial delisting review (refer note 1).

In accordance with the private placement agreement, on March 3, 2015, Mr. Ted Chan was appointed to SouthGobi's management team and joined the Company's Board of Directors as an Executive Director.

(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, 2014	2013
Auditor's remuneration	**$ 427**	$ 406
Loss on disposal of property, plant and equipment	**$ -**	$ 895
Depreciation and depletion		
Depreciation included in administration expenses	**$ 128**	$ 193
Depreciation included in evaluation and exploration expenses	**22**	5
Depreciation and depletion included in cost of sales	**37,540**	45,055
Total depreciation and depletion	**$ 37,690**	$ 45,253
Staff costs		
Directors' emoluments - executive directors (Note A2)	**$ 1,110**	$ 1,103
Directors' emoluments - non-executive directors (Note A2)	**538**	827
Other staff costs	**1,897**	1,985
Staff costs included in administration expenses	**3,545**	3,915
Staff costs included in evaluation and exploration expenses	**11**	46
Total staff costs	**$ 3,556**	$ 3,961

A2. DIRECTOR AND EMPLOYEE EMOLUMENTS

Directors' emoluments

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

	Year ended December 31, 2014	2013
Directors' fees	**$ 373**	$ 721
Other emoluments for executive and non-executive directors		
Salaries and other benefits	**1,110**	1,162
Share-based compensation	**165**	47
Directors' emoluments	**$ 1,648**	$ 1,930

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

A2. DIRECTOR AND EMPLOYEE EMOLUMENTS (CONTINUED)

Year ended December 31, 2014

Name of director	Directors' fees	Salaries and other benefits	Share-based compensation	Total
Executive directors				
K. Ross Tromans (i)	$ -	$ 1,110	$ -	$ 1,110
Non-executive directors				
Kay Priestly (i)	$ 67	$ -	$ -	$ 67
Sean Hinton (i)	28	-	-	28
Kelly Sanders	41	-	-	41
Lindsay Dove (i)	22	-	-	22
Pierre Lebel	70	-	55	125
André Deepwell	62	-	55	117
W. Gordon Lancaster	58	-	55	113
Bold Baatar	23	-	-	23
Jeffery Tygesen (ii)	2	-	-	2
	$ 373	$ -	$ 165	$ 538
Directors' emoluments	$ 373	$ 1,110	$ 165	$ 1,648

(i) Resigned from the Board of Directors during the year ended December 31, 2014.
(ii) Resigned from the Board of Directors on March 18, 2015.

Year ended December 31, 2013

Name of director	Directors' fees	Salaries and other benefits	Share-based compensation	Total
Executive directors				
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.

Salaries and other benefits paid to Ross Tromans during the year ended December 31, 2014 includes a bonus of $156 paid in accordance with the Company’s annual incentive plans. (2013: $193)

(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, 2014 and 2013. The emoluments of the five highest paid individuals are as follows:

	Year ended December 31, 2014	2013
Salaries and other benefits	**$ 2,540**	$ 2,138
Share-based compensation	**68**	-
Compensation for loss of office	**-**	344
Total emoluments	**$ 2,608**	$ 2,482

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

	Year ended December 31, 2014	2013
HK$ 1,500,001 to HK$ 2,000,000	**2**	1
HK$ 2,000,001 to HK$ 2,500,000	**1**	1
HK$ 2,500,001 to HK$ 3,000,000	**-**	1
HK$ 4,000,001 to HK$ 4,500,000	**-**	1
HK$ 6,000,001 to HK$ 6,500,000	**1**	-
HK$ 8,500,001 to HK$ 9,000,000	**1**	1
	5	5

A3. FIVE YEAR SUMMARY

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

	Year ended December 31, 2014	2013	2012	2011	2010
Revenue	**$ 24,494**	$ 58,636	$ 78,061	$ 130,756	$ 60,412
Gross profit/(loss)	**(57,638)**	(53,991)	(49,346)	38,578	7,761
Net comprehensive income/(loss) attributable to equity holders of the Company	**$ (104,197)**	$ (236,950)	$ (114,061)	$ 37,350	$ (89,855)
Basic income/(loss) per share from continuing and discontinued operations	**$ (0.55)**	$ (1.30)	$ (0.54)	$ 0.27	$ (0.67)
Diluted loss per share from continuing and discontinued operations	**$ (0.55)**	$ (1.30)	$ (0.60)	$ (0.24)	$ (0.67)

	As at December 31, 2014	2013	2012	2011	2010
Total assets	**$ 416,139**	$ 506,206	$ 732,452	$ 918,680	$ 968,682
Less: total liabilities	**(131,858)**	(131,149)	(128,469)	(213,113)	(291,212)
Total net assets	**$ 284,281**	$ 375,057	$ 603,983	$ 705,567	$ 677,470

(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,	
	2014	**2013**
Denominated in U.S. Dollars	**$ 2,553**	$ 15,912
Denominated in Chinese Renminbi	**587**	4,888
Denominated in Mongolian Tugriks	**77**	632
Denominated in Canadian Dollars	**333**	200
Denominated in Hong Kong Dollars	**239**	182
Denominated in Australian Dollars	**-**	23
Cash	**$ 3,789**	$ 21,837