SouthGobi Resources Ltd.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

June 30, 2012

(Unaudited)
(Expressed in U.S. Dollars)

TABLE OF CONTENTS

CONDENSED FINANCIAL STATEMENTS

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

ADDITIONAL STOCK EXCHANGE INFORMATION

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statement of Comprehensive Income

(Unaudited)

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

	Notes	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Revenue		**$ 8,412**	$ 47,336	**$ 48,565**	$ 67,494
Cost of sales	4	**(22,221)**	(37,592)	**(39,700)**	(50,060)
Gross profit/(loss)		**(13,809)**	9,744	**8,865**	17,434
Other operating expenses	2.3 , 5	**(3,803)**	(3,024)	**(6,380)**	(4,407)
Administration expenses	2.3 , 6	**(7,497)**	(6,808)	**(13,380)**	(12,144)
Evaluation and exploration expenses	7	**(2,099)**	(4,356)	**(7,132)**	(6,347)
Loss from operations		**(27,208)**	(4,444)	**(18,027)**	(5,464)
Finance costs	8	**(4,006)**	(2,378)	**(4,681)**	(7,542)
Finance income	8	**26,875**	74,406	**26,290**	34,423
Share of earnings of joint venture	11	**204**	-	**204**	-
Income/(loss) before tax		**(4,135)**	67,584	**3,786**	21,417
Current income tax recovery/(expense)		**3,747**	(1,722)	**(1,127)**	(3,475)
Deferred income tax recovery		**625**	1,461	**704**	2,779
Net income attributable to equity holders of the Company		**237**	67,323	**3,363**	20,721
OTHER COMPREHENSIVE INCOME/(LOSS)					
Gain/(loss) on available-for-sale assets, net of tax	11	**(20,087)**	(39,573)	**(25,509)**	11,175
Net comprehensive income/(loss) attributable to equity holders of the Company		**$ (19,850)**	$ 27,750	**$ (22,146)**	$ 31,896
BASIC INCOME/(LOSS) PER SHARE	9	**$ 0.00**	$ 0.37	**$ 0.02**	$ 0.11
DILUTED INCOME/(LOSS) PER SHARE	9	**$ (0.12)**	$ 0.00	**$ (0.10)**	$ (0.03)

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

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statement of Financial Position

(Unaudited)

(Expressed in thousands of U.S. Dollars)

	Notes	As at June 30, 2012	As at December 31, 2011
ASSETS			
Current assets			
Cash and cash equivalents		**$ 61,578**	$ 123,567
Trade and other receivables	10	**49,795**	80,285
Short term investments	11	**30,000**	-
Inventories	12	**57,330**	52,443
Prepaid expenses and deposits		**34,714**	38,308
Total current assets		**233,417**	294,603
Non-current assets			
Prepaid expenses and deposits		**8,389**	8,389
Property, plant and equipment	13	**555,483**	498,533
Deferred income tax assets		**20,264**	19,560
Long term investments	11	**28,935**	99,238
Total non-current assets		**613,071**	625,720
Total assets		**$ 846,488**	$ 920,323
EQUITY AND LIABILITIES			
Current liabilities			
Trade and other payables	14	**$ 14,282**	$ 52,235
Deferred revenue		**4,872**	-
Current portion of convertible debenture	15	**4,284**	6,301
Total current liabilities		**23,438**	58,536
Non-current liabilities			
Convertible debenture	15	**113,134**	139,085
Deferred income tax liabilities		**-**	2,366
Decommissioning liability		**3,934**	4,156
Total non-current liabilities		**117,068**	145,607
Total liabilities		**140,506**	204,143
Equity			
Common shares	16	**1,059,527**	1,054,298
Share option reserve		**50,957**	44,143
Investment revaluation reserve		**(8,950)**	16,559
Accumulated deficit	16	**(395,552)**	(398,820)
Total equity		**705,982**	716,180
Total equity and liabilities		**$ 846,488**	$ 920,323
Net current assets		**$ 209,979**	$ 236,067
Total assets less current liabilities		**$ 823,050**	$ 861,787

Commitments for expenditure (Note 20), contingencies (Note 21) and subsequent events (Note 22)

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

APPROVED BY THE BOARD:

"Andre Deepwell"
Director

"Pierre Lebel"
Director

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statement of Changes in Equity

(Unaudited)

(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, 2011	183,485	$ 1,061,560	$ 32,360	$ 27,761	$ (442,791)	$ 678,890
Shares issued for:						
Interest settlement on convertible debenture	375	4,011	-	-	-	4,011
Exercise of stock options, net of redemptions	643	6,960	(2,323)	-	-	4,637
Employee share purchase plan	3	50	-	-	-	50
Share-based compensation charged to operations	-	-	6,065	-	-	6,065
Common shares repurchased and cancelled	(1,470)	(8,532)	-	-	(9,647)	(18,179)
Common share repurchase costs	-	(54)	-	-	-	(54)
Net income for the period	-	-	-	-	20,721	20,721
Other comprehensive income for the period	-	-	-	11,175	-	11,175
Balances, June 30, 2011	183,036	$ 1,063,995	$ 36,102	$ 38,936	$ (431,717)	$ 707,316
Balances, January 1, 2012	**181,320**	**$1,054,298**	**$ 44,143**	**$ 16,559**	**$ (398,820)**	**$ 716,180**
Shares issued for:						
Interest settlement on convertible debenture	**522**	**4,000**	**-**	**-**	**-**	**4,000**
Exercise of stock options, net of redemptions	**163**	**1,882**	**(1,368)**	**-**	**-**	**514**
Employee share purchase plan	**30**	**212**	**-**	**-**	**-**	**212**
Share-based compensation charged to operations	**-**	**-**	**8,182**	**-**	**-**	**8,182**
Common shares repurchased and cancelled	**(148)**	**(860)**	**-**	**-**	**(95)**	**(955)**
Common share repurchase costs	**-**	**(5)**	**-**	**-**	**-**	**(5)**
Net income for the period	**-**	**-**	**-**	**-**	**3,363**	**3,363**
Other comprehensive loss for the period	**-**	**-**	**-**	**(25,509)**	**-**	**(25,509)**
Balances, June 30, 2012	**181,887**	**$1,059,527**	**$ 50,957**	**$ (8,950)**	**$ (395,552)**	**$ 705,982**

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

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statement of Cash Flows

(Unaudited)

(Expressed in thousands of U.S. Dollars)

	Notes	Six months ended June 30, 2012	Six months ended June 30, 2011
OPERATING ACTIVITIES			
Income before tax		**$ 3,786**	$ 21,417
Adjustments for:			
Depreciation and depletion		**14,273**	10,493
Share-based compensation	17	**8,182**	6,065
Finance costs	8	**4,681**	7,542
Finance income	8	**(26,290)**	(34,423)
Share of earnings of joint venture	11	**(204)**	-
Interest paid		**(8,130)**	(8,220)
Income taxes paid		**(2,349)**	(1,890)
Unrealized foreign exchange gain		**(511)**	(730)
Provision for doubtful trade and other receivables	10	**2,583**	-
Other non-cash adjustments		**342**	704
Operating cash flows before changes in non-cash working capital items		**(3,637)**	958
Net change in non-cash working capital items	19	**4,809**	(51,926)
Cash generated from/(used in) operating activities		**1,172**	(50,968)
INVESTING ACTIVITIES			
Purchase of property, plant and equipment		**(73,102)**	(135,778)
Proceeds from disposal of property, plant and equipment		**-**	1,289
Interest received		**247**	822
Proceeds from maturity or disposal of long term investments		**16,500**	32,490
Purchase of long term investments		**-**	(45,461)
Investment in joint venture		**(6,450)**	-
Cash used in investing activities		**(62,805)**	(146,638)
FINANCING ACTIVITIES			
Proceeds from issuance of common shares and exercise of stock options, net of issue costs		**726**	4,687
Repurchase of common shares, including transaction costs		**(960)**	(18,233)
Drawings under line of credit facility		**17,053**	102,216
Repayments of line of credit facility		**(17,327)**	(100,489)
Cash used in financing activities		**$ (508)**	$ (11,819)
Effect of foreign exchange rate changes on cash		**152**	120
Decrease in cash and cash equivalents		**(61,989)**	(209,305)
Cash and cash equivalents, beginning of period		**123,567**	492,038
Cash and cash equivalents, end of period		**$ 61,578**	$ 282,733
COMPRISED OF:			
Cash		**$ 61,578**	$ 257,707
Money market instruments		**-**	25,026
Total cash and cash equivalents		**$ 61,578**	$ 282,733

Supplemental cash flow information (Note 19)

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

1. CORPORATE INFORMATION

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 and Hong Kong Stock Exchange. The company, together with its subsidiaries (collectively referred to as the "Company"), is an integrated coal mining, development and exploration company. The Company's immediate parent company is Turquoise Hill Resources Ltd. (formerly Ivanhoe Mines Ltd.) ("Turquoise Hill") and at June 30, 2012, Turquoise Hill owned approximately 58% of the outstanding common shares of the Company (Note 22). Turquoise Hill is controlled by Rio Tinto plc.

The head office, principal address and registered and records office of the Company are located at 999 Canada Place, Suite 654, Vancouver, British Columbia, Canada V6C 3E1.

The Company's financial statements and those of all of its controlled subsidiaries are presented in U.S. Dollars and all values are rounded to the nearest thousand U.S. Dollars except where otherwise indicated. Information related to shares and stock options is presented in thousands except for per share information, which is presented in U.S. Dollars.

These condensed consolidated interim financial statements have been prepared on a going concern basis, which contemplates the realization of assets and settlement of liabilities in the normal course of business.

2. BASIS OF PREPARATION

2.1 Statement of compliance

These condensed consolidated interim financial statements, including comparatives, have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" ("IAS 34") using accounting policies consistent with the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the IFRS Interpretations Committee.

2.2 Basis of presentation

These condensed consolidated interim financial statements have been prepared on the basis of accounting policies and methods of computation consistent with those applied in the Company's December 31, 2011 consolidated annual financial statements.

2. BASIS OF PREPARATION (Continued)

2.3 Prior Period Reclassifications

Certain items within the Company's condensed consolidated interim statement of comprehensive income have been reclassified to better reflect the Company's increased mining operations.

The reclassifications have resulted in the introduction of a new line item entitled "other operating expenses". Expenses included in the other operating expenses line item include operating items such as: gains, losses and impairment charges on certain assets, public infrastructure expenses, sustainability and community relations expenses and foreign exchange amounts.

For the three months ended June 30, 2011, the reclassifications resulted in $3,024 from administration expenses being reclassified to other operating expenses. For the six months ended June 30, 2011, the reclassifications resulted in $4,407 from administration expenses being reclassified to other operating expenses.

2.4 Significant accounting judgments and estimates

The preparation of these interim financial statements requires management to make judgments and estimates and form assumptions that affect the reported amounts of assets and liabilities at the date of the interim financial statements and reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its judgments and estimates in relation to assets, liabilities, revenue and expenses. Management uses historical experience and various other factors it believes to be reasonable under the given circumstances as the basis for its judgments and estimates. Actual outcomes may differ from these estimates.

The most significant estimates relate to the valuation of embedded derivatives and determination of their expected life; decommissioning liabilities; property, plant and equipment, including economically recoverable reserves, depreciation and depletion; recoverability of trade and other receivables; inventory valuation; valuation of deferred income tax amounts; impairment testing; and the calculation of share-based payments.

The most significant judgments relate to the recoverability of capitalized amounts; accounting for stripping costs; recognition of deferred tax assets and liabilities; accounting for long term investments; determination of the commencement of commercial production; and the determination of the economic viability of a project.

2. BASIS OF PREPARATION (Continued)

2.5 Measurement uncertainty

On April 16, 2012, the Company announced that the Mineral Resources Authority of Mongolia (“MRAM”) held a press conference announcing a request to suspend exploration and mining activity on certain licenses owned by SouthGobi Sands LLC, a wholly-owned subsidiary of the Company. The request for suspension includes the mining license pertaining to the Ovoot Tolgoi Mine.

Advice to the Company suggests that the action has been taken under the broad national security powers of the Government of Mongolia. MRAM stated that the move is in connection to the proposed proportional takeover bid by the Aluminum Corporation of China Limited (“CHALCO”) and the agreement by Turquoise Hill to tender its controlling interest in the Company to such a takeover (Note 22).

Subsequently, on May 30, 2012, the Mongolian Minister of Mineral Resources and Energy (“MRE”) commented at a press conference that “the temporary suspension has been lifted, but regarding the new (Foreign Investment) law, the license of Ovoot Tolgoi will be discussed by the cabinet and parliament”. Subsequently, the Company has written to MRAM and the MRE requesting official clarification. However, as at August 13, 2012, no such clarification has been received.

As at August 13, 2012, the Company has not received any official notification to suspend exploration and mining activities and has no reason to believe the Company's licenses are not in good standing. The Company cautions that any official notification received will require a mandatory suspension of operations and may result in the impairment of the Company’s property, plant and equipment.

2. BASIS OF PREPARATION (Continued)

2.6 Adoption of new and revised standards and interpretations

At the date of authorization of these condensed consolidated interim financial statements, the IASB has issued the following new and revised standards, amendments and interpretations which are not yet effective for the year ended December 31, 2012.

- IFRS 9 — New financial instruments standard that replaces IAS 39 for classification and measurement of financial assets and financial liabilities (iii)
- IFRS 10 — New standard to establish principles for the presentation and preparation of consolidated financial statements when an entity controls multiple entities (ii)
- IFRS 11 — New standard to account for the rights and obligations in accordance with a joint arrangement (ii)
- IFRS 12 — New standard for the disclosure of interests in other entities not within the scope of IFRS 9/IAS 39 (ii)
- IFRS 13 — New standard on the measurement and disclosure of fair value (ii)
- IAS 1 (Amendment) — Presentation of other comprehensive income (i)
- IAS 19 (Amendment) — Revised recognition and measurement of post-employment benefits(ii)
- IAS 28 (Amendment) — New standard issued that supercedes IAS 28 (2003) to prescribe the accounting for investments in associates and joint ventures (ii)
- IFRIC 20 — New interpretation to prescribe the accounting for stripping costs in the production phase of a surface mine (ii)

(i) Effective for annual periods beginning on or after July 1, 2012
(ii) Effective for annual periods beginning on or after January 1, 2013
(iii) Effective for annual periods beginning on or after January 1, 2015

The Company is currently assessing these new and revised standards and interpretations to determine the potential impact on the consolidated financial statements.

3. SEGMENTED INFORMATION

The Company's one reportable operating segment is its Mongolian Coal Division. The Company's Chief Executive Officer (chief operating decision maker) reviews the Mongolian Coal Division's discrete financial information in order to make decisions about resources to be allocated to the segment and to assess its performance. The division is principally engaged in coal mining, development and exploration in Mongolia.

The Company's Corporate Division does not earn revenues and therefore does not meet the definition of an operating segment.

During the six months ended June 30, 2012, the Mongolian Coal Division had 6 active customers with the largest customer accounting for 44% of revenues, the second largest customer accounting for 33% of revenue and the other customers accounting for the remaining 23% of revenue.

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

3. SEGMENTED INFORMATION (Continued)

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 June 30, 2012	**$ 725,812**	**$ 120,676**	**$ 846,488**
As at December 31, 2011	696,732	223,591	920,323
Segment liabilities			
As at June 30, 2012	**$ 21,813**	**$ 118,693**	**$ 140,506**
As at December 31, 2011	51,256	152,887	204,143
Segment income/(loss)			
For the three months ended June 30, 2012	**$ (18,872)**	**$ 19,109**	**$ 237**
For the three months ended June 30, 2011	1,633	65,690	67,323
For the six months ended June 30, 2012	**$ (7,108)**	**$ 10,471**	**$ 3,363**
For the six months ended June 30, 2011	5,263	15,458	20,721
Segment revenues			
For the three months ended June 30, 2012	**$ 8,412**	**$ -**	**$ 8,412**
For the three months ended June 30, 2011	47,336	-	47,336
For the six months ended June 30, 2012	**$ 48,565**	**$ -**	**$ 48,565**
For the six months ended June 30, 2011	67,494	-	67,494

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

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

	Mongolia	Hong Kong	Canada	Consolidated Total
Revenues				
For the three months ended June 30, 2012	**$ 8,412**	**$ -**	**$ -**	**$ 8,412**
For the three months ended June 30, 2011	47,336	-	-	47,336
For the six months ended June 30, 2012	**$ 48,565**	**$ -**	**$ -**	**$ 48,565**
For the six months ended June 30, 2011	67,494	-	-	67,494
Non-current assets				
As at June 30, 2012	**$ 577,449**	**$ 197**	**$ 35,426**	**$ 613,071**
As at December 31, 2011	519,003	283	106,434	625,720

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

4. COST OF SALES

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Operating expenses	**$ 4,975**	$ 29,639	**$ 17,567**	$ 39,023
Share-based compensation expense (Note 17)	**189**	300	**1,205**	685
Depreciation and depletion	**1,470**	7,653	**5,341**	10,352
Cost of sales during mine operations	**6,634**	37,592	**24,113**	50,060
Cost of sales during idled mine period (i)	**15,587**	-	**15,587**	-
Cost of sales	**$ 22,221**	$ 37,592	**$ 39,700**	$ 50,060

(i) Cost of sales during idled mine period includes $8,785 of depreciation expense and $965 of stock-based compensation expense for the three and six month periods ended June 30, 2012. The depreciation expense relates to the Company's idled plant and equipment.

The Company curtailed its mining activities during the three months ended June 30, 2012 to varying degrees to manage coal inventories and to maintain efficient working capital levels. As at June 30, 2012, mining activities had been fully curtailed.

5. OTHER OPERATING EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Public infrastructure	**$ 1,176**	$ 3,202	**$ 1,186**	$ 3,938
Sustainability and community relations	**260**	145	**431**	480
Foreign exchange (gain)/loss	**(483)**	(323)	**1,960**	(11)
Provision for doubtful trade and other receivables (Note 10)	**2,583**	-	**2,583**	-
Other	**267**	-	**220**	-
Other operating expenses	**$ 3,803**	$ 3,024	**$ 6,380**	$ 4,407

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

6. ADMINISTRATION EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Corporate administration	**$ 1,544**	$ 1,634	**$ 3,033**	$ 3,386
Legal and professional fees	**1,338**	1,299	**1,682**	1,845
Salaries and benefits	**1,508**	986	**2,857**	1,863
Share-based compensation expense (Note 17)	**3,052**	2,848	**5,698**	4,934
Depreciation	**55**	41	**110**	116
Administration expenses	**$ 7,497**	$ 6,808	**$ 13,380**	$ 12,144

7. EVALUATION AND EXPLORATION EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Drilling and trenching	**$ 696**	$ 3,093	**$ 3,470**	$ 3,905
Other direct expenses	**458**	436	**992**	691
Share-based compensation expense (Note 17)	**177**	202	**314**	446
Overhead and other	**768**	625	**2,356**	1,305
Evaluation and exploration expenses	**$ 2,099**	$ 4,356	**$ 7,132**	$ 6,347

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

8. FINANCE COSTS AND INCOME

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Interest expense on convertible debenture (Note 15)	**$ 1,552**	$ 2,177	**$ 1,816**	$ 6,684
Unrealized loss on FVTPL investments [(i)]	**2,282**	-	**2,620**	488
Realized loss on disposal of FVTPL investments (Note 11)	**46**	-	**-**	-
Interest expense on line of credit facility	**99**	156	**187**	286
Accretion of decommissioning liability	**27**	45	**58**	84
Finance costs	**$ 4,006**	$ 2,378	**$ 4,681**	$ 7,542

(i) FVTPL is defined as "fair value through profit or loss"

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Unrealized gain on embedded derivatives in convertible debenture (Note 15)	**$ 26,770**	$ 70,422	**$ 25,995**	$ 33,641
Interest income	**105**	355	**256**	782
Unrealized gain on FVTPL investments	**-**	3,629	**-**	-
Realized gain on disposal of FVTPL investments (Note 11)	**-**	-	**39**	-
Finance income	**$ 26,875**	$ 74,406	**$ 26,290**	$ 34,423

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

9. EARNINGS/(LOSS) PER SHARE

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Net income	**$ 237**	$ 67,323	**$ 3,363**	$ 20,721
Weighted average number of shares	**181,860**	183,745	**181,802**	183,746
Basic income/(loss) per share	**$ 0.00**	$ 0.37	**$ 0.02**	$ 0.11
Income/(loss)				
Net income	**$ 237**	$ 67,323	**$ 3,363**	$ 20,721
Interest expense on convertible debenture	**1,552**	2,177	**1,816**	6,684
Unrealized gain on embedded derivatives in convertible debenture	**(26,770)**	(70,422)	**(25,995)**	(33,641)
Diluted net loss	**$ (24,981)**	$ (922)	**$ (20,816)**	$ (6,236)
Number of shares				
Weighted average number of shares	**181,860**	183,745	**181,802**	183,746
Convertible debenture	**28,128**	20,264	**28,406**	20,931
Weighted average number of dilutive stock options	**-** (i)	- (i)	**-** (i)	- (i)
Diluted weighted average number of shares	**209,988**	204,009	**210,208**	204,677
Diluted income/(loss) per share	**$ (0.12)**	$ 0.00	**$ (0.10)**	$ (0.03)

(i) The stock options were anti-dilutive for the three and six month periods ended June 30, 2012 and 2011

The diluted earnings/(loss) per share reflects the potential dilution of common share equivalents, such as the convertible debenture and outstanding stock options, in the weighted average number of common shares outstanding during the period, if dilutive.

Potentially dilutive items not included in the calculation of diluted earnings/(loss) per share for the three and six month periods ended June 30, 2012 were 10,974 stock options that were anti-dilutive (2011: 8,615 stock options).

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

10. TRADE AND OTHER RECEIVABLES

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

	As at	
	June 30, 2012	**December 31, 2011**
Trade receivables	**$ 43,852**	$ 64,051
VAT/HST receivable	**331**	144
Insurance proceeds receivable	**1,511**	12,913
Other receivables	**4,101**	3,177
Total trade and other receivables	**$ 49,795**	$ 80,285

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

	As at	
	June 30, 2012	**December 31, 2011**
Less than 1 month	**$ 4,254**	$ 50,824
1 to 3 months	**744**	3,337
3 to 6 months	**26,737**	23,699
Over 6 months	**18,060**	2,425
Total trade and other receivables	**$ 49,795**	$ 80,285

For the three and six months ended June 30, 2012, the Company recorded a $2,583 loss provision on certain customer trade receivables (2011: $nil). The loss provision relates to allowances granted to certain customers in order to expedite trade receivable cash collections.

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.

Included in trade and other receivables are amounts due from related parties which are further disclosed in Note 18. The amounts due from related parties are unsecured, interest free and repayable upon written notice from the Company.

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

11. INVESTMENTS

The Company's investments consist of the following amounts:

	As at	
	June 30, 2012	**December 31, 2011**
Short term investments at fair value		
Money market investments (i)	**$ 30,000**	$ -
Long term investments at fair value		
Money market investments (ii)	**-**	44,967
Investment in Kangaroo Resources Limited (iii)	**3,316**	7,431
Investment in Aspire Mining Limited (iv)	**18,962**	46,837
Equity-accounted investment in joint venture		
Investment in RDCC LLC	**6,657**	3
	28,935	99,238
Total short and long term investments	**$ 58,935**	$ 99,238

(i) Money market investments with original maturities greater than ninety days and maturing in less than one year
(ii) Money market investments with maturities greater than one year
(iii) At June 30, 2012, the Company owned 1.2% of Kangaroo's issued and outstanding shares
(iv) At June 30, 2012, the Company owned 19.9% of Aspire's issued and outstanding shares

11.1 Investment in Kangaroo Resources Limited

Kangaroo Resources Limited ("Kangaroo") is a company listed on the Australian Stock Exchange. Kangaroo's primary focus is its coal projects in Indonesia. The Company classifies its investment in Kangaroo as a FVTPL financial asset with any change in value being recognized in profit or loss. During the three months ended June 30, 2012, the Company disposed of 2,895 shares of Kangaroo for gross proceeds of $359 and realized a loss of $46. During the six months ended June 30, 2012, the Company disposed of 10,000 shares of Kangaroo for gross proceeds of $1,500 and realized a gain of $39.

11.2 Investment in Aspire Mining Limited

Aspire Mining Limited ("Aspire") is a company listed on the Australian Stock Exchange. Aspire's primary focus is its mineral exploration licenses in Mongolia, particularly those pertaining to the Ovoot Coking Coal Project. The Company classifies its investment in Aspire as an available-for-sale financial asset with any change in value being recognized in other comprehensive income. For the three months ended June 30, 2012, the Company recognized an unrealized loss of $20,087, net of tax, in other comprehensive income related to its investment in Aspire (2011: loss of $39,573). For the six months ended June 30, 2012, the Company recognized an unrealized loss of $25,509, net of tax, in other comprehensive income related to its investment in Aspire (2011: gain of $11,175).

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

11. INVESTMENTS (Continued)

11.3 Investment in RDCC LLC

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

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

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Balance, beginning of period	**$ 216**	$ -	**$ 3**	$ -
Funds advanced	**6,237**	-	**6,450**	-
Share of earnings of joint venture	**204**	-	**204**	-
Balance, end of period	**$ 6,657**	$ -	**$ 6,657**	$ -

For the three and six months ended June 30, 2012, RDCC LLC recognized construction revenue of $7,075 with a profit margin of $643 related to the construction of the paved highway and net earnings of $509.

12. INVENTORIES

The Company's inventories consist of the following amounts:

	As at June 30, 2012	As at December 31, 2011
Coal stockpiles	**$ 14,802**	$ 6,107
Materials and supplies	**42,528**	46,336
Total inventories	**$ 57,330**	$ 52,443

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

13. 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, 2011	$ 333,245	$ 10,253	$ 31,155	$ 94,641	$ 82,569	$ 551,863
Additions	**37,357**	**1,686**	**266**	**20,103**	**22,844**	**82,256**
Disposals	**(1,448)**	**(217)**	**-**	**-**	**(256)**	**(1,921)**
Reclassifications	**-**	**15,424**	**18,612**	**-**	**(34,036)**	**-**
As at June 30, 2012	**$369,154**	**$ 27,146**	**$ 50,033**	**$ 114,744**	**$ 71,121**	**$ 632,198**
Accumulated depreciation						
As at December 31, 2011	$ (41,498)	$ (3,465)	$ (4,631)	$ (3,736)	$ -	$ (53,330)
Charge for the period	**(20,052)**	**(2,507)**	**(1,747)**	**(734)**	**-**	**(25,040)**
Eliminated on disposals	**1,438**	**217**	**-**	**-**	**-**	**1,655**
As at June 30, 2012	**$ (60,112)**	**$ (5,755)**	**$ (6,378)**	**$ (4,470)**	**$ -**	**$ (76,715)**
Carrying amount						
As at December 31, 2011	$ 291,747	$ 6,788	$ 26,524	$ 90,905	$ 82,569	$ 498,533
As at June 30, 2012	**$309,042**	**$ 21,391**	**$ 43,655**	**$ 110,274**	**$ 71,121**	**$ 555,483**

13.1 Borrowing costs

For the three months ended June 30, 2012, the Company capitalized borrowing costs of $3,437 (2011: $2,827) into construction in progress. For the six months ended June 30, 2012, the Company capitalized borrowing costs of $8,168 (2011: $3,269) into construction in progress.

14. TRADE AND OTHER PAYABLES

Trade and other payables of the Company consist 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.

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

14. TRADE AND OTHER PAYABLES (Continued)

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

	As at	
	June 30, 2012	**December 31, 2011**
Less than 1 month	**$ 12,327**	$ 52,032
1 to 3 months	**886**	76
3 to 6 months	**1,067**	105
Over 6 months	**2**	22
Total trade and other payables	**$ 14,282**	$ 52,235

Included in trade and other payables are amounts due to related parties which are further disclosed in Note 18.

15. CONVERTIBLE DEBENTURE

15.1 Debt host and embedded derivatives

On November 19, 2009, the Company issued a convertible debenture to a wholly owned subsidiary of the China Investment Corporation ("CIC") for $500,000. The convertible debenture is secured, 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.

On March 29, 2010, pursuant to the debenture conversion terms, the Company exercised its conversion right and completed the conversion of $250,000 of the convertible debenture into 21,471 shares at a conversion price of $11.64 (Cdn$11.88).

The 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.

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

15. CONVERTIBLE DEBENTURE (Continued)

15.2 Valuation assumptions

The assumptions used in the Company's valuation models as at June 30, 2012 and December 31, 2011 are as follows:

	As at	
	June 30, 2012	**December 31, 2011**
Floor conversion price	**Cdn$8.88**	Cdn$8.88
Ceiling conversion price	**Cdn$11.88**	Cdn$11.88
Historical volatility	**71%**	71%
Risk free rate of return	**2.25%**	2.41%
Foreign exchange spot rate (U.S. Dollar to Cdn$)	**0.98**	0.98
Forward foreign exchange rate curve (U.S. Dollar to Cdn$)	**0.95 - 0.98**	0.96 - 1.01

15.3 Presentation

Based on the Company's valuations as at June 30, 2012, the fair value of the embedded derivatives decreased by $26,770 compared to March 31, 2012. This decrease was recorded as finance income for the three months ended June 30, 2012. The fair value of the embedded derivatives decreased by $25,995 compared to December 31, 2011. This decrease was recorded as finance income for the six months ended June 30, 2012.

For the three months ended June 30, 2012, the Company recorded interest expense of $4,989 (2011: $5,005) related to the convertible debenture of which $3,437 was capitalized as borrowing costs and the remaining $1,552 was recorded as a finance cost. For the six months ended June 30, 2012, the Company recorded interest expense of $9,984 (2011: $9,953) related to the convertible debenture of which $8,168 was capitalized as borrowing costs and the remaining $1,816 was recorded as a finance cost.

The interest expense consists of the interest at the contract rate and the accretion of the debt host component of the convertible debenture. To calculate the interest expense, the Company uses the contract life of 30 years and an effective interest rate of 22.2%.

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

15. CONVERTIBLE DEBENTURE (Continued)

15.3 Presentation (Continued)

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Balance, beginning of period	**$ 147,156**	$ 289,529	**$ 145,386**	$ 251,810
Interest expense on convertible debenture	**4,989**	5,005	**9,984**	9,953
Decrease in fair value of embedded derivatives	**(26,770)**	(70,422)	**(25,995)**	(33,641)
Interest paid	**(7,957)**	(7,935)	**(11,957)**	(11,945)
Balance, end of period	**$ 117,418**	$ 216,177	**$ 117,418**	$ 216,177

The convertible debenture balance consists of the following amounts:

	As at June 30, 2012	As at December 31, 2011
Debt host	**$ 90,740**	$ 90,696
Fair value of embedded derivatives	**22,394**	48,389
Interest payable	**4,284**	6,301
Convertible debenture	**$ 117,418**	$ 145,386

16. EQUITY

16.1 Share capital

The Company has authorized an unlimited number of common and preferred shares with no par value. At June 30, 2012, the Company had 181,887 common shares outstanding (December 31, 2011: 181,364) and no preferred shares outstanding (December 31, 2011: nil).

During the six months ended June 30, 2012, the Company repurchased 148 common shares on the Toronto Stock Exchange and Hong Kong Stock Exchange (2011: 1,470 common shares) at an average price of Cdn$6.44 per share (2011: Cdn$12.18 per share). As at June 30, 2012, the Company had cancelled all of the repurchased common shares.

The Company's volume weighted average share price for the six months ended June 30, 2012 was Cdn$6.48 (2011: Cdn$13.95).

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

16. EQUITY (Continued)

16.2 Accumulated deficit and dividends

At June 30, 2012, the Company has accumulated a deficit of $395,552 (December 31, 2011: $398,820). No dividends have been paid or declared by the Company since inception.

17. SHARE-BASED PAYMENTS

17.1 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 options for a maximum of 10% of the issued and outstanding common shares pursuant to the stock option plan.

For the six months ended June 30, 2012, the Company granted 1,475 stock options (2011: 1,020) to officers, employees, directors and other eligible persons at an exercise price of Cdn$6.16 (2011: exercise prices ranging from Cdn$10.79 to Cdn$14.09) and an expiry date of March 21, 2017 (2011: expiry dates ranging from January 8, 2016 to May 30, 2016). The weighted average fair value of the options granted in the six months ended June 30, 2012 was estimated at $2.87 (Cdn$2.85) (2011: $7.01, Cdn$6.84) 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:

	Six months ended June 30,	
	2012	**2011**
Risk free interest rate	**1.62%**	2.34%
Expected life	**3.5 years**	3.5 years
Expected volatility (i)	**60%**	69%
Expected dividend per share	**$nil**	$nil

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

A share-based compensation expense of $3,950 for the options granted in the six months ended June 30, 2012 (2011: $6,680) will be amortized over the vesting period, of which $668 was recognized in the six months ended June 30, 2012 (2011: $1,125).

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

17. SHARE-BASED PAYMENTS (Continued)

17.1 Stock option plan (Continued)

The total share-based compensation expense recognized for the three months ended June 30, 2012 was $4,383 (2011: $3,350). Share-based compensation of $3,052 (2011: $2,848) has been allocated to administration expenses, $1,154 (2011: $300) has been allocated to cost of sales and $177 (2011: $202) has been allocated to evaluation and exploration expenses.

The total share-based compensation expense recognized for the six months ended June 30, 2012 was $8,182 (2011: $6,065). Share-based compensation of $5,698 (2011: $4,934) has been allocated to administration expenses, $2,170 (2011: $685) has been allocated to cost of sales and $314 (2011: $446) has been allocated to evaluation and exploration expenses.

17.2 Outstanding stock options

The option transactions under the stock option plan for the six months ended June 30, 2012 and 2011 are as follows:

	Six months ended June 30, 2012		**Six months ended June 30, 2011**	
	Number of options	Weighted average exercise price (Cdn$)	Number of options	Weighted average exercise price (Cdn$)
Balance, beginning of period	**10,768**	**$ 10.73**	9,276	$ 10.82
Options granted	**1,475**	**6.16**	1,020	13.13
Options exercised	**(433)**	**5.81**	(643)	7.08
Options forfeited	**(380)**	**10.89**	(1,038)	12.99
Options expired	**(456)**	**5.95**	-	-
Balance, end of period	**10,974**	**$ 10.50**	8,615	$ 11.11

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

17. SHARE-BASED PAYMENTS (Continued)

17.2 Outstanding stock options (Continued)

The stock options outstanding and exercisable as at June 30, 2012 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)
$5.10 - $6.16	2,088	$ 5.84	3.28	768	$ 5.30	0.80
$7.16 - $11.24	4,118	9.36	3.18	1,832	9.11	2.09
$11.46 - $14.25	3,834	12.81	2.47	2,301	12.79	2.02
$15.07 - $18.86	934	16.43	0.94	867	16.54	0.81
	10,974	$ 10.50	2.76	5,768	$ 11.19	1.70

18. RELATED PARTY TRANSACTIONS

For the three and six months ended June 30, 2012 and 2011, 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 June 30, 2012 owned approximately 58% of the outstanding common shares of the Company (Note 22). Turquoise Hill provides various administrative services to the Company on a cost-recovery basis. The Company also provides some office and investor relations services to Turquoise Hill in the Company's Hong Kong office and recovers the costs for those services on a cost-recovery basis.
- Global Mining Management ("GMM") – GMM is a private Company owned equally by seven companies, two of which include the Company and Turquoise Hill. GMM provides administration, accounting and other office services to the Company on a cost-recovery basis.
- I2MS.NET Pte. Ltd. ("I2MS") – I2MS is a private company 100% owned by Turquoise Hill. I2MS provides information technology and other related services to the Company on a cost-recovery basis.
- Ivanhoe Energy Inc. ("Ivanhoe Energy") – Ivanhoe Energy is a publicly listed company with two directors in common with the Company. The Company provides some office and investor relations services to Ivanhoe Energy in the Company's Hong Kong office and recovers the costs for those services on a cost-recovery basis.

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

18. RELATED PARTY TRANSACTIONS (Continued)

18.1 Related party expenses

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Corporate administration	**$ 479**	$ 580	**$ 847**	$ 923
Salaries and benefits	**245**	357	**571**	625
Related party expenses	**$ 724**	$ 937	**$ 1,418**	$ 1,548

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
GMM	**$ 286**	$ 593	**$ 717**	$ 987
Turquoise Hill	**23**	14	**27**	70
I2MS	**415**	330	**674**	491
Related party expenses	**$ 724**	$ 937	**$ 1,418**	$ 1,548

18.2 Related party expense recoveries

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Corporate administration	**$ 248**	$ 116	**$ 512**	$ 233

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

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Turquoise Hill	**$ 210**	$ 78	**$ 435**	$ 156
Ivanhoe Energy	**38**	38	**77**	77
Related party expense recoveries	**$ 248**	$ 116	**$ 512**	$ 233

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

18. RELATED PARTY TRANSACTIONS (Continued)

18.3 Related party assets

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

	As at	
	June 30, 2012	**December 31, 2011**
Amounts due from GMM	**$ 238**	$ 238
Amounts due from Turquoise Hill	**358**	26
Amounts due from Ivanhoe Energy	**38**	13
Total assets due from related parties	**$ 634**	$ 277

18.4 Related party liabilities

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

	As at	
	June 30, 2012	**December 31, 2011**
Amounts payable to GMM	**$ 219**	$ 255
Amounts payable to I2MS	**89**	189
Total liabilities due to related parties	**$ 308**	$ 444

19. SUPPLEMENTAL CASH FLOW INFORMATION

19.1 Non-cash financing and investing activities

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

	Six months ended June 30,	
	2012	**2011**
Interest settlement on convertible debenture	**$ 4,000**	$ 4,011
Transfer of share option reserve upon exercise of options	**1,368**	2,323

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

19. SUPPLEMENTAL CASH FLOW INFORMATION (Continued)

19.2 Net change in non-cash working capital items

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

	Six months ended June 30, 2012	2011
Decrease/(increase) in trade and other receivables	**$ 28,652**	$ (36,021)
Increase in inventories	**(7,929)**	(17,500)
Decrease/(increase) in prepaid expenses and deposits	**3,593**	(5,653)
Increase/(decrease) in trade and other payables	**(24,379)**	7,248
Increase in deferred revenue	**4,872**	-
Net change in non-cash working capital items	**$ 4,809**	$ (51,926)

20. COMMITMENTS FOR EXPENDITURE

As at June 30, 2012, the Company's commitments for expenditure that have not been disclosed elsewhere in the condensed consolidated interim financial statements are as follows:

	As at June 30, 2012			
	Within 1 year	**2-3 years**	**Over 3 years**	**Total**
Capital expenditure commitments	**$ 36,280**	**$ 29,675**	**$ -**	**$ 65,955**
Operating expenditure commitments	**17,502**	**11**	**-**	**$ 17,513**
Commitments	**$ 53,782**	**$ 29,686**	**$ -**	**$ 83,468**

21. CONTINGENCIES

Due to the size, complexity and nature of the Company's operations, various legal and tax matters arise in the ordinary course of business. In the opinion of management, at June 30, 2012 a provision for these matters is not required.

22. SUBSEQUENT EVENTS

22.1 CHALCO proportional takeover bid

On April 2, 2012, the Company announced a Cooperation Agreement with CHALCO and received official notification of CHALCO's intention to make a proportional takeover bid for up to 60% of the issued and outstanding common shares of the Company at Cdn$8.48 per share ("Proportional Offer"). The Company has also been informed by its 58% major shareholder, Turquoise Hill, that Turquoise Hill has signed a lock-up agreement with CHALCO, committing to tender all of its shares held or thereafter acquired by it during the offer period of CHALCO into the Proportional Offer. CHALCO's obligations under the Cooperation Agreement will become effective upon CHALCO acquiring a shareholding in the Company.

CHALCO had stated that it expected to mail the takeover bid circular in connection with the Proportional Offer on or about July 5, 2012. On July 3, 2012, CHALCO and Turquoise Hill announced a 30 day extension for CHALCO to mail the takeover bid circular.

Subsequently, on August 2, 2012, an additional 30 day extension was announced by CHALCO and Turquoise Hill. CHALCO has agreed to mail the takeover bid circular on or before September 4, 2012.

23. APPROVAL OF THE FINANCIAL STATEMENTS

The condensed consolidated interim financial statements of SouthGobi Resources Ltd. for the six months ended June 30, 2012 were approved and authorized for issue by the Board of Directors on August 13, 2012.

(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 in the half-year interim report and not shown elsewhere in this report is as follows:

A1. TAXATION ON PROFITS

The Company and its subsidiaries are subject to income or profits tax in the jurisdictions in which the Company operates, including Canada, Hong Kong, Singapore and Mongolia. Income or profits tax was not provided for the Company's operations in Canada, Hong Kong or Singapore as the Company had no assessable income or profit arising in or derived from these jurisdictions.

For the six months ended June 30, 2012 the Company recorded current income tax expense of $1,127 (2011: $3,475) related to assessable profit derived from Mongolia at prevailing rates. For the six months ended June 30, 2012, the Company recorded a deferred income tax recovery of $704 (2011: $2,779) related to its Mongolian operations.

A2. SHARE REPURCHASE

During the six months ended June 30, 2012, the Company repurchased its own common shares through the Toronto Stock Exchange and Hong Kong Stock Exchange as follows:

Month of repurchase	Shares repurchased	Price per share Highest	Price per share Lowest	Aggregate consideration paid
March 2012	**148**	**Cdn$6.58**	**Cdn$6.36**	**$ 955**
	148			**$ 955**

As at June 30, 2012, the Company had cancelled all of the repurchased common shares. None of the Company's subsidiaries repurchased, sold or redeemed any of the Company's shares during the six months ended June 30, 2012.

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

A3. FINANCIAL INSTRUMENTS

Cash and cash equivalents

The Company's cash and cash equivalents are denominated in the following currencies:

	As at June 30, 2012	As at December 31, 2011
Denominated in U.S. Dollars	**$ 55,967**	$ 114,941
Denominated in Mongolian Tugriks	**2,386**	1,440
Denominated in Canadian Dollars	**1,740**	3,027
Denominated in Hong Kong Dollars	**1,485**	3,757
Others	**-**	402
Cash and cash equivalents	**$ 61,578**	$ 123,567

Exposure to fluctuations in foreign exchange rates

The sensitivity of the Company's comprehensive income due to changes in the carrying values of 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 June 30, 2012	As at December 31, 2011
Increase / decrease in foreign exchange rate		
+5%	**$ 3,285**	$ 4,414
−5%	**(3,285)**	(4,414)

A4. COMPLIANCE WITH CORPORATE GOVERNANCE

The Company has, throughout the six months ended June 30, 2012, applied the principles and complied with the requirements of its corporate governance practices as defined by the Board of Directors and all applicable statutory, regulatory and stock exchange listings standards (old Corporate Governance Code from January 1, 2012 to March 31, 2012 and new Corporate Governance Code from April 1, 2012 to June 30, 2012).

A5. COMPLIANCE WITH MODEL CODE

The Company has adopted policies regarding directors' securities transactions in its Corporate Disclosure, Confidentiality and Securities Trading policy that has terms that are no less exacting than those set out in the Model Code of Appendix 10 of the rules governing the listing of securities on the Hong Kong Stock Exchange.

The Board of Directors confirms that all of the Directors of the Company have complied with the required policies in the Company's Corporate Disclosure, Confidentiality and Securities Trading policy throughout the six months ended June 30, 2012.

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

A6. DIRECTORS' AND CHIEF EXECUTIVES' INTEREST IN SHARES AND SHARE OPTIONS

As at June 30, 2012, the interests of the directors, Mr. Curt Church, the Chief Operating Officer of the Company and Mr. Matthew O'Kane, the Chief Financial Officer of the Company, in the shares and share options of the Company and its associated corporations were as follows:

Shares

Name	Name of company	Nature of interest	Shares held	Approximate percentage interest in the company
Peter Meredith	SouthGobi Resources Ltd.	N/A	nil	nil
	Turquoise Hill Resources Ltd.	N/A	nil	nil
Alexander Molyneux	SouthGobi Resources Ltd.	Personal	27	0.015%
	Turquoise Hill Resources Ltd.	N/A	nil	nil
Pierre Lebel	SouthGobi Resources Ltd.	Personal	5	0.003%
	Turquoise Hill Resources Ltd.	N/A	nil	nil
André Deepwell	SouthGobi Resources Ltd.	Personal	2	0.001%
	Turquoise Hill Resources Ltd.	N/A	nil	nil
Robert Hanson	SouthGobi Resources Ltd.	Personal	8	0.004%
	Turquoise Hill Resources Ltd.	N/A	nil	nil
R. Edward Flood	SouthGobi Resources Ltd.	N/A	nil	nil
	Turquoise Hill Resources Ltd.	Personal	30	0.004%
Gordon Lancaster	SouthGobi Resources Ltd.	N/A	nil	nil
	Turquoise Hill Resources Ltd.	N/A	nil	nil
Curt Church	SouthGobi Resources Ltd.	Personal	9	0.005%
	Turquoise Hill Resources Ltd.	N/A	nil	nil
Matthew O'Kane	SouthGobi Resources Ltd.	N/A	nil	nil
	Turquoise Hill Resources Ltd.	N/A	nil	nil

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

A6. DIRECTORS' AND CHIEF EXECUTIVES' INTEREST IN SHARES AND SHARE OPTIONS (Continued)

Options

Name	**Name of company**	**Number of options held**
Peter Meredith	SouthGobi Resources Ltd.	440
	Turquoise Hill Resources Ltd.	2,049
Alexander Molyneux	SouthGobi Resources Ltd.	1,550
	Turquoise Hill Resources Ltd.	69
Pierre Lebel	SouthGobi Resources Ltd.	175
	Turquoise Hill Resources Ltd.	nil
André Deepwell	SouthGobi Resources Ltd.	170
	Turquoise Hill Resources Ltd.	nil
Robert Hanson	SouthGobi Resources Ltd.	168
	Turquoise Hill Resources Ltd.	64
R. Edward Flood	SouthGobi Resources Ltd.	168
	Turquoise Hill Resources Ltd.	87
Gordon Lancaster	SouthGobi Resources Ltd.	203
	Turquoise Hill Resources Ltd.	nil
Curt Church	SouthGobi Resources Ltd.	845
	Turquoise Hill Resources Ltd.	nil
Matthew O'Kane	SouthGobi Resources Ltd.	545
	Turquoise Hill Resources Ltd.	nil

SouthGobi Resources Ltd.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

June 30, 2012

(Unaudited)

(Expressed in U.S. Dollars)

FORWARD-LOOKING STATEMENTS

Except for statements of fact relating to the Company, certain information contained herein constitutes forward-looking statements. Forward-looking statements are frequently characterized by words such as "plan", "expect", "project", "intend", "believe", "anticipate" and other similar words, or statements that certain events or conditions "may" or "will" occur. Forward-looking statements are based on the opinions and estimates of management at the dates the statements are made, and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements. These factors include the inherent risks involved in the exploration and development of mineral properties, the uncertainties involved in interpreting drilling results and other geological data, fluctuating commodity prices, the possibility of project cost overruns or unanticipated costs and expenses, uncertainties related to completion results of planned exploration and development programs on the Company's material properties, issuance of licenses and permits and the availability of and costs of financing needed in the future and other factors described in this discussion under the heading "Outlook". Except as required by law, the Company undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change. The reader is cautioned not to place undue reliance on forward-looking statements.

TABLE OF CONTENTS

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

1. OVERVIEW

SouthGobi Resources Ltd. (which, together with its subsidiaries, is collectively referred to as the "Company" or "SouthGobi") is an integrated coal mining, development and exploration company. Since acquiring significant coal assets in Mongolia in a series of transactions with Turquoise Hill Resources Ltd. (formerly Ivanhoe Mines Ltd.) ("Turquoise Hill"), the Company's strategic focus has been in developing and operating coal mining projects.

SouthGobi's common shares trade on the Toronto Stock Exchange ("TSX") under the symbol SGQ and on the Hong Kong Stock Exchange ("HKEX") under the stock code symbol 1878.

The Company owns the following significant coal projects in Mongolia: the Ovoot Tolgoi open pit producing coal mine ("Ovoot Tolgoi Mine") and three 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 ("km") of each other and in close proximity to the Mongolia-China border.

The Ovoot Tolgoi Mine, together with the Ovoot Tolgoi Underground Deposit, forms the Ovoot Tolgoi Complex. The Ovoot Tolgoi Complex is separated into two distinct areas, the Sunrise and Sunset Pits.

The Ovoot Tolgoi Mine, strategically located approximately 40km from the Shivee Khuren-Ceke crossing at the Mongolia-China border ("Shivee Khuren Border Crossing"), is the Company's flagship asset. SouthGobi commenced mining at Ovoot Tolgoi's Sunset Pit in April 2008 and commenced coal sales in September 2008. In August 2011, the Company commenced mining and sales at Ovoot Tolgoi's Sunrise Pit. Products from the Ovoot Tolgoi Mine include coals with coking (or metallurgical) applications, primarily a raw semi-soft coking coal together with raw medium and higher-ash coals, which can be washed and blended into semi-soft coking coal. The Ovoot Tolgoi Mine is covered by a single 9,308 hectare ("ha") mining license and a corresponding permit to mine.

The Soumber Deposit, comprising the Central Soumber, East Soumber, Biluut, South Biluut and Jargalant Fields, is located approximately 20km to the east of the Ovoot Tolgoi Mine, which will allow any future mining operation at the Soumber Deposit to share existing infrastructure with the Ovoot Tolgoi Mine. Exploration results show potential for thick coking coal seams and a resource has been established confirming the deposit. On June 3, 2011, the Company announced that it had successfully registered the resource associated with the Soumber Deposit (at that time comprising the Central Soumber, East Soumber and Biluut Fields) with the Mineral Resources Authority of Mongolia ("MRAM"). Further, on July 6, 2011, the Company announced that MRAM had issued the Company a mining license pertaining to the Soumber Deposit. The new 10,993ha mining license was granted for an initial term of 30 years with an option for two 20 year extensions.

1. OVERVIEW (Continued)

A successful exploration program in the vicinity of the Soumber Deposit during 2011 resulted in additional coal resources being identified. Resources associated with the South Biluut and Jargalant Fields have been through the resource registration process and the exploration licenses pertaining to resources outside the mining license are subject to valid Pre-Mining Agreement ("PMA") applications (refer to Section 2.1 for additional information). Subsequent to the receipt of the PMAs, the Company intends to proceed through to the mining license application process.

The Zag Suuj Deposit is located approximately 150km east of the Ovoot Tolgoi Mine and approximately 80km north of the Mongolia-China border. A maiden National Instrument 43-101 ("NI 43-101") compliant resource has been established for the Zag Suuj Deposit. Exploration results indicate potential for thick coal seams and it is anticipated that the coals from the Zag Suuj Deposit can be washed to produce a coking coal or coking coal blend product. The Zag Suuj Deposit resource has been through the resource registration process and the exploration licenses pertaining to it are subject to valid PMA applications (refer to Section 2.1 for additional information).

The Company has conducted substantial exploration activities at the Ovoot Tolgoi Underground Deposit and has delineated mineral resources. The Ovoot Tolgoi Underground Deposit is covered by the existing Ovoot Tolgoi mining license.

As at June 30, 2012, SouthGobi owned 19.9% of Aspire Mining Limited ("Aspire"), a company listed on the Australian Stock Exchange under the symbol AKM. Aspire's primary focus is its mineral exploration licenses in Mongolia, particularly those pertaining to the Ovoot Coking Coal Project.

As at August 13, 2012, Turquoise Hill directly owned 104.8 million common shares representing approximately 58% of the issued and outstanding common shares of SouthGobi.

1.1 Corporate Highlights

Sales volume and revenue declined to 0.16 million tonnes and $8.4 million, respectively, in the second quarter of 2012 primarily due to the significant uncertainty resulting from the proposed proportional takeover bid by the Aluminum Corporation of China Limited ("CHALCO"), which resulted in MRAM holding a press conference announcing a request to suspend exploration and mining activity on certain licenses, various infrastructure constraints in Mongolia and the softening of inland China coking coal markets towards the end of the second quarter.

1. OVERVIEW (Continued)

The Company produced 0.27 million tonnes of raw coal with a strip ratio of 4.31 in the second quarter of 2012 compared to production of 0.87 million tonnes of raw coal with a strip ratio of 4.74 in the second quarter of 2011. SouthGobi curtailed its mining activities in the second quarter of 2012 to varying degrees to manage coal inventories and to maintain efficient working capital levels. As at June 30, 2012, mining activities had been fully curtailed. Due to the curtailment of its mining operations, the Company suspended uncommitted capital expenditures and exploration expenditures to preserve the Company's financial resources.

On April 2, 2012, SouthGobi announced that it had signed a Cooperation Agreement with CHALCO and received official notification of CHALCO's intention to make a proportional takeover bid for up to 60% of the issued and outstanding common shares of SouthGobi at Cdn$8.48 per share (refer to Section 8 for additional information).

On April 16, 2012, SouthGobi announced that MRAM held a press conference announcing a request to suspend exploration and mining activity on certain licenses owned by SouthGobi Sands LLC, a wholly-owned subsidiary of SouthGobi Resources Ltd. As at August 13, 2012, the Company has not received any official notification and has no reason to believe SouthGobi's licenses are not in good standing. However, the Company cautions that any official notification received will require a mandatory suspension of operations.

On May 29, 2012, SouthGobi announced the opening of expanded border crossing infrastructure at the Shivee Khuren Border Crossing. The eight new border gates, exclusively for coal transportation, will significantly increase the capacity for exportation of coal from Mongolia to China.

On June 19, 2012, the Company announced that a ribbon cutting ceremony had been held to commemorate the start of construction on the new paved coal highway from the Ovoot Tolgoi Complex to the Shivee Khuren Border Crossing.

On July 11, 2012, the Company announced that SGQ Coal Investment Pte. Ltd., a wholly-owned subsidiary of SouthGobi Resources Ltd. that owns 100% of the Company's Mongolian operating subsidiary SouthGobi Sands LLC, filed a Notice of Investment Dispute on the Government of Mongolia pursuant to the Bilateral Investment Treaty between Singapore and Mongolia.

2. MINERAL PROPERTIES

Disclosure of a scientific or technical nature in this Management's Discussion and Analysis ("MD&A") with respect to the Company's Mongolian Coal Division was prepared by, or under the supervision of Dave Bartel, P.Eng., the Company's Senior Engineer. Mr. Bartel is a "qualified person" for the purposes of NI 43-101 of the Canadian Securities Administrators.

2.1 Mongolian Coal Division

The Company currently holds three mining licenses and eight exploration licenses (four of which have valid PMA applications lodged), which in total cover an area of approximately 418,000ha.

Unless stated otherwise, the Company owns a 100% interest in its coal projects.

Regulatory Issues in Mongolia

On April 16, 2012, SouthGobi announced that MRAM held a press conference announcing a request to suspend exploration and mining activity on certain licenses owned by SouthGobi Sands LLC. The request for suspension includes the mining license pertaining to the Ovoot Tolgoi Mine.

Advice to the Company suggests that the action has been taken under the broad national security powers of the Government of Mongolia. MRAM stated that the move is in connection to the proposed proportional takeover bid by CHALCO and the agreement by Turquoise Hill to tender its controlling interest in SouthGobi to such a takeover (refer to Section 8 for additional information).

Subsequently, on May 30, 2012, the Mongolian Minister of Mineral Resources and Energy ("MRE") commented at a press conference that "the temporary suspension has been lifted, but regarding the new (Foreign Investment) law, the license of Ovoot Tolgoi will be discussed by the cabinet and parliament." Subsequently, the Company has written to MRAM and the MRE requesting official clarification. However, as at August 13, 2012, no such clarification has been received.

As at August 13, 2012, the Company has not received any official notification to suspend exploration and mining activity on certain licenses and has no reason to believe SouthGobi's licenses are not in good standing. However, the Company cautions that any official notification received will require a mandatory suspension of operations and may result in the impairment of the Company's property, plant and equipment.

2. MINERAL PROPERTIES (Continued)

Although no official notification has been received to date, SouthGobi continues to be impacted by the uncertainty over its licenses. Many government bodies and regulatory authorities in Mongolia are reluctant to provide approvals and permits. For example, SouthGobi has been unable to receive an approval for a revision to its Environmental Impact Assessment for the dry coal handling facility ("DCHF") from the Mongolian Ministry of Environment. As a result, SouthGobi may be unable to operate the DCHF until it receives approval for the revised Environmental Impact Assessment.

Notice of Investment Dispute

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

The Notice of Investment Dispute consists of, but is not limited to, the failure by MRAM to execute the PMAs associated with certain exploration licenses of the Company pursuant to which valid PMA applications had been lodged in 2011. The areas covered by the valid PMA applications include the Zag Suuj Deposit and certain areas associated with the Soumber Deposit outside the existing mining license.

The Notice of Investment Dispute triggers the dispute resolution process under the Bilateral Investment Treaty whereby the Government of Mongolia has a six-month cure period from the date of receipt of the notice to satisfactorily resolve the dispute through negotiations. If the negotiations are not successful, the Company will be entitled to commence conciliation/arbitration proceedings under the auspices of the International Centre for Settlement of Investment Disputes ("ICSID") pursuant to the Bilateral Investment Treaty. However, in the event that the Government of Mongolia fails to negotiate, ICSID arbitration proceedings may be accelerated before the six months have expired.

Activities historically carried out on the exploration licenses with valid PMA applications include drilling, trenching and geological reconnaissance. The Company has no immovable assets located on these licenses and the loss of any or all of these licenses would not materially and adversely affect the existing operations.

2. MINERAL PROPERTIES (Continued)

Mining Prohibition in Specified Areas Law

Pursuant to the Mining Prohibition in Specified Areas Law, the Government of Mongolia was to define the boundaries of the areas in which exploration and mining would be prohibited by October 16, 2009. However, the Government of Mongolia has not yet approved and published this information.

A draft list of licenses has been prepared that overlap with the prohibited areas described in the new law based on information submitted by water authority agencies, forest authority agencies and local authorities for submission to the Government of Mongolia. In February 2011, the potential forest and water areas were updated. The Government of Mongolia must give its final approval before the final list can be published; licenses may be added or subtracted to the list at any time prior to approval and publication of the final list.

The Company's Tsagaan Tolgoi mining license and exploration licenses pertaining to the Zag Suuj Deposit and the South Biluut and Jargalant Fields within the Soumber Deposit, as well as two other exploration licenses, may be included on the draft list of licenses published by the Government of Mongolia, potentially affecting the status of those licenses under the Mining Prohibition in Specified Areas Law.

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

Operating Mines

Ovoot Tolgoi Mine

The Ovoot Tolgoi Mine is located in the southwest corner of the Umnugobi Aimag (South Gobi Province) of Mongolia. The deposit is within the administrative unit of Gurvantes Soum, 270km southwest of the provincial capital of Dalanzadgad and 700km southwest of the nation's capital of Ulaanbaatar. To date, mining operations at the Ovoot Tolgoi Mine have been carried out in two distinct areas, the Sunset Pit to the west and the Sunrise Pit to the east.

Products from the Ovoot Tolgoi Mine include coals with coking (or metallurgical) applications, primarily a raw semi-soft coking coal together with raw medium and higher-ash coals, which can be washed and blended into semi-soft coking coal.

2. MINERAL PROPERTIES (Continued)

Reserves and Resources

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

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

Select Financial and Operational Data

	Three months ended June 30,		**Six months ended June 30,**	
	2012	**2011**	**2012**	**2011**
Volumes, Prices and Costs				
Raw coal production *(millions of tonnes)*	**0.27**	0.87	**1.33**	1.98
Coal sales *(millions of tonnes)*	**0.16**	1.05	**1.00**	1.50
Average realized selling price *(per tonne)*	**$ 62.56**	$ 54.06	**$ 57.71**	$ 52.92
Direct cash costs of product sold excluding idled mine costs *(per tonne)* [(i)]	**$ 22.57**	$ 26.77	**$ 12.67**	$ 24.39
Total cash costs of product sold excluding idled mine costs *(per tonne)* [(i)]	**$ 31.49**	$ 27.61	**$ 17.65**	$ 25.49
Operating Statistics				
Production waste material moved *(millions of bank cubic meters)*	**1.16**	4.08	**3.36**	7.93
Strip ratio *(bank cubic meters of waste rock per tonne of coal produced)*	**4.31**	4.74	**2.52**	4.03
Pre-production waste material moved *(millions of bank cubic meters)*	**-**	0.80	**-**	1.28
Operating Results *($ in thousands)*				
Revenue	**$ 8,412**	$ 47,336	**$ 48,565**	$ 67,494
Cost of sales				
Mine operations	**6,634**	37,592	**24,113**	50,060
Idled mine costs	**15,587**	-	**15,587**	-
Gross profit/(loss)	**$ (13,809)**	$ 9,744	**$ 8,865**	$ 17,434

(i) A non-IFRS financial measure, see Section 4

2. MINERAL PROPERTIES (Continued)

For the three months ended June 30, 2012

For the three months ended June 30, 2012, the Company produced 0.27 million tonnes of raw coal with a strip ratio of 4.31 compared to production of 0.87 million tonnes of raw coal for the three months ended June 30, 2011 with a strip ratio of 4.74. SouthGobi curtailed its mining activities during the three months ended June 30, 2012 to varying degrees to manage coal inventories and to maintain efficient working capital levels. As at June 30, 2012, mining activities had been fully curtailed.

For the three months ended June 30, 2012, the Company sold 0.16 million tonnes of coal at an average realized selling price of $62.56 per tonne compared to sales of 1.05 million tonnes of coal at an average realized selling price of $54.06 per tonne for the three months ended June 30, 2011. The increase in the average realized selling price is primarily related to the Company's improved sales mix. Revenue decreased to $8.4 million for the three months ended June 30, 2012 from $47.3 million for the three months ended June 30, 2011.

For the three months ended June 30, 2012 customers were reluctant to enter into significant sales contracts primarily due to the following:

- Customers' ability to export coal through the Shivee Khuren Border Crossing for the first half of 2012 was far below their projections due to: a) the delayed opening of the expanded border crossing infrastructure at the Shivee Khuren Border Crossing; b) the extended closure of the Shivee Khuren Border Crossing for the Chinese New Year and Mongolian Tsagaan Sar public holidays in the first quarter of 2012; c) the closure of the existing gravel road used to transport coal from the Ovoot Tolgoi Mine and neighboring mines to the Shivee Khuren Border Crossing for over four weeks in the second quarter of 2012;
- Uncertainty with respect to whether SouthGobi would receive a formal request from MRAM to suspend mining activities on its Ovoot Tolgoi mining license had customers concerned that they would be unable to collect and export additional coal purchased from the Ovoot Tolgoi Mine; and
- The softening of inland China coking coal markets closest to SouthGobi's operations towards the end of the second quarter.

2. MINERAL PROPERTIES (Continued)

Revenues are presented net of royalties and selling fees. The Company is subject to a 5% royalty on all coal sales exported out of Mongolia based on a set reference price per tonne published monthly by the Government of Mongolia. Effective January 1, 2011, the Company is also subject to a sliding scale additional royalty of up to 5% on coal sales exported out of Mongolia based on the set reference price. Based on the reference prices for the second quarter of 2012, the Company was subject to an average 8% royalty based on a weighted average reference price of $97.83 per tonne. The Company's effective royalty rate for the second quarter of 2012, based on the Company's average realized selling price of $62.56 per tonne, was 13%.

Together with other Mongolian mining companies affected by the escalation of effective royalty rates, a dialog was opened on this topic with the appropriate Government of Mongolia authorities with a view to moving to a more equitable process for setting reference prices. There has been a successful outcome and commencing February 2012 royalty reference prices are now based on prices for coal products sold at the two main coal export border locations in Mongolia, namely Shivee Khuren-Ceke and Gashuun Sukhait-Ganqimaodao. The dialog is continuing, with the aim of having prices based on actual contract prices for sales at these locations, excluding export fees and Chinese VAT (i.e. revenue received for coal delivered to the Mongolia-China border prior to export).

Cost of sales was $22.2 million for the three months ended June 30, 2012 compared to $37.6 million for the three months ended June 30, 2011. Cost of sales comprise the direct cash costs of product sold, mine administration cash costs of product sold, idled mine costs, equipment depreciation, depletion of mineral properties and share-based compensation. Of the $22.2 million recorded as cost of sales for the three months ended June 30, 2012, $6.6 million related to mine operations and $15.6 million related to idled mine costs. Cost of sales related to mine operations decreased for the three months ended June 30, 2012 compared to the three months ended June 30, 2011 primarily due to lower sales volumes, partially offset by higher unit costs.

Direct cash costs of product sold excluding idled mine costs (a non-IFRS financial measure, see Section 4) were $22.57 per tonne for the three months ended June 30, 2012 compared to $26.77 per tonne for the three months ended June 30, 2011. Direct cash costs of product sold excluding idled mine costs have primarily decreased as a result of a lower strip ratio and reduced fuel prices.

Mine administration cash costs of product sold excluding idled mine costs (a non-IFRS financial measure, see Section 4) increased to $8.92 per tonne for the three months ended June 30, 2012 from $0.84 per tonne for the three months ended June 30, 2011 due to increased mine administration costs being allocated over lower sales volumes.

2. MINERAL PROPERTIES (Continued)

For the six months ended June 30, 2012

For the six months ended June 30, 2012, the Company produced 1.33 million tonnes of raw coal with a strip ratio of 2.52 compared to production of 1.98 million tonnes of raw coal with a strip ratio of 4.03 for the six months ended June 30, 2011. The decrease in production primarily related to the curtailment of the Company's mining operations in the second quarter of 2012; whereas, the decrease in the strip ratio primarily related to the below-trend strip ratio in the first quarter of 2012 which will be normalized over the life-of-mine.

For the six months ended June 30, 2012, the Company sold 1.00 million tonnes of coal at an average realized selling price of $57.71 per tonne compared to sales of 1.50 million tonnes of coal at an average realized selling price of $52.92 per tonne for the six months ended June 30, 2011. Revenue decreased to $48.6 million for the six months ended June 30, 2012 from $67.5 million for the six months ended June 30, 2011 primarily due to decreased sales volumes in the second quarter of 2012, partially offset by higher sales volumes in the first quarter of 2012 and higher average realized selling prices for the first half of 2012.

Revenues are presented net of royalties and selling fees. Based on the reference prices for the first half of 2012, the Company was subject to an average 8% royalty based on a weighted average reference price of $95.44 per tonne. The Company's effective royalty rate for the first half of 2012, based on the Company's average realized selling price of $57.71 per tonne, was 13%.

Cost of sales was $39.7 million for the six months ended June 30, 2012 compared to $50.1 million for the six months ended June 30, 2011. Cost of sales comprise the direct cash costs of product sold, mine administration cash costs of product sold, idled mine costs, equipment depreciation, depletion of mineral properties and share-based compensation. Of the $39.7 million recorded as cost of sales for the six months ended June 30, 2012, $24.1 million related to mine operations and $15.6 million related to idled mine costs. Cost of sales related to mine operations decreased for the six months ended June 30, 2012 compared to the six months ended June 30, 2011 primarily due to lower sales volumes and lower unit costs.

Direct cash costs of product sold excluding idled mine costs (a non-IFRS financial measure, see Section 4) were $12.67 per tonne for the six months ended June 30, 2012 compared to $24.39 per tonne for the six months ended June 30, 2011. Direct cash costs of product sold excluding idled mine costs have primarily decreased as a result of a lower strip ratio and reduced fuel prices.

2. MINERAL PROPERTIES (Continued)

Mine administration cash costs of product sold excluding idled mine costs (a non-IFRS financial measure, see Section 4) increased to $4.98 per tonne for the six months ended June 30, 2012 from $1.10 per tonne for the six months ended June 30, 2011 due to increased mine administration costs being allocated over lower sales volumes.

Processing Infrastructure

On February 13, 2012, the Company announced the successful commissioning of the DCHF at the Ovoot Tolgoi Mine. However, until the Company receives approval for a revision to its Environmental Impact Assessment from the Mongolian Ministry of Environment it may be unable to operate the DCHF. The DCHF has capacity to process nine million tonnes of run-of-mine ("ROM") coal per year. The DCHF includes a 300-tonne-capacity dump hopper, which receives ROM coal from the Ovoot Tolgoi Mine and feeds a coal rotary breaker that sizes coal to a maximum of 50 millimeters ("mm") and rejects oversize ash. Prior to the commissioning of the rotary breaker, temporary screening operations were used at the Ovoot Tolgoi Mine to process higher-ash coals. Screening performed a similar function to the rotary breaker, namely rejecting oversize ash and sizing the coal to a maximum of 50mm; however, the rotary breaker is anticipated to reduce screening costs and improve yield recoveries. If the DCHF is unable to operate until the revised Environmental Impact Assessment is received, the Company will continue to temporarily screen higher-ash coals.

During the course of 2012, the Company will continue to upgrade the DCHF to include dry air separation modules and covered load out conveyors with fan stackers to take processed coals to stockpiles and enable more efficient blending. However, uncommitted capital expenditures have been suspended while mining operations at the Ovoot Tolgoi Mine are curtailed to preserve the Company's financial resources.

To further enhance product value, the Company entered into an agreement with Ejinaqi Jinda Coal Industry Co. Ltd ("Ejin Jinda"), a subsidiary of China Mongolia Coal Co. Ltd ("CMC") to wet wash coal from the Ovoot Tolgoi Mine on a tolling arrangement. The agreement has a duration of 5 years from commencement and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input coal (i.e. sufficient capacity to wet wash medium and higher-ash coals after DCHF processing).

2. MINERAL PROPERTIES (Continued)

Ejin Jinda's wet washing facility is located approximately 10km inside China from the Shivee Khuren Border Crossing (i.e. approximately 50km from the Ovoot Tolgoi Mine). Medium and higher-ash coals with only basic processing through Ovoot Tolgoi's on-site DCHF will be transported from the Ovoot Tolgoi Mine to the facility under a separate transport agreement. Based on preliminary studies, the Company expects these coals can then be washed to produce coals with ash in the range of 8% to 11% at a yield of 85% to 90%. Ejin Jinda will charge the Company a single toll washing fee which will cover their expenses, capital recovery and profit. Washed coal will generally meet semi-soft coking coal specifications.

Construction of Ejin Jinda's wet washing facility is now complete and it has been connected to utility supply. Commencement of toll washing of coals from the Ovoot Tolgoi Mine has been delayed due to the curtailment of the Company's mining operations at the Ovoot Tolgoi Mine. The delay in commissioning has no impact on the carrying value of the Company's prepaid toll washing fees of $33.6 million.

Transportation Infrastructure

In July 2009, Chinese and Mongolian authorities agreed to create designated coal transportation corridors at the Shivee Khuren Border Crossing. In 2011, SouthGobi, together with Mongolyn Alt Corporation ("MAK"), completed the road and construction works required on the Mongolian side of the border to match the existing Chinese infrastructure. On May 28, 2012, the expanded border crossing infrastructure, consisting of eight new border gates exclusively for coal transportation, opened at the Shivee Khuren Border Crossing. The expanded border crossing infrastructure will eliminate the existing bottleneck at the Shivee Khuren Border Crossing and is expected to increase capacity to approximately 20 million tonnes or more of coal per year.

In June 2012, due to the expanded border crossing infrastructure at the Shivee Khuren Border Crossing, the Company's customers exported 0.58 million tonnes of Ovoot Tolgoi Mine coal (mostly from customer inventories) from Mongolia to China, representing a monthly export record of coal from the Ovoot Tolgoi Mine.

2. MINERAL PROPERTIES (Continued)

On August 2, 2011, the State Property Committee of Mongolia awarded the tender to construct a paved highway from the Ovoot Tolgoi Complex to the Shivee Khuren Border Crossing to consortium partners NTB LLC and SouthGobi Sands LLC (together referred to as "RDCC"). SouthGobi Sands LLC holds a 40% interest in RDCC. On October 26, 2011, RDCC signed a concession agreement with the State Property Committee of Mongolia. RDCC now has the right to conclude a 17 year build, operate and transfer agreement under the Mongolian Law on Concessions. RDCC has engaged a contractor and construction on the paved highway has commenced. Completion of the paved highway is expected mid-2013. The paved highway will have an intended carrying capacity upon completion in excess of 20 million tonnes of coal per year.

A north-south railway line currently connects Ceke with Jiayuguan City in Gansu Province and with the interior of China. Another east-west railway line connects Ceke to Linhe, an industrial city in eastern Inner Mongolia. This line has a stated initial transportation capacity of approximately 15 million tonnes per year, with a planned increase to 25 million tonnes per year.

Mining Equipment

The key elements of the currently commissioned mining fleets include: Two Liebherr 996 ($34m^3$) hydraulic excavators, two Liebherr R9250 ($15m^3$) hydraulic excavators, eighteen Terex MT4400 (218 tonne capacity) haul trucks and nine Terex TR100 (91 tonne capacity) haul trucks, together with various pieces of ancillary equipment. The Company commissioned a second Liebherr 996 ($34m^3$) hydraulic excavator in the second quarter of 2012.

On September 27, 2011, a fire occurred on the Company's Liebherr 996 hydraulic shovel that was commissioned at the Ovoot Tolgoi Mine in December 2009 (previously included in the mining fleet). Safety protocols were followed and there were no injuries. Following subsequent inspection and third-party reports, the Company decommissioned the machine.

To compensate for the loss of the Liebherr 996 hydraulic shovel, the Company has contracted to purchase an additional Liebherr R9250 ($15m^3$) hydraulic excavator, which will be commissioned in second half of 2012.

The Company has also contracted to purchase three additional Terex MT4400 (218 tonne capacity) haul trucks to replace its existing Terex TR100 (91 tonne capacity) haul trucks to increase the overall efficiency of the mining fleet.

2. MINERAL PROPERTIES (Continued)

Through the purchase of the additional mining equipment, SouthGobi has secured additional mining capacity to ramp-up its operations towards achieving steady-state production in 2015.

Workforce

As at June 30, 2012, SouthGobi Sands LLC employed 673 employees, of which only 245 are active due to the curtailment of the mining operations. Of the 673 employees, 69 are employed in the Ulaanbaatar office, 3 in outlying offices and 601 at the Ovoot Togloi Mine site. Of the total 673 employees based in Mongolia, 662 (98%) are Mongolian nationals and of those, 369 (55%) are residents of the local Gurvantes, Dalanzadgad, Sevrei and Noyon Soums.

Development Projects

Soumber Deposit

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

The 2011 exploration and drilling program at the Soumber Deposit (at that time comprising the Central Soumber, East Soumber and Biluut Fields) included 83,980m of core and reverse circulation holes. A successful exploration program in 2011 resulted in additional coal resources being identified.

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

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

2. MINERAL PROPERTIES (Continued)

On March 19, 2012, the Company announced an updated NI 43-101 compliant independent resource estimate prepared by MMC. MMC estimated that the Soumber Deposit contains measured coal resources of 57.9 million tonnes, indicated coal resources of 79.3 million tonnes and inferred coal resources of 83.0 million tonnes as at January 25, 2012. Approximately 80% of the Soumber resource is located above 300m and is amenable to surface mining. Details of the assumptions and parameters used to calculate the resources and coal quality estimates and information on data verification are set out in the Annual Information Form dated March 19, 2012, and available at www.sedar.com.

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

On June 3, 2011, the Company announced that it had successfully registered the resource associated with the Soumber Deposit (at that time comprising the Central Soumber, East Soumber and Biluut Fields) with MRAM. Further, on July 6, 2011, the Company announced that MRAM had issued the Company a mining license pertaining to the Soumber Deposit. The 10,993ha mining license was granted for an initial term of 30 years with an option for two 20 year extensions.

Resources associated with the South Biluut and Jargalant Fields have been through the resource registration process and the exploration licenses pertaining to resources outside the mining license are subject to valid PMA applications. Subsequent to the receipt of the PMAs, the Company intends to proceed through to the mining license application process.

Environmental baseline studies have been completed and general environmental impact assessments have been approved. The Company is also studying the feasibility of building a coal preparation plant for the Soumber coal to remove rock partings and produce a hard coking coal product.

The Company has delayed plans to complete a pre-feasibility study for the Soumber Deposit to preserve the Company's financial resources while mining operations at the Ovoot Tolgoi Mine are curtailed.

Zag Suuj Deposit

The Zag Suuj Deposit, located approximately 150km east of the Ovoot Tolgoi Mine and approximately 80km north of the Mongolia-China border, lies within the administrative units of Noyon and Bayandalai Soums in the Umnugobi Aimag (South Gobi Province).

2. MINERAL PROPERTIES (Continued)

The 2011 drilling program was aimed at establishing a maiden NI 43-101 compliant resource estimate at the Zag Suuj Deposit. Since exploration commenced in 2007, approximately 45,445m of core and reverse circulation holes have been drilled at the Zag Suuj Deposit.

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

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

On March 19, 2012, the Company reported its maiden NI 43-101 compliant independent resource estimate for the Zag Suuj Deposit prepared by MMC. MMC estimated that the Zag Suuj Deposit contains indicated coal resources of 17.0 million tonnes and inferred coal resources of 66.0 million tonnes as at December 31, 2011. The entire Zag Suuj resource is located above 300m and is amenable to surface mining. Details of the assumptions and parameters used to calculate the resources and coal quality estimates and information on data verification are set out in the Annual Information Form dated March 19, 2012, and available at www.sedar.com.

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

The resource associated with the Zag Suuj Deposit has been through the resource registration process and the exploration licenses pertaining to it are subject to valid PMA applications. The 2012 exploration program planned to better define and expand the existing resource at the Zag Suuj Deposit; however, exploration expenditures have been delayed while mining operations at the Ovoot Tolgoi Mine are curtailed to preserve the Company's financial resources. It is anticipated that coals from the Zag Suuj Deposit can be washed to produce a coking coal product or a coking coal blend product.

2. MINERAL PROPERTIES (Continued)

Ovoot Tolgoi Underground Deposit

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

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

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

The Company has delayed studies to determine the feasibility and economics of conducting an underground mining operation at the Ovoot Tolgoi Underground Deposit to preserve the Company's financial resources while mining operations at the Ovoot Tolgoi Mine are curtailed.

Tsagaan Tolgoi Deposit

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

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

2. MINERAL PROPERTIES (Continued)

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

On March 5, 2012, SouthGobi announced an agreement to sell the Tsagaan Tolgoi Deposit to Modun Resources Limited ("Modun"), a company listed on the Australian Stock Exchange under the symbol MOU. Under the transaction, SouthGobi expects to receive $30.0 million of total consideration, comprising $7.5 million up-front in cash, $12.5 million up-front in Modun shares and deferred consideration of an additional $10.0 million also payable in Modun shares.

As a result, SouthGobi will have a significant shareholding in Modun and it will have the right to nominate one director to the board of Modun subject to SouthGobi holding an equity interest in excess of 14.9%. The transaction is subject to Modun shareholder approval, regulatory approvals under the laws of Mongolia, Hong Kong and Singapore, and Australian Foreign Investment Review Board approval. The transaction is expected to be completed by December 31, 2012.

Investments

Aspire (19.9% owned)

As at June 30, 2012, SouthGobi owned 19.9% of Aspire, a company listed on the Australian Stock Exchange under the symbol AKM. Aspire's primary focus is its mineral exploration licenses in Mongolia, particularly those pertaining to the Ovoot Coking Coal Project. The Company's interest in Aspire was primarily acquired through a placement in December 2010 whereby SouthGobi acquired a 19.9% interest in Aspire for $20.3 million. On October 12, 2011, Aspire completed a private placement issuing 80 million additional common shares. SouthGobi participated in the placement, exercising its right to maintain its 19.9% ownership interest. As at August 13, 2012, SouthGobi has invested a total of $27.9 million in Aspire and its interest in Aspire has a market value of $15.0 million.

2. MINERAL PROPERTIES (Continued)

In a press release dated May 28, 2012, Aspire announced a maiden JORC compliant reserve estimate of 178.0 million tonnes of probable surface coal reserves, 156.0 million tonnes of measured coal resources, 70.1 million tonnes of indicated coal resources and 25.7 million tonnes of inferred coal resources for the Ovoot Coking Coal Project. The mineral resources are inclusive of mineral reserves. Further, on June 1, 2012, Aspire announced that the pre-feasibility study for the Ovoot Coking Coal Project had been completed. Based on information provided by Aspire, coking coal from the Ovoot Coking Coal Project has been classified as a low ash quality blending feedstock for coke manufacture. Indicative coal quality specifications are an ash product of 9%, volatiles of 25-28% and crucible swelling number ranging from 8-9 (all specifications on an air dried basis).

Exploration Program

The 2012 exploration program has been suspended in order to preserve the Company's financial resources while mining operations at the Ovoot Tolgoi Mine are curtailed, with the exception of limited water exploration activities.

The 2012 exploration program originally planned to include further drilling of prospective greenfields exploration properties, as well as the broader Ovoot Tolgoi Complex, the Soumber Deposit and the Zag Suuj Deposit. The Company also planned to complete a pre-feasibility study for its Soumber Deposit and continue its detailed water exploration program.

The 2011 drilling program focused primarily on further definition of known coal occurrences with the intention to bring them to a NI 43-101 compliant resource definition stage and to allow for registration with the Government of Mongolia as the next step towards expanding the Company's mining license holdings. The Company's 2011 exploration program delineated significant coal resources.

2. MINERAL PROPERTIES (Continued)

2.2 Administrative and Other

For the three months ended June 30, 2012

Refer to Section 3 for additional information.

For the six months ended June 30, 2012

Other operating expenses for the six months ended June 30, 2012 increased to $6.4 million compared to $4.4 million for the six months ended June 30, 2011. The increase in other operating expenses primarily relates to provisions for doubtful trade and other receivables and increased foreign exchange losses, partially offset by reduced public infrastructure costs. The increased loss provisions related to allowances granted to certain customers in order to expedite trade receivable cash collections. Public infrastructure costs decreased for the six months ended June 30, 2012 compared to the six months ended June 30, 2011 due to reduced maintenance costs on transportation infrastructure from the Ovoot Tolgoi Mine to the Shivee Khuren Border Crossing and reduced works on the expanded border crossing infrastructure at the Shivee Khuren Border Crossing. Public infrastructure costs should continue to be lower than prior periods due to the completion of the expanded border crossing infrastructure at the Shivee Khuren Border Crossing.

Administration expenses for the six months ended June 30, 2012 were $13.4 million compared to $12.1 million for the six months ended June 30, 2011. The increase in administration expenses for the six months ended June 30, 2012 primarily related to increased salaries and benefits and increased share-based compensation. In the second quarter of 2012, salaries and benefits included severance payments resulting from personnel separations.

Exploration expenses for the six months ended June 30, 2012 were $7.1 million compared to $6.3 million for the six months ended June 30, 2011. Exploration expenses will vary period to period depending on the number of projects and the related seasonality of the exploration programs. In the second quarter of 2012, the Company curtailed exploration activities to preserve financial resources. The majority of the exploration activities for the six months ended June 30, 2012 related to water exploration activities. For the six months ended June 30, 2011, exploration programs had not received all required government approvals; thus a higher proportion of expenses were incurred in the second half of 2011.

2. MINERAL PROPERTIES (Continued)

Finance costs for the six months ended June 30, 2012 were $4.7 million compared to $7.5 million for the six months ended June 30, 2011. Finance costs in the first half of 2012 primarily consisted of $1.8 million of interest expense on the CIC convertible debenture and a $2.6 million unrealized loss on fair value through profit or loss ("FVTPL") investments; whereas, finance costs in the first half of 2011 primarily consisted of $6.7 million of interest expense on the CIC convertible debenture and a $0.5 million unrealized loss on FVTPL investments.

Finance income for the six months ended June 30, 2012 was $26.3 million compared to $34.4 million for the six months ended June 30, 2011. In the first half of 2012, finance income primarily consisted of a $26.0 million unrealized gain on the fair value change of the embedded derivatives in the CIC convertible debenture; whereas, in the first half of 2011, finance income primarily consisted of a $33.6 million unrealized gain on the fair value change of the embedded derivatives in the CIC convertible debenture.

The fair value of the embedded derivatives in the CIC convertible debenture is driven by many factors including: share price, foreign exchange rates and share price volatility. The Company's share price decreased from Cdn$6.00 as at December 31, 2011 to Cdn$3.85 as at June 30, 2012 resulting in a decrease in the fair value of the embedded derivatives and contributed to the unrealized gain of $26.0 million in the first half of 2012.

For the six months ended June 30, 2012, the Company recorded a current income tax expense of $1.1 million related to its Mongolian operations compared to a current tax expense of $3.5 million for the six months ended June 30, 2011. The Company recorded a deferred income tax recovery related to deductible temporary differences of $0.7 million for the six months ended June 30, 2012 compared to $2.8 million for the six months ended June 30, 2011.

3. SUMMARY OF QUARTERLY RESULTS

($ in thousands, except per share information unless otherwise indicated)

	2012		2011				2010	
QUARTER ENDED	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Revenue	**$ 8,412**	$ 40,153	$ 51,064	$ 60,491	$ 47,336	$ 20,158	$ 41,595	$ 6,597
Gross profit excluding idled mine costs	**1,778**	22,674	16,637	17,635	9,744	7,690	3,950	336
Gross profit margin excluding idled mine costs	***21%***	*56%*	*33%*	*29%*	*21%*	*38%*	*9%*	*5%*
Gross profit/(loss) including idled mine costs	**(13,809)**	22,674	16,637	17,635	9,744	7,690	3,950	336
Other operating expenses	**(3,803)**	(2,578)	(24,644)	(138)	(3,024)	(1,383)	(2,121)	(7,586)
Administration expenses	**(7,497)**	(5,882)	(8,612)	(7,993)	(6,808)	(5,336)	(6,599)	(7,405)
Evaluation and exploration expenses	**(2,099)**	(5,033)	(14,513)	(10,908)	(4,356)	(1,991)	(4,144)	(6,314)
Income/(loss) from operations	**(27,208)**	9,181	(31,132)	(1,404)	(4,444)	(1,020)	(8,914)	(20,969)
Net income/(loss)	**237**	3,126	(18,897)	55,921	67,323	(46,602)	(28,720)	27,495
Basic income/(loss) per share	**0.00**	0.02	(0.10)	0.31	0.37	(0.25)	(0.16)	0.15
Diluted income/(loss) per share	**(0.12)**	0.02	(0.14)	(0.02)	-	(0.25)	(0.16)	(0.08)

	2012		2011				2010	
QUARTER ENDED	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Volumes and prices								
Raw semi-soft coking coal								
Raw coal production *(millions of tonnes)*	**0.07**	0.28	0.47	0.55	0.52	0.48	0.41	0.18
Coal sales *(millions of tonnes)*	**0.12**	0.31	0.53	0.66	0.60	0.34	0.35	0.11
Average realized selling price *(per tonne)*	**$ 67.17**	$ 67.59	$ 67.62	$ 66.83	$ 65.96	$ 56.50	$ 47.08	$ 46.04
Raw medium-ash coal								
Raw coal production *(millions of tonnes)*	**0.11**	0.64	0.37	0.20	-	-	-	-
Coal sales *(millions of tonnes)*	**0.04**	0.53	0.37	0.20	-	-	-	-
Average realized selling price *(per tonne)*	**$ 49.91**	$ 50.40	$ 48.59	$ 48.17	$ -	$ -	$ -	$ -
Raw higher-ash coal								
Raw coal production *(millions of tonnes)*	**0.09**	0.15	0.50	0.50	0.35	0.63	0.97	0.39
Coal sales *(millions of tonnes)*	**0.00**	-	0.25	0.51	0.45	0.11	1.12	0.08
Average realized selling price *(per tonne)*	**$ 38.80**	$ -	$ 40.30	$ 39.74	$ 38.32	$ 31.68	$ 26.75	$ 25.34
Total								
Raw coal production *(millions of tonnes)*	**0.27**	1.07	1.34	1.25	0.87	1.11	1.38	0.57
Coal sales *(millions of tonnes)*	**0.16**	0.84	1.15	1.37	1.05	0.45	1.47	0.19
Average realized selling price *(per tonne)*	**$ 62.56**	$ 56.79	$ 55.51	$ 54.01	$ 54.06	$ 50.29	$ 31.56	$ 37.15
Costs								
Direct cash costs of product sold excluding idled mine costs *(per tonne)* (i)	**$ 22.57**	$ 10.80	$ 22.14	$ 22.64	$ 26.77	$ 18.91	$ 18.53	$ 18.59
Total cash costs of product sold excluding idled mine costs *(per tonne)* (i)	**$ 31.49**	$ 15.04	$ 23.09	$ 23.17	$ 27.61	$ 20.61	$ 19.25	$ 22.04
Waste movement and stripping ratio								
Production waste material moved *(millions of bank cubic meters)*	**1.16**	2.20	4.58	4.10	4.08	3.85	3.56	2.90
Strip ratio *(bank cubic meters of waste rock per tonne of coal produced)*	**4.31**	2.07	3.42	3.28	4.74	3.47	2.58	5.09
Pre-production waste material moved *(millions of bank cubic meters)*	**-**	-	-	0.39	0.80	0.49	0.73	0.43
Other operating capacity statistics								
Capacity								
Number of mining shovels/excavators available at period end	**4**	3	3	3	4	3	3	2
Total combined stated mining shovel/excavator capacity at period end *(cubic meters)*	**98**	64	64	64	98	83	82	48
Number of haul trucks available at period end	**27**	27	25	16	16	16	15	12
Total combined stated haul truck capacity at period end *(tonnes)*	**4,743**	4,743	4,561	2,599	2,599	2,599	2,254	1,727
Employees and safety								
Employees at period end	**693**	720	720	695	658	600	544	472
Lost time injury frequency rate (ii)	**1.1**	1.4	1.2	0.9	0.6	0.7	0.8	0.9

(i) A non-IFRS financial measure, see Section 4
(ii) Per 1,000,000 man hours

3. SUMMARY OF QUARTERLY RESULTS (Continued)

The changes in comparative results of operations on a quarter over quarter basis are due primarily to fluctuations in the following areas:

The Company recognized revenue of $8.4 million in the second quarter of 2012 compared to $40.2 million in the first quarter of 2012 and $47.3 million in the second quarter of 2011. The decrease in revenue from the first quarter of 2012 and the second quarter of 2011 can primarily be attributed to decreased sales volume, partially offset by a higher average realized selling price due to an improved product mix.

The effective royalty rate in the second quarter of 2012 was 13%, consistent with the first quarter of 2012. Although the effective royalty rate has declined from the second half of 2011, revenue continues to be negatively impacted by the current royalty regime. The reference price levels applied to the Company's raw semi-soft coking coal and raw medium-ash coal were identical, despite the lower realized selling price for the Company's raw medium-ash coal. SouthGobi, together with other Mongolian mining companies affected by the current royalty regime, continue to engage the appropriate Government of Mongolia authorities with a view of moving to a more equitable process for setting reference prices.

Cost of sales was $22.2 million in the second quarter of 2012 compared to $17.5 million in the first quarter of 2012 and $37.6 million in the second quarter of 2011. Cost of sales comprise the direct cash costs of product sold, mine administration cash costs of product sold, idled mine costs, equipment depreciation, depletion of mineral properties and share-based compensation. Of the $22.2 million recorded as cost of sales for the three months ended June 30, 2012, $6.6 million related to mine operations and $15.6 million related to idled mine costs. Cost of sales related to mine operations decreased in the second quarter of 2012 compared to the first quarter of 2012 and the second quarter of 2011 primarily due to lower sales volumes, partially offset by higher unit costs.

In the second quarter of 2012, gross profit was negatively impacted by $15.6 million of idled mine costs, resulting in a gross loss of $13.8 million for the period. The Company recorded a gross profit excluding idled mine costs of $1.8 million (21% gross profit margin) in the second quarter of 2012 compared to $22.7 million (56% gross profit margin) in the first quarter of 2012 and $9.7 million (21% gross profit margin) in the second quarter of 2011. Gross profit will vary by quarter depending on sales volume, sales price and unit costs.

3. SUMMARY OF QUARTERLY RESULTS (Continued)

Other operating expenses in the second quarter of 2012 increased to $3.8 million compared to $2.6 million in the first quarter of 2012 and $3.0 million in the second quarter of 2011. In the second quarter of 2012, other operating expenses consisted primarily of public infrastructure costs and provisions for doubtful trade and other receivables. The loss provision relates to allowances granted to certain customers in order to expedite trade receivable cash collections. Other operating expenses consisted primarily of foreign exchange losses in the first quarter of 2012 and of public infrastructure costs in the second quarter of 2011.

Administration expenses in the second quarter of 2012 were $7.5 million compared to $5.9 million in the first quarter of 2012 and $6.8 million in the second quarter of 2011. The increased administration expenses in the second quarter of 2012 compared to the first quarter of 2012 primarily related to increased legal and professional fees, primarily due to increased legal activities, and increased share-based compensation. The increased administration expenses in the second quarter of 2012 compared to the second quarter of 2011 primarily related to increased salaries and benefits expenses. In the second quarter of 2012, salaries and benefits included severance payments resulting from personnel separations.

Exploration expenses in the second quarter of 2012 were $2.1 million compared to $5.0 million in the first quarter of 2012 and $4.4 million in the second quarter of 2011. Exploration expenses will vary from quarter to quarter depending on the number of projects and the related seasonality of the exploration programs. In the second quarter of 2012, the Company curtailed exploration activities to preserve financial resources. The majority of the exploration activities in the second quarter of 2012 related to water exploration activities.

Finance costs in the second quarter of 2012 were $4.0 million compared to $2.4 million in the second quarter of 2011. Finance costs in the second quarter of 2012 primarily consisted of $1.6 million of interest expense on the CIC convertible debenture and a $2.3 million unrealized loss on FVTPL investments; whereas, finance costs in the second quarter of 2011 primarily consisted of $2.2 million of interest expense on the CIC convertible debenture.

Finance income in the second quarter of 2012 was $26.9 million compared to $74.4 million in the second quarter of 2011. In the second quarter of 2012, finance income primarily consisted of a $26.8 million unrealized gain on the fair value change of the embedded derivatives in the CIC convertible debenture; whereas, in the second quarter of 2011, finance income primarily consisted of a $70.4 million unrealized gain on the fair value change of the embedded derivatives in the CIC convertible debenture and a $3.6 million unrealized gain on FVTPL investments.

(Expressed in U.S. Dollars)

3. SUMMARY OF QUARTERLY RESULTS (Continued)

The fair value of the embedded derivatives in the CIC convertible debenture is driven by many factors including: share price, foreign exchange rates and share price volatility. The Company's share price decreased from Cdn$6.62 as at March 31, 2012 to Cdn$3.85 as at June 30, 2012 resulting in a decrease in the fair value of the embedded derivatives and contributed to the unrealized gain of $26.8 million.

In the second quarter of 2012, the Company recorded a current income tax recovery of $3.7 million related to its Mongolian operations compared to a current tax expense of $1.7 million in the second quarter of 2011. The Company has recorded a deferred income tax recovery related to deductible temporary differences of $0.6 million in the second quarter of 2012 compared to $1.5 million in the second quarter of 2011.

As a result of the above factors, the Company recorded net income of $0.2 million in the second quarter of 2012 compared to net income of $3.1 million in the first quarter of 2012 and net income of $67.3 million in the second quarter of 2011.

Adjusted net loss (a non-IFRS financial measure, see Section 4) was $6.8 million in the second quarter of 2012 compared to adjusted net income of $7.0 million in the first quarter of 2012 and adjusted net loss of $3.1 million in the second quarter of 2011. Adjusted net income decreased in the second quarter of 2012 compared to the first quarter of 2012 primarily due to decreased gross profits excluding idled mine costs, mainly as a result of lower sales volumes, partially offset by higher tax recoveries. Adjusted net loss increased in the second quarter of 2012 compared to the second quarter of 2011 primarily due to decreased gross profits excluding idled mine costs, mainly as a result of lower sales volumes, partially offset by lower exploration costs and higher tax recoveries.

	2012		2011				2010	
QUARTER ENDED	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Net income/(loss)	**$ 237**	$ 3,126	$ (18,897)	$ 55,921	$ 67,323	$ (46,602)	$ (28,720)	$ 27,495
Income/(loss) adjustments, net of tax								
Idled mine costs	**10,966**	-	-	-	-	-	-	-
Share-based compensation	**4,383**	3,799	4,050	4,296	3,349	2,715	3,840	3,695
Net impairment loss/(recovery) on assets	**2,583**	-	23,818	(2,925)	-	-	574	7,010
Unrealized foreign exchange losses/(gains)	**(511)**	(950)	34	103	263	(993)	(1,837)	(1,116)
Unrealized loss/(gain) on embedded derivatives in CIC debenture	**(26,770)**	776	(10,790)	(62,058)	(70,422)	36,780	19,995	(49,772)
Realized loss/(gain) on disposal of FVTPL investments	**46**	(85)	-	-	-	-	-	-
Unrealized loss/(gain) on FVTPL investments	**2,282**	339	155	2,449	(3,629)	4,116	(4,375)	(1,735)
Adjusted net income/(loss) (i)	**(6,784)**	7,005	(1,630)	(2,214)	(3,116)	(3,984)	(10,523)	(14,423)

(i) A non-IFRS financial measure, see Section 4

4. NON-IFRS FINANCIAL MEASURES

($ in thousands, unless otherwise stated)

The Company has included certain non-IFRS financial measures including "cash costs" and "adjusted net income/(loss)" to supplement its Condensed Consolidated Interim Financial Statements, which are presented in accordance with IFRS.

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

Cash costs

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

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

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

4. NON-IFRS FINANCIAL MEASURES (Continued)

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Cash costs				
Cost of sales per financial statements	**$ 22,221**	$ 37,592	**$ 39,700**	$ 50,060
Less non-cash expenses	**(1,659)**	(8,724)	**(6,546)**	(11,830)
Less non-cash idled mine costs	**(9,750)**	-	**(9,750)**	-
Total cash costs	**10,812**	28,868	**23,404**	38,230
Less idled mine cash costs	**(5,837)**	-	**(5,837)**	-
Total cash costs excluding idled mine costs	**4,975**	28,868	**17,567**	38,230
Coal sales *(000's of tonnes)*	**158**	1,046	**995**	1,500
Total cash costs of product sold excluding idled mine costs *(per tonne)*	**$ 31.49**	$ 27.61	**$ 17.65**	$ 25.49

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Cash costs				
Direct cash costs of product sold excluding idled mine costs *(per tonne)*	**$ 22.57**	$ 26.77	**$ 12.67**	$ 24.39
Mine administration cash costs of product sold excluding idled mine costs *(per tonne)*	**8.92**	0.84	**4.98**	1.10
Total cash costs of product sold excluding idled mine costs *(per tonne)*	**$ 31.49**	$ 27.61	**$ 17.65**	$ 25.49

Adjusted net income/(loss)

Adjusted net income/(loss) excludes idled mine costs, share-based compensation, net impairment loss/(recovery) on assets, unrealized foreign exchange losses/(gains), unrealized loss/(gain) on the fair value change of the embedded derivatives in the CIC convertible debenture, realized gains on the disposal of FVTPL investments and unrealized losses/(gains) on FVTPL investments. The Company excludes these items from net income/(loss) to provide a measure which allows the Company and investors to evaluate the results of the underlying core operations of the Company and its profitability from operations. The items excluded from the computation of adjusted net income/(loss), which are otherwise included in the determination of net income/(loss) prepared in accordance with IFRS, are items that the Company does not consider to be meaningful in evaluating the Company's past financial performance or the future prospects and may hinder a comparison of its period-to-period results.

5. LIQUIDITY AND CAPITAL RESOURCES

Consistent with the Company's overall capital management strategy, the Company continues to have sufficient liquidity and capital resources to meet its ongoing obligations and future contractual commitments. In the near term, the Company expects its liquidity to remain strong based on residual proceeds from the CIC convertible debenture offering and proceeds from the global equity offering. However, due to the curtailment of mining operations at the Ovoot Togloi Mine, the Company has suspended uncommitted capital expenditures and exploration expenditures to preserve the Company's financial resources. The Company has in place a planning, budgeting and forecasting process to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans. Factors that could impact the Company's liquidity are monitored regularly and include but are not limited to Chinese economic growth, market prices of coal, production levels, operating cash costs, capital costs, exchange rates of currencies of countries where the Company operates, exploration and discretionary expenditures. Factors currently creating uncertainty for the Company's operations include the announced CHALCO transaction (refer to Section 8 for additional information), the MRAM press conference announcing an unofficial request to suspend exploration and mining activity on certain licenses owned by SouthGobi Sands LLC, the softening of inland China coking coal markets, the curtailment of mining operations at the Ovoot Tolgoi Mine and the Notice of Investment Dispute filed by SouthGobi on the Mongolian Government pursuant to the Bilateral Investment Treaty between Singapore and Mongolia. As at June 30, 2012, the Company is not subject to any externally imposed capital requirements.

In November 2009, the Company entered into a financing agreement with a wholly owned subsidiary of the CIC for $500 million in the form of a secured, convertible debenture bearing interest at 8.0% with a maximum term of 30 years. The convertible debenture is secured by a charge over the Company's assets and certain subsidiaries. The financing is required primarily to support the accelerated investment program in Mongolia and up to $120 million of the financing may also be used for working capital, repayment of debt due on funding, general and administrative expenses and other general corporate purposes.

On March 29, 2010, the Company exercised its right to call for the conversion of up to $250 million of the convertible debenture into 21.5 million shares at a conversion price of $11.64 (Cdn$11.88). As at June 30, 2012, the CIC owned through its indirect wholly owned subsidiary approximately 14% of the Company.

On January 29, 2010, the Company announced that it had closed the global equity offering of 27.0 million common shares of the Company at a price of Cdn$17.00 per common share, for gross proceeds of $437.4 million. On February 26, 2010, the Company announced a partial exercise of the over-allotment option and issued an additional 0.2 million common shares of the Company at a price of Cdn$17.00 per share for gross proceeds of $3.7 million.

5. LIQUIDITY AND CAPITAL RESOURCES (Continued)

At the time of the financings, the Company planned to use the net proceeds to carry out the following activities:

- Expansion of the production capacity at the Company's Ovoot Tolgoi Mine
- Assessment, construction and development of regional transportation infrastructure
- Assessment and construction of value added facilities such as a coal-handling facility and a washing plant
- Exploration and development of the Soumber Deposit
- General exploration, development and acquisition activities
- Working capital, general and administrative expenses and other general corporate purposes

To date, the Company's actual use of such proceeds has not varied from the anticipated use of proceeds at the time of the financing.

As at June 30, 2012, the Company had cash and cash equivalents of $61.6 million and short term money market investments of $30.0 million for a total of $91.6 million in cash and cash equivalents and money market investments compared to cash and cash equivalents of $123.6 million and long term money market investments of $45.0 million for a total of $168.6 million in cash and cash equivalents and money market investments as at December 31, 2011. Working capital (excess current assets over current liabilities) was $210.0 million as at June 30, 2012 compared to $236.1 million as at December 31, 2011.

As at June 30, 2012, the Company's gearing ratio was 0.14 (December 31, 2011: 0.16), which was calculated based on the Company's long term liabilities to total assets.

Trade receivables and other receivables decreased to $49.8 million as at June 30, 2012 compared to $80.3 million as at December 31, 2011. The Company closely monitors collectability of outstanding accounts receivables for coal sales. The Company sells to recognized, creditworthy third parties and expects to collect all outstanding receivables. However, unforeseen unfavorable market conditions could have an impact on future collectability.

Effective November 10, 2010, the Government of Mongolia issued the list defining finished mineral products. Based on that list, the Company's current coal products do not qualify as finished mineral products. When the Company completes the upgrade of the DCHF to include the dry air separation modules, its coal products should qualify as finished mineral products and from that point forward the Company will once again be eligible to reclaim any VAT amounts paid.

5. LIQUIDITY AND CAPITAL RESOURCES (Continued)

As at June 30, 2012, the non-current portion of the CIC convertible debenture was $113.1 million compared to $139.1 million as at December 31, 2011. For the three months ended June 30, 2012, the decrease in the fair value of the embedded derivatives in the CIC convertible debenture resulted in a unrealized gain of $26.8 million.

Cash Flow Highlights
($ in thousands)

	Six months ended June 30, 2012	Six months ended June 30, 2011
Cash generated from/(used in) operating activities	**$ 1,172**	$ (50,968)
Cash used in investing activities	**(62,805)**	(146,638)
Cash used in financing activities	**(508)**	(11,819)
Effect of foreign exchange rate changes on cash	**152**	120
Decrease in cash for the period	**(61,989)**	(209,305)
Cash balance, beginning of the period	**123,567**	492,038
Cash balance, end of the period	**$ 61,578**	$ 282,733

Cash generated from/(used) in operating activities

Cash generated from operating activities for the six months ended June 30, 2012 was $1.2 million compared to cash used in operating activities for the six months ended June 30, 2011 of $51.0 million. The increased inflows for the six months ended June 30, 2012 primarily related to reduced working capital requirements.

Cash used in investing activities

Cash used in investing activities was $62.8 million for the six months ended June 30, 2012 compared to $146.6 million for the six months ended June 30, 2011 primarily due to decreased purchases of property, plant and equipment and long term investments partially offset by decreased proceeds from maturing long term investments and an investment in RDCC.

Cash used in financing activities

Cash used in financing activities was $0.5 million for the six months ended June 30, 2012 compared to cash used in financing activities of $11.8 million for the six months ended June 30, 2011. For the six months ended June 30, 2012, the Company repurchased $1.0 million of its common shares. This amount was partially offset by the $0.7 million received from the issuance of common shares and exercise of stock options.

5. LIQUIDITY AND CAPITAL RESOURCES (Continued)

The Company has access to a revolving line of credit facility with Golomt Bank. The line of credit facility is secured by a charge over certain equipment held by SouthGobi Sands LLC. The line of credit facility is used by the Company's subsidiaries as part of their working capital management. Under the agreement the maximum draw-down available is $3.5 million and MNT8.1 billion (approximately $6.1 million) and bears interest at 12% for any U.S. Dollar amounts outstanding and 14% for any Mongolian Tugrik amounts outstanding. The line of credit facility also includes a commitment fee of 0.2% per month for any undrawn amounts. There were no amounts due under the line of credit facility at both June 30, 2012 and December 31, 2011.

Contractual Obligations and Guarantees

($ in thousands)

Day-to-day mining, expansionary and sustaining capital expenditures as well as administrative operations give rise to commitments for future minimum payments. Management is of the view that such commitments will be sufficiently funded by current working capital, future operating cash flows and available lines of credit. As at June 30, 2012, the Company's operating and capital commitments were:

	As at June 30, 2012			
	Within 1 year	2-3 years	Over 3 years	Total
Capital expenditure commitments	$ 36,280	$ 29,675	$ -	$ 65,955
Operating expenditure commitments	17,502	11	-	$ 17,513
Commitments	$ 53,782	$ 29,686	$ -	$ 83,468

Share repurchase program

On June 8, 2010, the Company announced that its Board of Directors authorized a share repurchase program to purchase up to 2.5 million common shares of the Company on each or either of the TSX and the HKEX, in aggregate representing up to 5.0 million common shares of the Company. On June 8, 2011, the Company announced the renewal of its share repurchase program. The share repurchase program concluded on June 14, 2012. As at June 14, 2012, the Company had repurchased 1.6 million shares on the HKEX and 2.8 million shares on the TSX for a total of 4.4 million common shares. The Company cancelled all repurchased shares.

5. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Financial instruments

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

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

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

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

5. LIQUIDITY AND CAPITAL RESOURCES (Continued)

	As at	
Financial assets *($ in thousands)*	**June 30, 2012**	**December 31, 2011**
Loans-and-receivables		
Cash and cash equivalents	**$ 61,578**	$ 123,567
Trade and other receivables	**49,795**	80,285
Available-for-sale		
Investment in Aspire	**18,962**	46,837
Fair value through profit or loss		
Investment in Kangaroo	**3,316**	7,431
Money market investments	**30,000**	44,967
Total financial assets	**$ 163,651**	$ 303,087
Financial liabilities *($ in thousands)*		
Fair value through profit or loss		
Convertible debenture - embedded derivatives	**$ 22,394**	$ 48,389
Other-financial-liabilities		
Trade and other payables	**14,282**	52,235
Convertible debenture - debt host	**95,024**	96,997
Total financial liabilities	**$ 131,700**	$ 197,621

Net income for the three and six months ended June 30, 2012 and June 30, 2011 included the following amounts of unrealized losses/(gains) from the fair value adjustments to certain financial instruments which are classified as FVTPL:

	Three months ended June 30,		Six months ended June 30,	
($ in thousands)	**2012**	**2011**	**2012**	**2011**
Unrealized loss/(gain) on FVTPL investments	**$ 2,282**	$ (3,629)	**$ 2,620**	$ 488
Unrealized gain on embedded derivatives in CIC debenture	**(26,770)**	(70,422)	**(25,995)**	(33,641)

Other comprehensive income includes an unrealized after tax loss of $20.1 million and an unrealized after tax loss of $25.5 million for the three and six months ended June 30, 2012 and an unrealized after tax loss of $39.6 million and an unrealized after tax gain of $11.2 million for the three and six months ended June 30, 2011.

6. ENVIRONMENT

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

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

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

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

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

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

7. RELATED PARTY TRANSACTIONS

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

- Turquoise Hill – Turquoise Hill is the Company's immediate parent company and at June 30, 2012 owned approximately 58% of the outstanding common shares of the Company. Turquoise Hill provides various administrative services to the Company on a cost-recovery basis. The Company also provides some office and investor relations services to Turquoise Hill in the Company's Hong Kong office and recovers the costs for those services on a cost-recovery basis
- Global Mining Management ("GMM") – GMM is a private Company owned equally by seven companies, two of which include the Company and Turquoise Hill. GMM provides administration, accounting and other office services to the Company on a cost-recovery basis.
- I2MS.NET Pte. Ltd. ("I2MS") – I2MS is a private company 100% owned by Turquoise Hill. I2MS provides information technology and other related services to the Company on a cost-recovery basis.
- Ivanhoe Energy Inc. ("Ivanhoe Energy") – Ivanhoe Energy is a publicly listed company with two directors in common with the Company. The Company provides some office and investor relations services to Ivanhoe Energy in the Company's Hong Kong office and recovers the costs for those services on a cost-recovery basis.

The following tables summarize related party expenses incurred by the Company with the companies listed above:

($ in thousands)	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Corporate administration	**$ 479**	$ 580	**$ 847**	$ 923
Salaries and benefits	**245**	357	**571**	625
Total related party expenses	**$ 724**	$ 937	**$ 1,418**	$ 1,548

($ in thousands)	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
GMM	**$ 286**	$ 593	**$ 717**	$ 987
Turquoise Hill	**23**	14	**27**	70
I2MS	**415**	330	**674**	491
Total related party expenses	**$ 724**	$ 937	**$ 1,418**	$ 1,548

7. RELATED PARTY TRANSACTIONS (Continued)

The Company recorded recoveries of $0.2 million and $0.5 million for the three and six months ended June 30, 2012 compared to recoveries of $0.1 million and $0.2 million for the three and six months ended June 30, 2011 for administration expenses with Turquoise Hill and Ivanhoe Energy.

The Company had accounts receivable of $0.6 million as at June 30, 2012 (December 31, 2011: $0.3 million) and accounts payable of $0.3 million as at June 30, 2012 (December 31, 2011: $0.4 million) with related parties.

Emolument Policy

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

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

The Company has also adopted an equity incentive plan to incentivize directors and eligible employees. Details of the plan are set out in Note 17 of the Condensed Consolidated Interim Financial Statements.

As at June 30, 2012, the Company employed 693 employees, of which only 265 are active due to the curtailment of the mining operations.

8. PROPOSED TRANSACTION

On April 2, 2012, SouthGobi announced a Cooperation Agreement with CHALCO and received official notification of CHALCO's intention to make a proportional takeover bid for up to 60% of the issued and outstanding common shares of SouthGobi at Cdn$8.48 per share ("Proportional Offer"). SouthGobi has also been informed by its 58% major shareholder, Turquoise Hill, that Turquoise Hill has signed a lock-up agreement with CHALCO, committing to tender all of its shares held or thereafter acquired by it during the offer period of CHALCO into the Proportional Offer. The Proportional Offer will be made by way of a takeover bid circular under British Columbia law and will be made to all SouthGobi shareholders. If shareholders tender more than 60% of the outstanding common shares of SouthGobi to the takeover bid, a proportional amount of shares will be taken up from each shareholder. SouthGobi has not received any formal documentation relating to the Proportional Offer.

On April 25, 2012, CHALCO and Turquoise Hill announced that in the event of new foreign investment legislation being implemented by the Government of Mongolia prior to the completion of the Proportional Offer, CHALCO and Turquoise Hill will cooperate with the Government of Mongolia to ensure any requirements under such legislation are satisfied.

On May 17, 2012, the Parliament of Mongolia approved a Foreign Investment Law ("FIL") that regulates foreign direct investment into a number of key sectors of strategic importance, which includes mineral resources. The FIL is extremely ambiguous and leaves a lot of discretion in the parliamentary approval process. If foreign shareholding exceeds 49% of an asset and the amount of the investment at the time is to exceed MNT100 billion (approximately $75.0 million), then parliamentary approval is required. In the case of state owned entities ("SOE") there is no minimum threshold and all proposed investments from SOE's require parliamentary approval. In addition, if a foreign entity wants to acquire one third or more of the shares in an investment in a strategic sector, then the MNT100 billion threshold is not applicable and cabinet approval for the investment is required regardless of the value. As a result, the Proportional Offer will require Government of Mongolia approval.

In conjunction with the Proportional Offer, CHALCO and SouthGobi have entered into a Cooperation Agreement. CHALCO's obligations under the Cooperation Agreement will become effective upon CHALCO acquiring a shareholding in SouthGobi.

Key benefits under the Cooperation Agreement between SouthGobi and CHALCO include:

- Coal off-take by CHALCO – SouthGobi will have the right to offer up to 100% of its salable coal to CHALCO and CHALCO will have the obligation to purchase the coal at market prices for a period of 24 months.

8. PROPOSED TRANSACTION (Continued)

- Infrastructure support – CHALCO will assist SouthGobi to procure electricity for its Mongolian business operations either through a direct connection to grid power, or through development of a conveniently located power plant. CHALCO will also provide support to SouthGobi's coal-haul highway project.

SouthGobi has also been notified that CHALCO has entered into consultancy agreements with nine key senior executives, officers and staff to assist CHALCO with the integration and transition following CHALCO's acquisition of a shareholding in SouthGobi. Services would be retained for 12 months from the termination of their employment or for a period of 12-months less the notice period actually served by them on their resignation, after CHALCO becomes a shareholder of SouthGobi. Following arm's length negotiation between CHALCO and the relevant individuals, it has been agreed that fees totaling $9.0 million would be paid by CHALCO for the consulting services. Consultancy agreements have been entered into with the President and Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, and key Vice Presidents, officers and staff.

CHALCO had stated that it expected to mail the takeover bid circular in connection with the Proportional Offer on or about July 5, 2012. On July 3, 2012, CHALCO and Turquoise Hill announced a 30 day extension for CHALCO to mail the takeover bid circular.

Subsequently, on August 2, 2012, an additional 30 day extension was announced by CHALCO and Turquoise Hill. CHALCO has agreed to mail the takeover bid circular on or before September 4, 2012.

9. OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value and an unlimited number of preferred shares without par value. As at August 13, 2012, 181.9 million common shares were issued and outstanding. There are also incentive share options outstanding to acquire 10.4 million unissued common shares with exercise prices ranging from Cdn$5.10 to Cdn$18.86. There are no preferred shares outstanding.

As at August 13, 2012, Turquoise Hill directly owned 104.8 million common shares representing approximately 58% of the issued and outstanding common shares of the Company.

10. INTERNAL CONTROLS OVER FINANCIAL REPORTING

There has been no change in the Company's internal controls over financial reporting that occurred during the most recently completed quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

11. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

A detailed summary of the Company's significant accounting policies is included in Note 3 to the annual Consolidated Financial Statements for the year ended December 31, 2011.

12. RISK FACTORS

The business of mineral exploration, development and extraction involves a high degree of risk. Few properties that are explored are ultimately developed into production.

Material risks and uncertainties affecting the Company, their potential impact and the Company's principal risk management strategies are substantially unchanged from those disclosed in the Company's MD&A for the year ended December 31, 2011, which is available at www.sedar.com.

13. OUTLOOK

The announcement by CHALCO that it intends to make a proportional takeover bid for up to 60% of the issued and outstanding common shares of SouthGobi continues to create significant uncertainty for the Company's business. Further uncertainly results from the MRAM press conference announcing a request to suspend exploration and mining activity on certain licenses owned by SouthGobi Sands LLC and general difficulty receiving permits and valid cooperation from departments of the Government of Mongolia. This uncertainty has been compounded by worsening conditions in coal markets in inland China.

Inland China coking coal markets closest to SouthGobi's operations have continued to soften in the third quarter of 2012. The Company has observed a substantial deterioration in sentiment among its customers and a decline in key reference prices in key end-use markets.

13. OUTLOOK (Continued)

Due to the uncertainty surrounding SouthGobi's business, the Company anticipates its operations will remain fully curtailed in the third quarter of 2012. Further, the Company cautions that production volumes, sales volumes and pricing for the full year of 2012 cannot be estimated.

SouthGobi is uniquely positioned, with a number of key competitive strengths, including:

- Strategic location – SouthGobi is the closest major coking coal producer in the world to China. The Ovoot Tolgoi Mine is approximately 40km from China, which is approximately 190km closer than Tavan Tolgoi coal producers in Mongolia and 7,000 to 10,000km closer than Australian and North American coking coal producers. The Company has an infrastructure advantage, being approximately 50km from existing railway infrastructure, which is approximately one tenth the distance to rail of Tavan Tolgoi coal producers in Mongolia.
- Premium quality coals – Most of the Company's coal resources have coking properties, including a mixture of semi-soft coking coals and hard coking coals. SouthGobi is also completing its investment in processing infrastructure to capture more of the value by selling 'clean' instead of 'raw' coal products.
- Sustainable volume growth – Subject to market conditions, the Ovoot Tolgoi Mine, has the potential to produce well in excess of 2011 levels. Currently undeveloped resources at the Soumber Deposit and the Zag Suuj Deposit may provide additional growth in the future.
- Expanding margins – The Company believes, subject to market conditions, it will continue expanding margins through the benefits of coal processing and increasing economies of scale.
- Exploration as a core business competency – SouthGobi's resources in Mongolia have been acquired through a long term in-house exploration program. The Company continues to maintain exploration as a core long-term strategy to provide additional resources of coal in a cost effective manner.

Objectives

The Company's objectives for 2012 have been impacted by the external conditions faced by it. SouthGobi intends to attempt to mitigate the issues, to the extent possible, and reduce capital expenditures, operating costs and exploration to preserve the Company's financial resources.

August 13, 2012