SouthGobi Resources Ltd.

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

December 31, 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.

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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 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 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. A National Instrument 43-101 ("NI 43-101") compliant resource has been established and exploration results indicate potential for thick coking coal seams. On July 6, 2011, SouthGobi announced that the Mineral Resources Authority of Mongolia ("MRAM") issued the Company a mining license pertaining to the Soumber Deposit. The 10,993ha mining license was granted for an initial term of 30 years with an option for two 20 year extensions. Further, on January 18, 2013, MRAM issued the Company a pre-mining agreement ("PMA") pertaining to the Soumber Deposit, complementing its existing mining license. The Company has applied for a mining license on the area of the Soumber Deposit covered by the PMA.

1. OVERVIEW (Continued)

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 and the PMA are subject to valid PMA applications (refer to Section 3.1 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 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 3.1 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 December 31, 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 Mongolian coal assets, particularly those pertaining to the Ovoot Coking Coal Project.

As at March 25, 2012, Turquoise Hill directly owned 104.8 million common shares representing approximately 58% of the issued and outstanding common shares of SouthGobi.

1.1 Significant Events

Mining activities at the Ovoot Tolgoi Mine were curtailed to varying degrees in the second quarter of 2012, with mining activities being fully curtailed at the end of the second quarter, to manage coal inventories and to maintain efficient working capital levels. Mining activities remained fully curtailed for the remainder of 2012; however, operations at the Ovoot Tolgoi Mine resumed on March 22, 2013. The Company continues to minimize uncommitted capital expenditures and exploration expenditures in order to preserve the Company's financial resources.

1. OVERVIEW (Continued)

Sales volumes and revenue declined to 1.33 million tonnes and $53.1 million, respectively, in 2012 compared to 4.02 million tonnes and $179.0 million in 2011. In 2012, the Company's operations were impacted by infrastructure constraints in Mongolia, the significant uncertainty resulting from regulatory issues facing the Company and the softening of inland China coking coal markets.

On February 13, 2012, the Company announced the successful commissioning of the dry coal-handling facility ("DCHF") at the Ovoot Tolgoi Mine. 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. The rotary breaker is anticipated to reduce screening costs and improve yield recoveries.

On April 2, 2012, SouthGobi announced that it had signed a cooperation agreement with the Aluminum Corporation of China Limited ("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. Subsequently, on September 3, 2012, SouthGobi was notified that CHALCO's proportional takeover bid had been terminated, which also resulted in the termination of the cooperation agreement (refer to Section 9 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. SouthGobi never received formal notification from MRAM requesting to suspend any of the Company's licenses. On September 6, 2012, the Company received a letter from MRAM confirming that as of September 4, 2012 all exploration and mining licenses held by the Company were in good standing.

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.

1. OVERVIEW (Continued)

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 (refer to Section 3.1 "notice of investment dispute" for additional information).

On September 4, 2012, SouthGobi announced changes to its Board of Directors, accepting the resignations of Mr. Edward Flood, the Honorable Robert Hanson and Mr. Peter Meredith (Chairman) and subsequently appointing Ms. Kay Priestly (Chairman), Mr. Sean Hinton (Deputy Chairman), Mr. Lindsay Dove, Mr. Brett Salt and Mr. Kelly Sanders. On September 17, 2012, Mr. Alexander Molyneux tendered his resignation as a director of the Company. Further, on November 8, 2012, Mr. Ross Tromans was appointed as an Executive Director.

In the third and fourth quarters of 2012, the Company also announced senior management changes with the departures of Mr. Alexander Molyneux, former President and Chief Executive Officer, Mr. Curtis Church, former Chief Operating Officer and Mr. Matthew O'Kane, former Chief Financial Officer. Mr. Tromans was appointed as President and Chief Executive Officer. Mr. Tromans also assumed the duties formerly handled by the Chief Operating Officer. The Company is in the process of identifying a candidate for the Chief Financial Officer role. In the interim, Mr. Tromans has acted as the Company's Principal Financial Officer.

On February 7, 2013, SouthGobi noted recent public statements and Mongolian media reports referencing SouthGobi Resource Ltd.'s wholly owned subsidiary, SouthGobi Sands LLC, in connection with the recent trial and conviction of the former Chairman and the former director of the Geology, Mining and Cadastral Department of MRAM, and others. The Company also provided an update on recent developments in relation to the current investigation being conducted by the Mongolian Independent Authority Against Corruption (the "IAAC") and the Company's receipt of a PMA pertaining to the Soumber Deposit.

On March 22, 2013, SouthGobi announced the resumption of operations at its flagship Ovoot Tolgoi Mine. The Company plans to produce 3.2 million tonnes of semi-soft coking coal over the remainder of 2013.

On March 25, 2013, SouthGobi announced updated NI 43-101 compliant resource estimates for the Soumber and Zag Suuj Deposits, which increased the Company's total measured and indicated resources to 533 million tonnes (8% increase) and inferred resources to 302 million tonnes (24% increase).

2. SELECTED ANNUAL INFORMATION

($ in thousands, except per share information)

	Year ended December 31,		
	2012	**2011**	**2010**
Revenue	**$ 53,116**	$ 179,049	$ 79,777
Gross profit/(loss)	**(44,002)**	51,706	9,873
Net income/(loss)	**(103,019)**	57,745	(116,195)
Net income/(loss) per share - basic	**(0.57)**	0.32	(0.66)
Net loss per share - diluted	**(0.63)**	(0.19)	(0.66)
Adjusted net loss (i)	**(31,369)**	(10,943)	(49,208)
Cash and cash equivalents	**19,674**	123,567	492,038
Short term investments	**15,000**	-	17,529
Long term investments			
Money market investments	**-**	44,967	45,173
Other long term investments (ii)	**24,084**	54,271	62,243
Total assets	**729,367**	920,323	961,866
Total long term liabilities	**103,771**	145,607	252,527

(i) A non-IFRS financial measure, see Section 5
(ii) As at December 31, 2012, other long term investments include a $1.5 million investment in Kangaroo Resources Ltd. ("Kangaroo"), a $8.7 million investment in Aspire and a $13.9 million investment in RDCC LLC ("RDCC").

Mining activities at the Ovoot Tolgoi Mine were curtailed to varying degrees in the second quarter of 2012, with mining activities being fully curtailed at the end of the second quarter, to manage coal inventories and to maintain efficient working capital levels. Mining activities remained fully curtailed for the remainder of 2012; however, operations at the Ovoot Tolgoi Mine resumed on March 22, 2013.

In 2012, SouthGobi recorded revenue of $53.1 million compared to $179.0 million in 2011 and $79.8 million in 2010. In 2012, the Company's operations were impacted by infrastructure constraints in Mongolia, the significant uncertainty resulting from regulatory issues facing the Company and the softening of inland China coking coal markets. These issues led to decreased sales volumes and decreased selling prices for individual coal products.

In 2012, the Company's gross profit/(loss) was negatively impacted by $53.0 million of idled mine costs, resulting in a gross loss of $44.0 million. The Company recorded a gross profit excluding idled mine costs of $9.0 million in 2012 compared to a gross profit excluding idled mine costs of $51.7 million in 2011 and $9.9 million in 2010. Gross profit will vary by year depending on sales volumes, sales prices and unit costs.

2. SELECTED ANNUAL INFORMATION (Continued)

The Company recorded a net loss of $103.0 million in 2012 compared to a net income of $57.7 million in 2011 and a net loss of $116.2 million in 2010. In 2010, $250.0 million of the China Investment Corporation ("CIC") convertible debenture was converted to common shares resulting in a $151.4 million non-cash loss on partial conversion of the debt.

The Company's 2012 net loss includes a gross loss of $44.0 million (2011: gross profit of $51.7 million), other operating expenses of $54.3 million (2011: $29.2 million), administration expenses of $24.6 million (2011: $28.7 million) and evaluation and exploration expenses of $8.6 million (2011: $31.8 million). The Company's 2012 net loss also includes financing costs related to the CIC convertible debenture. In 2012, the fair value change of the embedded derivatives in the CIC convertible debenture resulted in a non-cash gain of $39.5 million (2011: $106.5 million gain).

Adjusted net loss (a non-IFRS financial measure, see Section 5) was $31.4 million in 2012 compared to $10.9 million in 2011 and $49.2 million 2010. Adjusted net loss increased compared to 2011 primarily due to decreased gross profits excluding idled mine costs and coal stockpile impairments, mainly as a result of lower sales volumes, and an increased proportion of interest expense on the CIC convertible debenture being expensed as opposed to capitalized, partially offset by lower exploration costs and a higher tax recovery.

The Company's total assets at December 31, 2012 were $729.4 million compared to $920.3 million at December 31, 2011 and $961.9 million at December 31, 2010. At December 31, 2012, the Company had $19.7 million in cash, $15.0 million in short term money market investments and $24.1 million in long term investments compared to $123.6 million in cash and $99.2 million in long term investments at December 31, 2011. Long term investments include $nil of money market investments (2011: $45.0 million), a $1.5 million investment in Kangaroo (2011: $7.4 million), a $8.7 million investment in Aspire (2011: $46.8 million) and a $13.9 million investment in RDCC (2011: $nil). The decrease in cash from 2011 primarily resulted from the purchase of property, plant and equipment for the Ovoot Tolgoi Mine. These purchases were committed prior to operations being fully curtailed at the end of the second quarter of 2012.

The Company's long term liabilities at December 31, 2012 were $103.8 million compared to $145.6 million at December 31, 2011 and $252.5 million at December 31, 2010. The decrease in the long term liabilities is primarily due to the $39.5 million and $106.5 million fair value change of the embedded derivatives in the CIC convertible debenture in 2012 and 2011, respectively.

3. MINERAL PROPERTIES

3.1 Mongolian Coal Division

The Company currently holds three mining licenses and six exploration licenses, which in total cover an area of approximately 378,000ha. Of the six exploration licenses held by the Company, one exploration license, pertaining to the Soumber Deposit, was issued a PMA on January 18, 2013 by MRAM; while four exploration licenses have valid PMA applications lodged. The remaining exploration license does not have a PMA application lodged.

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

Regulatory Issues

Status of Mining and Exploration Licenses

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 included the mining license pertaining to the Ovoot Tolgoi Mine.

The Company believed that the action was taken under the broad national security powers of the Government of Mongolia. MRAM stated that the move was in connection with the proposed proportional takeover bid by CHALCO and the agreement by Turquoise Hill to tender its controlling interest in SouthGobi to such a takeover. On September 3, 2012, the proposed proportional takeover bid by CHALCO was terminated (refer to Section 9 for additional information).

Subsequently, on September 6, 2012, the Company received official notification from MRAM confirming that as of September 4, 2012 all exploration and mining licenses held by the Company were in good standing. The Notice of Investment Dispute filed by the Company pertaining to its valid PMA applications remains ongoing (refer to Section 3.1 "notice of investment dispute" for additional information).

3. MINERAL PROPERTIES (Continued)

Governmental, Regulatory and Internal Investigations

The Company is subject to continuing investigations by the IAAC and other governmental and regulatory authorities in the Republic of Mongolia regarding allegations against SouthGobi and some of its employees involving possible breaches of Mongolian laws, including anti-corruption and taxation laws. Certain of those allegations (including allegations of bribery, money laundering and tax evasion) have been the subject of public statements and Mongolian media reports, both prior to and in connection with the recent trial and conviction of the former Chairman and the former director of the Geology, Mining and Cadastral Department of the MRAM, and others. SouthGobi was not a party to that case. The Company understands that the court's decision is the subject of an appeal.

A number of the media reports referred to above suggest that, in its decision, the court in the above-mentioned case referred to two matters specifically involving SouthGobi Sands LLC.

In respect of the first matter, being an alleged failure to meet minimum expenditure requirements under the Mongolian Minerals Law in relation to four exploration licenses, the Company is investigating these allegations, but advises that three of the four licenses were considered to be non-material and allowed to lapse between November 2009 and December 2011. Activities historically carried out on the fourth (and the only currently-held) license include drilling, trenching and geological reconnaissance. The Company has no immovable assets located on this license and it does not contain any of SouthGobi's NI 43-101 reserves or resources. This license does not relate to the Company's Ovoot Tolgoi Mine and SouthGobi does not consider this license to be material to its business.

The second matter referred to by the court was an alleged impropriety in the transfer of License 5261X by SouthGobi Sands LLC to a third party in March 2010 in violation of Mongolian anti-corruption laws. The Company understands, based on media reports, that the court has invalidated the transfer of this license, and so the license's current status is unclear.

3. MINERAL PROPERTIES (Continued)

In addition, the IAAC has advised the Company that it is investigating other alleged improprieties by SouthGobi Sands LLC as described above. Neither SouthGobi nor any of its employees have been charged in connection with the IAAC's investigation, but certain current and former employees have been advised that they are suspects. The IAAC has imposed orders placing a travel ban on those employees, and administrative restrictions on certain of the Company's Mongolian assets, including local bank accounts, in connection with its continuing investigation of those allegations. While the orders restrict the use of in-country funds pending the outcome of the investigation, they are not expected to have a material impact on the Company's activities in the short term, although they could create operational difficulties for the Company in the medium to long term. SouthGobi is taking and intends to take all necessary steps to protect its ability to continue to conduct its business activities in the ordinary course.

Through its Audit Committee (comprised solely of independent directors), SouthGobi is conducting an internal investigation into possible breaches of law, internal corporate policies and codes of conduct arising from the allegations that have been raised. The Audit Committee has the assistance of independent legal counsel in connection with its investigation. The Chair of the Audit Committee is also participating in a tripartite committee, comprised of the Audit Committee Chairs of the Company and Turquoise Hill and a representative of Rio Tinto, which is focused on the investigation of those allegations, including possible violations of anti-corruption laws. Independent legal counsel and forensic accountants have been engaged by this committee to assist it with its investigation. All of these investigations are ongoing but are not yet complete. Information that has been provided to the IAAC by the Company has also been provided by the tripartite committee to Canadian and United States regulatory authorities that are monitoring the Mongolian investigations. The Company continues to cooperate with all relevant regulatory agencies in respect of the ongoing investigations.

The investigations referred to above could result in one or more Mongolian, Canadian, United States or other governmental or regulatory agencies taking civil or criminal action against the Company, its affiliates or its current or former employees. The likelihood or consequences of such an outcome are unclear at this time but could include financial or other penalties, which could be material, and which could have a material adverse effect on the Company. Refer to risk factors, "the Company is subject to continuing governmental, regulatory and internal investigations, the outcome of which is unclear at this time but could have a material adverse effect on the Company", in section 13.

3. MINERAL PROPERTIES (Continued)

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

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 filed the Notice of Investment Dispute following a determination by management that they had exhausted all other possible means to resolve an ongoing investment dispute between SouthGobi Sands LLC and the Mongolian authorities.

The Notice of Investment Dispute 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. The Company continues to have the right to commence conciliation/arbitration proceedings under the auspices of the ICSID pursuant to the Bilateral Investment Treaty. On January 18, 2013, MRAM issued the Company a PMA pertaining to the Soumber Deposit; however, four valid PMA applications remain outstanding.

3. MINERAL PROPERTIES (Continued)

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.

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 prohibited 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 one other exploration license, 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.

3. MINERAL PROPERTIES (Continued)

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.

Reserves and Resources

On March 19, 2012, the Company announced an updated NI 43-101 compliant independent resource estimate prepared by RungePincockMinarco ("RPM"). RPM estimated that the Ovoot Tolgoi Mine contains 175.7 million tonnes of proven and probable surface coal reserves, 133.3 million tonnes of measured coal resources, 59.9 million tonnes of indicated coal resources and 24.0 million tonnes of inferred coal resources as at October 31, 2011. All of these resources are located above 300m and are amenable to surface mining. The 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 25, 2013, 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

On March 22, 2013, SouthGobi announced the resumption of operations at its flagship Ovoot Tolgoi Mine. The Company plans to produce 3.2 million tonnes of semi-soft coking coal over the remainder of 2013.

3. MINERAL PROPERTIES (Continued)

	Year ended December 31, 2012	Year ended December 31, 2011
Volumes, Prices and Costs		
Raw coal production *(millions of tonnes)*	**1.33**	4.57
Coal sales *(millions of tonnes)*	**1.33**	4.02
Average realized selling price *(per tonne)*	**$ 47.76**	$ 54.03
Direct cash costs of product sold excluding idled mine costs *(per tonne)* (i)	**$ 12.02**	$ 23.15
Total cash costs of product sold excluding idled mine costs *(per tonne)* (i)	**$ 16.75**	$ 24.01
Operating Statistics		
Production waste material moved *(millions of bank cubic meters)*	**3.36**	16.61
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**2.52**	3.63
Pre-production waste material moved *(millions of bank cubic meters)*	**-**	1.68
Operating Results *($ in thousands)*		
Revenue	**$ 53,116**	$ 179,049
Cost of sales		
Mine operations	**44,160**	127,343
Idled mine costs	**52,958**	-
Gross profit/(loss)	**$ (44,002)**	$ 51,706

(i) A non-IFRS financial measure, see Section 5

In 2012, the Company produced 1.33 million tonnes of raw coal with a strip ratio of 2.52 compared to production of 4.57 million tonnes of raw coal with a strip ratio of 3.63 in 2011. The decrease in production primarily related to the curtailment of the Company's mining operations in the last three quarters of the year; 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.

In 2012, the Company sold 1.33 million tonnes of coal at an average realized selling price of $47.76 per tonne compared to sales of 4.02 million tonnes of coal at an average realized selling price of $54.03 per tonne in 2011. The Company's average realized selling price was negatively impacted by the softening of the inland China coking coal markets closest to SouthGobi's operations throughout 2012. The Company's higher-ash coals were impacted more substantially than its other products.

3. MINERAL PROPERTIES (Continued)

Revenue decreased to $53.1 million in 2012 from $179.0 million in 2011 primarily due to decreased sales volumes in the last three quarters of 2012 and lower average realized selling prices in the second half of 2012, partially offset by higher sales volumes in the first quarter of 2012.

In the last three quarters of 2012, customers were reluctant to enter into new 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 significantly 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;
- The uncertainty with respect to whether SouthGobi would receive a formal request from MRAM to suspend mining activities on its Ovoot Tolgoi mining license, which caused customers concern that they would be unable to collect and export additional coal purchased from the Ovoot Tolgoi Mine in the second and third quarters of 2012; and
- The softening of inland China coking coal markets closest to SouthGobi's operations throughout the last three quarters of 2012.

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 2012 reference prices, the Company was subject to an average 8% royalty based on a weighted average reference price of $88.07 per tonne. The Company's effective royalty rate for 2012, based on the Company's average realized selling price of $47.76 per tonne, was 14%.

SouthGobi, together with other Mongolian mining companies impacted by the escalation of effective royalty rates, opened a dialog with the appropriate Government of Mongolia authorities with a view of moving to a more equitable process for setting reference prices. A successful outcome was achieved and commencing October 1, 2012 (for a six month trial period) the royalty rate will be determined using the contracted sales price per tonne, not the reference price per tonne published by the Government of Mongolia. The dialog has continued with the appropriate Government of Mongolia authorities with the goal of extending the trial period until the end of 2013.

3. MINERAL PROPERTIES (Continued)

In the fourth quarter of 2012 (a full quarter under the trial period), the Company's effective royalty rate was 6%, a significant reduction from prior quarters in 2012.

Cost of sales was $97.1 million in 2012 compared to $127.3 million in 2011. Cost of sales comprise the direct cash costs of product sold, mine administration cash costs of product sold, idled mine costs, inventory impairments, equipment depreciation, depletion of mineral properties and share-based compensation expense. Of the $97.1 million recorded as cost of sales in 2012, $44.2 million related to mine operations and $53.0 million related to idled mine costs. Cost of sales related to mine operations decreased in 2012 compared to 2011 primarily due to lower sales volumes and lower unit costs, partially offset by coal stockpile impairments totaling $14.2 million. Cost of sales related to idled mine costs primarily consist of period costs, which are expensed as incurred and depreciation expense. The depreciation expense relates to the Company's idled plant and equipment.

Direct cash costs of product sold excluding idled mine costs (a non-IFRS financial measure, see Section 5) were $12.02 per tonne in 2012 compared to $23.15 per tonne in 2011. Direct cash costs of product sold excluding idled mine costs primarily decreased due to a lower strip ratio, reduced fuel prices and non-cash coal stockpile impairments recorded in the second half of 2012.

Mine administration cash costs of product sold excluding idled mine costs (a non-IFRS financial measure, see Section 5) increased to $4.73 per tonne in 2012 from $0.86 per tonne in 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. The DCHF has capacity to process nine million tonnes of 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 50mm 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.

3. MINERAL PROPERTIES (Continued)

The Company has received all permits to operate the DCHF. However, the 2013 mine plan considers only limited utilization of the DCHF at the latter end of 2013 due to higher quality coals being mined that likely will not require processing through the DCHF and can be sold raw or processed directly through the wet washing facility. The 2013 mine plan assumes a conservative resumption of operations, designed to achieve a cost effective approach that will allow operations to continue on a sustainable basis.

The Company has delayed construction 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. Uncommitted capital expenditures have been minimized to preserve the Company's financial resources.

To further enhance product value, in 2011, 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 toll-wash coal from the Ovoot Tolgoi Mine. The agreement has a duration of 5 years from commencement and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input coal. Pursuant to the terms of the agreement, the Company prepaid $33.6 million of toll washing fees.

Ejin Jinda's wet washing facility is located approximately 10km inside China from the Shivee Khuren Border Crossing, approximately 50km from the Ovoot Tolgoi Mine. Primarily, 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. The Company plans to commence wet washing coals in the second half of 2013. As at December 31, 2012, the delay in commencing wet washing coals has had 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 other companies, completed the road and construction works required on the Mongolian side of the border to match the existing Chinese infrastructure.

3. MINERAL PROPERTIES (Continued)

Further, 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 eliminated the previous bottleneck at the Shivee Khuren Border Crossing and is expected to increase capacity to approximately 20 million tonnes or more of coal per year.

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; however, as planned, the contractor has demobilized until the second quarter of 2013 due to winter weather conditions. Completion of the paved highway is expected in late 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 fleet includes: Two Liebherr 996 ($34m^3$) hydraulic excavators, three Liebherr R9250 ($15m^3$) hydraulic excavators (one of which was commissioned in the fourth quarter of 2012), eighteen Terex MT4400 (218 tonne capacity) haul trucks and nine Terex TR100 (91 tonne capacity) haul trucks, together with various pieces of ancillary equipment.

Prior to the curtailment of its mining operations, the Company had 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.

SouthGobi has secured mining capacity to achieve annual production levels of approximately 7.2 million tonnes in 2014. The Company's 2013 production forecast will not fully utilize its existing mining fleet.

3. MINERAL PROPERTIES (Continued)

Workforce

As at December 31, 2012, SouthGobi Sands LLC employed 451 employees, of which only 269 were active due to the curtailment of the mining operations. Of the 451 employees, 61 are employed in the Ulaanbaatar office, 3 in outlying offices and 388 at the Ovoot Tolgoi Mine site. Of the total 451 employees based in Mongolia, 443 (98%) are Mongolian nationals and of those, 226 (50%) are residents of the local Gurvantes, Dalanzadgad, Sevrei and Noyon Soums. SouthGobi Sands LLC's current workforce has been assembled to efficiently support the Company's 2013 production forecast.

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

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

On March 25, 2013, the Company reported an updated NI 43-101 compliant independent resource estimate prepared by RPM. RPM estimated that the Soumber Deposit contains measured coal resources of 62.4 million tonnes, indicated coal resources of 110.3 million tonnes and inferred coal resources of 123.0 million tonnes as at January 10, 2013. Approximately 76% of the Soumber resource is located above 300m and is amenable to surface mining.

3. MINERAL PROPERTIES (Continued)

The increase in resource estimate over 2012 were identified by RPM when reviewing the technical data for the resources in the course of on-going mine planning studies for the Company. These studies included the reconciliation of RPM Minescape and McElroy Bryan Geological Services Pty Ltd ("MBGS") Minex models. This reconciliation identified aggregation anomalies which resulted in an increase in the resource estimates that were originally reported. 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 25, 2013, and available at www.sedar.com.

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

On July 6, 2011, SouthGobi announced that MRAM issued the Company a mining license pertaining to the Soumber Deposit. The 10,993ha mining license was granted for an initial term of 30 years with an option for two 20 year extensions. Further, on January 18, 2013, MRAM issued the Company a PMA pertaining to the Soumber Deposit, complementing its existing mining license. The Company has applied for a mining license on the area of the Soumber Deposit covered by the PMA.

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 and the PMA 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 planning to complete a pre-feasibility study for the Soumber Deposit, pertaining to resources located above 300m, by September 2013. However, the Company has delayed studying the feasibility of building a coal preparation plant for the Soumber coals to preserve the Company's financial resources and is reviewing other alternatives.

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).

3. MINERAL PROPERTIES (Continued)

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

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

On March 25, 2013, the Company reported an updated NI 43-101 compliant independent resource estimate for the Zag Suuj Deposit prepared by RPM. RPM estimated that the Zag Suuj Deposit contains indicated coal resources of 21.5 million tonnes and inferred coal resources of 84.0 million tonnes as at January 10, 2013. The entire Zag Suuj resource is located above 300m and is amenable to surface mining.

The increase in resource estimate over 2012 were identified by RPM when reviewing the technical data for the resources in the course of on-going mine planning studies for the Company. These studies included the reconciliation of RPM Minescape and MBGS Minex models. This reconciliation identified aggregation anomalies which resulted in an increase in the resource estimates that were originally reported. 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 25, 2013, 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 were curtailed while mining operations at the Ovoot Tolgoi Mine were suspended. It is anticipated that coals from the Zag Suuj Deposit can be washed to produce a coking coal product or a coking coal blend product. Limited exploration is planned for 2013 to meet the requisite requirements under the Mongolian Minerals Law.

3. 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 RPM. RPM estimated that the Ovoot Tolgoi Underground Deposit contains measured coal resources of 65.8 million tonnes, indicated coal resources of 43.3 million tonnes and inferred coal resources of 62.0 million tonnes as at October 31, 2011. Details of the assumptions and parameters used to calculate the resources and coal quality estimates and information on data verification are set out in the Annual Information Form dated March 25, 2013, and available at www.sedar.com.

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

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

Tsagaan Tolgoi Deposit

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

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

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

3. MINERAL PROPERTIES (Continued)

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 expected 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. Subsequently, on August 29, 2012, SouthGobi announced that the proposed sale of the Tsagaan Tolgoi Deposit to Modun had been cancelled by mutual agreement of both parties.

Investments

Aspire (19.9% owned)

As at December 31, 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 Mongolian coal assets, 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. Subsequent to year-end, on February 21, 2013, Aspire completed a private placement, diluting SouthGobi's interest to 18.8%. As at March 25, 2013, SouthGobi has invested a total of $27.9 million in Aspire and its interest in Aspire has a market value of $10.6 million.

On August 28, 2012, Aspire announced that it had received a mining license for the Ovoot Coking Coal Project. Further, on November 2, 2012, Aspire announced an updated JORC compliant reserve estimate of 219.0 million tonnes of probable coal reserves, 156.0 million tonnes of measured coal resources, 86.1 million tonnes of indicated coal resources and 15.3 million tonnes of inferred coal resources for the Ovoot Coking Coal Project. The mineral resources are inclusive of mineral reserves. On December 6, 2012, Aspire announced that a pre-feasibility study review was completed for the Ovoot Coking Coal Project. 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 washed coking coal average specifications are an ash content of 9%, volatiles of 25-28% and crucible swelling number of 9.

3. MINERAL PROPERTIES (Continued)

Exploration Program

Exploration expenses in 2012 were $8.6 million compared to $31.8 million in 2011. Exploration expenses will vary period to period depending on the number of projects and the related seasonality of the exploration programs. The 2012 exploration program was suspended in the second quarter of 2012 in order to preserve the Company's financial resources while mining operations at the Ovoot Tolgoi Mine were curtailed, with the exception of certain water exploration activities and minimum exploration activities required on exploration licenses held by the Company.

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 Company's 2013 exploration program will focus on further defining the Soumber Deposit; whereas, exploration on other licenses will ensure that the requisite requirements under the Mongolian Minerals Law are achieved. The Company also plans to continue its water exploration program throughout 2013.

3.2 Administrative and Other

Other operating expenses in 2012 increased to $54.3 million compared to $29.2 million in 2011. The increase in other operating expenses primarily relates to provisions for doubtful trade and other receivables, an impairment loss on available-for-sale financial assets and an impairment of property, plant and equipment, partially offset by reduced public infrastructure costs.

In 2012, the Company recorded $52.8 million of provisions and impairments in other operating expenses related to the following:

- Trade and other receivables – the Company recorded a loss provision of $18.4 million in 2012. The loss provision relates to provisions for certain uncollectible trade receivables of $17.4 million and a reduction in the expected insurance proceeds of $1.0 million. The Company anticipates full recovery of its remaining outstanding trade and other receivables (refer to Section 6 for additional information).
- Available-for-sale financial asset – in 2012, the Company determined that objective evidence of impairment in the Company's investment in Aspire existed. Therefore, an impairment loss of $19.2 million was recognized in other operating expenses.

3. MINERAL PROPERTIES (Continued)

- Property, plant and equipment – the Company recorded $15.2 million of impairment charges to reduce various items of property, plant and equipment to their recoverable amounts. The impairment charges consist of a $13.0 million impairment pertaining to non-refundable prepayments made on cancelled mobile equipment orders to preserve the Company's financial resources, a $1.1 million provision on tires held for sale and a $1.1 million impairment of construction in progress expenditures that were not expected to be recovered.

Public infrastructure costs decreased in 2012 compared to 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.

In 2011, other operating expenses primarily consisted of a $16.0 million impairment charge on various capitalized construction projects and $8.1 million of public infrastructure costs.

Administration expenses in 2012 were $24.6 million compared to $28.7 million in 2011. The decrease in administration expenses primarily related to reduced corporate administration and share-based compensation expense, partially offset by increased legal and professional fees. Legal and professional fees were higher due to additional legal fees as a result of the CHALCO proportional takeover bid (refer to Section 9 for additional information), the Notice of Investment Dispute (refer to Section 3.1 "notice of investment dispute" for additional information) and in support of the ongoing investigations (refer to Section 3.1 "governmental, regulatory and internal investigations" for additional information).

4. SUMMARY OF QUARTERLY RESULTS

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

	2012				2011			
QUARTER ENDED	**31-Dec**	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar
Revenue	**$ 1,213**	$ 3,337	$ 8,412	$ 40,153	$ 51,064	$ 60,491	$ 47,336	$ 20,158
Gross profit/(loss) excluding idled mine costs	**(6,894)**	(8,601)	1,778	22,674	16,637	17,635	9,744	7,690
Gross profit margin excluding idled mine costs	***-568%***	*-258%*	*21%*	*56%*	*33%*	*29%*	*21%*	*38%*
Gross profit/(loss) including idled mine costs	**(25,336)**	(27,532)	(13,809)	22,674	16,637	17,635	9,744	7,690
Other operating expenses	**(18,664)**	(29,301)	(3,803)	(2,578)	(24,644)	(138)	(3,024)	(1,383)
Administration expenses	**(6,079)**	(5,178)	(7,497)	(5,882)	(8,612)	(7,993)	(6,808)	(5,336)
Evaluation and exploration expenses	**(508)**	(958)	(2,099)	(5,033)	(14,513)	(10,908)	(4,356)	(1,991)
Income/(loss) from operations	**(50,586)**	(62,969)	(27,208)	9,181	(31,132)	(1,404)	(4,444)	(1,020)
Net income/(loss)	**(51,818)**	(54,564)	237	3,126	(18,897)	55,921	67,323	(46,602)
Basic income/(loss) per share	**(0.28)**	(0.30)	0.00	0.02	(0.10)	0.31	0.37	(0.25)
Diluted income/(loss) per share	**(0.28)**	(0.30)	(0.12)	0.02	(0.14)	(0.02)	-	(0.25)

	2012				2011			
QUARTER ENDED	**31-Dec**	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar
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
Coal sales *(millions of tonnes)*	**0.03**	-	0.12	0.31	0.53	0.66	0.60	0.34
Average realized selling price *(per tonne)*	**$ 47.86**	$ -	$ 67.17	$ 67.59	$ 67.62	$ 66.83	$ 65.96	$ 56.50
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
Coal sales *(millions of tonnes)*	**-**	0.31	0.00	-	0.25	0.51	0.45	0.11
Average realized selling price *(per tonne)*	**$ -**	$ 15.79	$ 38.80	$ -	$ 40.30	$ 39.74	$ 38.32	$ 31.68
Total								
Raw coal production *(millions of tonnes)*	**-**	-	0.27	1.07	1.34	1.25	0.87	1.11
Coal sales *(millions of tonnes)*	**0.03**	0.31	0.16	0.84	1.15	1.37	1.05	0.45
Average realized selling price *(per tonne)*	**$ 47.86**	$ 15.79	$ 62.56	$ 56.79	$ 55.51	$ 54.01	$ 54.06	$ 50.29
Costs								
Direct cash costs of product sold excluding idled mine costs *(per tonne)* (i)	**$ 33.11**	$ 8.23	$ 22.57	$ 10.80	$ 22.14	$ 22.64	$ 26.77	$ 18.91
Total cash costs of product sold excluding idled mine costs *(per tonne)* (i)	**$ 38.17**	$ 12.12	$ 31.49	$ 15.04	$ 23.09	$ 23.17	$ 27.61	$ 20.61
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
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**-**	-	4.31	2.07	3.42	3.28	4.74	3.47
Pre-production waste material moved *(millions of bank cubic meters)*	**-**	-	-	-	-	0.39	0.80	0.49
Other operating capacity statistics								
Capacity								
Number of mining shovels/excavators available at period end	**5**	4	4	3	3	3	4	3
Total combined stated mining shovel/excavator capacity at period end *(cubic meters)*	**113**	98	98	64	64	64	98	83
Number of haul trucks available at period end	**27**	27	27	27	25	16	16	16
Total combined stated haul truck capacity at period end *(tonnes)*	**4,743**	4,743	4,743	4,743	4,561	2,599	2,599	2,599
Employees and safety								
Employees at period end	**465**	644	693	720	720	695	658	600
Lost time injury frequency rate (ii)	**0.5**	0.8	1.1	1.4	1.2	0.9	0.6	0.7

(i) A non-IFRS financial measure, see Section 5
(ii) Per 1,000,000 man hours

4. 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:

In the fourth quarter of 2012, the Company's mining activities remained fully curtailed; however, the Company generated revenue through the sale of existing coal stockpiles. The Company recognized revenue of $1.2 million in the fourth quarter of 2012 compared to $3.3 million in the third quarter of 2012 and $51.1 million in the fourth quarter of 2011. The significant decrease in revenue in the fourth and third quarters of 2012 compared to the fourth quarter of 2011 can be attributed to decreased sales volume and a reduction in the Company's average realized selling price. In the fourth quarter of 2012, the Company's sales volumes and average realized selling price continued to be negatively impacted by the softening of the inland China coking coal markets closest to SouthGobi's operations. However, subsequent to year-end, the Company signed contracts with a number of customers to sell the majority of its remaining coal stockpiles.

SouthGobi's effective royalty rate in the fourth quarter of 2012 was 6%, a significant reduction from prior quarters in 2012. Effective October 1, 2012 (for a six month trial period) the royalty rate is determined using the contracted sales price per tonne, not the reference price per tonne published by the Government of Mongolia. SouthGobi, together with other Mongolian mining companies, have continued their dialog with the appropriate Government of Mongolia authorities with the goal of extending the trial period until the end of 2013.

Cost of sales was $26.5 million in the fourth quarter of 2012 compared to $30.9 million in the third quarter of 2012 and $34.4 million in the fourth quarter of 2011. Cost of sales comprise the direct cash costs of product sold, mine administration cash costs of product sold, idled mine costs, inventory impairments, equipment depreciation, depletion of mineral properties and share-based compensation expense. Of the $26.5 million and $30.9 million recorded as cost of sales in the fourth and third quarters of 2012, $8.1 million and $12.0 million related to mine operations and $18.4 million and $18.9 million related to idled mine costs, respectively. Cost of sales related to mine operations decreased in the fourth quarter of 2012 compared to the third quarter of 2012 primarily due to lower sales volumes, partially offset by higher unit costs. Cost of sales related to mine operations decreased in the fourth quarter of 2012 compared to the fourth quarter of 2011 primarily due to lower sales volumes, partially offset by higher unit costs and coal stockpile impairments totaling $7.0 million. In the fourth quarter of 2012, the Company recorded a coal stockpile impairment of $7.0 million to reduce the carrying value to its net realizable value.

4. SUMMARY OF QUARTERLY RESULTS (Continued)

In the fourth and third quarters of 2012, gross profit was negatively impacted by $18.4 million and $18.9 million of idled mine costs, respectively, contributing to a gross loss of $25.3 million in the fourth quarter of 2012 and $27.5 million in the third quarter of 2012. The Company recorded a gross loss excluding idled mine costs of $6.9 million in the fourth quarter of 2012 compared to a gross loss excluding idled mine costs of $8.6 million in the third quarter of 2012 and a gross profit excluding idled mine costs of $16.6 million in the fourth quarter of 2011. Gross profit will vary by quarter depending on sales volumes, sales prices and unit costs.

Direct cash costs of product sold excluding idled mine costs (a non-IFRS financial measure, see Section 5) were $33.11 per tonne in the fourth quarter of 2012 compared to $8.23 per tonne in the third quarter of 2012 and $22.14 in the fourth quarter of 2011. Direct cash costs of product sold excluding idled mine costs primarily increased in the fourth quarter of 2012 due to higher cost coal inventory being sold.

Mine administration cash costs of product sold excluding idled mine costs (a non-IFRS financial measure, see Section 5) were $5.06 per tonne in the fourth quarter of 2012 compared to $3.89 per tonne in the third quarter of 2012 and $0.95 in the fourth quarter of 2011. Mine administration cash costs of product sold excluding idled mine costs increased in the fourth quarter of 2012 due to mine administration costs being allocated over lower sales volumes.

Other operating expenses in the fourth quarter of 2012 decreased to $18.7 million compared to $29.3 million in the third quarter of 2012 and $24.6 million in the fourth quarter of 2011. The decrease in other operating expenses compared to the third quarter of 2012 primarily relates to a reduced provision for doubtful trade and other receivables and recognizing a smaller impairment loss on available-for-sale financial assets, partially offset by an increased impairment of property, plant and equipment. The decrease in other operating expenses compared to the fourth quarter of 2011 primarily relates to recognizing a smaller impairment of property, plant and equipment.

For the three months ended December 31, 2012, the Company recorded $20.8 million of provisions and impairments in other operating expenses related to the following:

- Trade and other receivables – the Company recorded a loss provision of $4.7 million related to provisions for certain uncollectible trade receivables of $3.7 million and a reduction in the expected insurance proceeds of $1.0 million. The Company anticipates full recovery of its remaining outstanding trade and other receivables (refer to Section 6 for additional information).

4. SUMMARY OF QUARTERLY RESULTS (Continued)

- Available-for-sale financial asset – in the third quarter of 2012, the Company determined that objective evidence of impairment in the Company's investment in Aspire existed. Therefore, a further impairment loss of $3.1 million was recognized in other operating expenses.
- Property, plant and equipment – the Company recorded $13.0 million of impairment charges to reduce non-refundable prepayments made on cancelled mobile equipment orders to their recoverable amounts. The mobile equipment orders were cancelled to preserve the Company's financial resources.

Administration expenses in the fourth quarter of 2012 were $6.1 million compared to $5.2 million in the third quarter of 2012 and $8.6 million in the fourth quarter of 2011. Administration expenses increased in the fourth quarter of 2012 compared to the third quarter of 2012 primarily due to increased corporate administration, legal and professional fees and salaries and benefits, partially offset by reduced share-based compensation expenses. Administration expenses decreased in the fourth quarter of 2012 compared to the fourth quarter of 2011 primarily due to decreased salaries and benefits and share-based compensation expenses, partially offset by increased legal and professional fees.

Exploration expenses in the fourth quarter of 2012 were $0.5 million compared to $1.0 million in the third quarter of 2012 and $14.5 million in the fourth 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. The Company curtailed exploration activities in the fourth and third quarters of 2012 to preserve financial resources. The majority of the exploration activities in these periods related to water exploration activities. Exploration expenses in the fourth quarter of 2011 included a higher proportion of the 2011 exploration program expenses due to delays in receiving required government approvals in the first half of 2011.

Finance costs in the fourth quarter of 2012 were $5.6 million compared to $1.1 million in the fourth quarter of 2011. Finance costs in the fourth quarter of 2012 primarily consisted of $4.8 million of interest expense on the CIC convertible debenture and a $0.7 million unrealized loss on FVTPL investments; whereas, finance costs in the fourth quarter of 2011 primarily consisted of $0.9 million of interest expense on the CIC convertible debenture.

4. SUMMARY OF QUARTERLY RESULTS (Continued)

Finance income in the fourth quarter of 2012 was $0.7 million compared to $11.0 million in the fourth quarter of 2011. In the fourth quarter of 2012, finance income primarily consisted of a $0.7 million unrealized gain on the fair value change of the embedded derivatives in the CIC convertible debenture; whereas, in the fourth quarter of 2011, finance income primarily consisted of a $10.8 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.

In the fourth quarter of 2012, the Company recorded a current income tax expense of $0.1 million related to its Mongolian operations compared to a current income tax recovery of $0.4 million in the fourth quarter of 2011. The Company has recorded a deferred income tax recovery related to deductible temporary differences of $3.5 million in the fourth quarter of 2012 compared to a deferred income tax recovery of $2.0 million in the fourth quarter of 2011.

As a result of the above factors, the Company recorded a net loss of $51.8 million in the fourth quarter of 2012 compared to a net loss of $54.6 million in the third quarter of 2012 and a net loss of $18.9 million in the fourth quarter of 2011.

Adjusted net loss (a non-IFRS financial measure, see Section 5) was $14.9 million in the fourth quarter of 2012 compared to adjusted net loss of $16.7 million in the third quarter of 2012 and adjusted net loss of $1.6 million in the fourth quarter of 2011. Adjusted net loss increased in the fourth quarter of 2012 compared to the fourth quarter of 2011 primarily due to decreased gross profits excluding idled mine costs and coal stockpile impairments, mainly as a result of lower sales volumes, and an increased proportion of interest expense on the CIC convertible debenture being expensed as opposed to capitalized, partially offset by lower exploration costs.

($ in thousands)

	2012				2011			
QUARTER ENDED	**31-Dec**	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar
Net income/(loss)	**$ (51,818)**	$ (54,564)	$ 237	$ 3,126	$ (18,897)	$ 55,921	$ 67,323	$ (46,602)
Income/(loss) adjustments, net of tax								
Idled mine costs	**14,474**	13,572	10,966	-	-	-	-	-
Share-based compensation expense/(recovery)	**(1,144)**	1,490	4,383	3,799	4,050	4,296	3,349	2,715
Net impairment loss/(recovery) on assets	**22,814**	34,299	2,583	-	23,818	(2,925)	-	-
Unrealized foreign exchange losses/(gains)	**750**	179	(511)	(950)	34	103	263	(993)
Unrealized loss/(gain) on embedded derivatives in CIC debenture	**(662)**	(12,856)	(26,770)	776	(10,790)	(62,058)	(70,422)	36,780
Realized loss/(gain) on disposal of FVTPL investments	**15**	-	46	(85)	-	-	-	-
Unrealized loss/(gain) on FVTPL investments	**664**	1,197	2,282	339	155	2,449	(3,629)	4,116
Adjusted net income/(loss) [(i)]	**(14,907)**	(16,683)	(6,784)	7,005	(1,630)	(2,214)	(3,116)	(3,984)

(i) A non-IFRS financial measure, see Section 5

5. 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 Consolidated 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 expense, inventory impairments, 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.

5. NON-IFRS FINANCIAL MEASURES (Continued)

	Year ended December 31,	
	2012	**2011**
Cash costs		
Cost of sales per financial statements	**$ 97,118**	$ 127,343
Less non-cash expenses	**(21,883)**	(30,808)
Less non-cash idled mine costs	**(34,300)**	-
Total cash costs	**40,935**	96,535
Less idled mine cash costs	**(18,658)**	-
Total cash costs excluding idled mine costs	**22,277**	96,535
Coal sales *(000's of tonnes)*	**1,330**	4,021
Total cash costs of product sold excluding idled mine costs *(per tonne)*	**$ 16.75**	$ 24.01

	Year ended December 31,	
	2012	**2011**
Cash costs		
Direct cash costs of product sold excluding idled mine costs *(per tonne)*	**$ 12.02**	$ 23.15
Mine administration cash costs of product sold excluding idled mine costs *(per tonne)*	**4.73**	0.86
Total cash costs of product sold excluding idled mine costs *(per tonne)*	**$ 16.75**	$ 24.01

Adjusted net income/(loss)

Adjusted net income/(loss) excludes idled mine costs, share-based compensation expense, 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, the loss on the partial conversion of the CIC convertible debenture, realized losses/(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.

(Expressed in U.S. Dollars)

5. NON-IFRS FINANCIAL MEASURES (Continued)

	Year ended December 31,		
	2012	**2011**	**2010**
Net income/(loss)	**$ (103,019)**	$ 57,745	$ (116,195)
Income/(loss) adjustments, net of tax			
Idled mine costs	**39,012**	-	-
Share-based compensation expense	**8,528**	14,410	13,260
Net impairment loss on assets	**59,696**	20,893	7,584
Unrealized foreign exchange gains	**(532)**	(593)	(3,703)
Unrealized gain on embedded derivatives in CIC debenture	**(39,512)**	(106,489)	(100,637)
Loss on partial conversion of CIC debenture	**-**	-	151,353
Realized gain on disposal of FVTPL investments	**(24)**	-	-
Unrealized loss/(gain) on FVTPL investments	**4,482**	3,091	(870)
Adjusted net loss	**$ (31,369)**	$ (10,943)	$ (49,208)

6. LIQUIDITY AND CAPITAL RESOURCES

Consistent with the Company's capital risk management strategy, the Company expects to have sufficient liquidity and capital resources to meet its ongoing obligations and future contractual commitments for at least twelve months from the end of the December 31, 2012 reporting period. The Company expects its liquidity to remain sufficient based on existing capital resources and income from mining operations. Liquidity beyond the twelve month period is dependent on the success of the recommencement of operations and ongoing demand and prices in the coal market. On March 22, 2013, the Company recommenced mining activities at the Ovoot Tolgoi Mine. The Company continues to minimize uncommitted capital expenditures and exploration expenditures in order 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 and exploration and discretionary expenditures.

Factors currently creating uncertainty for the Company's operations include the continued softness of inland China coking coal markets, ongoing governmental, regulatory and internal investigations (refer to Section 3.1 "governmental, regulatory and internal investigations" for additional information) and the Notice of Investment Dispute filed by SouthGobi on the Government of Mongolia pursuant to the Bilateral Investment Treaty between Singapore and Mongolia (refer to Section 3.1 "notice of investment dispute" for additional information).

In November 2009, the Company entered into a financing agreement with a wholly owned subsidiary of the CIC for $500 million in the form of a secured, convertible debenture bearing interest at 8.0% (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's shares) with a maximum term of 30 years. The CIC convertible debenture is secured by a charge over the Company's assets and certain subsidiaries. The financing 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 $250.0 million of the CIC convertible debenture into 21.5 million shares at a conversion price of $11.64 (Cdn$11.88). As at December 31, 2012, the CIC owned through its indirect wholly owned subsidiary approximately 14% of the Company.

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

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.

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.

The terms of the CIC convertible debenture provide for the 1.6% share interest payment of $4.0 million to be paid annually in common shares of the Company. As a result of the Foreign Investment Law ("FIL") (refer to Section 13 for additional information) the Company expected it would require parliamentary approval for the shares to be issued for the November 19, 2012 interest payment. Subsequent to December 31, 2012, the Company settled this obligation by payment of $4.0 million in cash.

Subsequent to December 31, 2012, the IAAC informed the Company that orders, placing restrictions on certain of its Mongolian assets, had been imposed in connection with its continuing investigation.

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

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

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

As at December 31, 2012, the Company had cash of $19.7 million and short term money market investments of $15.0 million for a total of $34.7 million in cash and money market investments compared to cash of $123.6 million and long term money market investments of $45.0 million for a total of $168.6 million in cash and money market investments as at December 31, 2011. Working capital (excess current assets over current liabilities) was $127.2 million as at December 31, 2012 compared to $236.1 million as at December 31, 2011.

As at December 31, 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. As at December 31, 2012, the Company is not subject to any externally imposed capital requirements.

Trade and other receivables decreased to $17.4 million as at December 31, 2012 compared to $80.3 million as at December 31, 2011. In 2012, the Company recorded a loss provision of $18.4 million for certain uncollectible trade and other receivables. The Company closely monitors collectability of outstanding accounts receivables for coal sales and expects to collect all outstanding receivables. The Company seeks to manage its credit risk on trade and other receivables by trading with third party customers it considers to be creditworthy. 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.

As at December 31, 2012, the non-current portion of the CIC convertible debenture was $99.7 million, compared to $139.1 million as at December 31, 2011. In 2012, the decrease in the fair value of the embedded derivatives in the CIC convertible debenture resulted in an unrealized gain of $39.5 million.

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Cash Flow Highlights

($ in thousands)

	Year ended December 31, 2012	Year ended December 31, 2011
Cash used in operating activities	**$ (26,283)**	$ (70,023)
Cash used in investing activities	**(77,737)**	(270,432)
Cash used in financing activities	**(51)**	(27,574)
Effect of foreign exchange rate changes on cash	**178**	(442)
Decrease in cash for the year	**(103,893)**	(368,471)
Cash balance, beginning of the year	**123,567**	492,038
Cash balance, end of the year	**$ 19,674**	$ 123,567

Cash used in operating activities

Cash used in operating activities for the year ended December 31, 2012 was $26.3 million compared to cash used in operating activities for the year ended December 31, 2011 of $70.0 million. The decreased outflows in 2012 primarily related to reduced working capital requirements partially offset by reduced cash flow from operations.

Cash used in investing activities

Cash used in investing activities was $77.7 million for the year ended December 31, 2012 compared to $270.4 million for the year ended December 31, 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 $0.1 million for the year ended December 31, 2012 compared to $27.6 million for the year ended December 31, 2011. In 2012, the Company repurchased $1.0 million of its common shares. This amount was primarily offset by the $0.9 million received from the issuance of common shares and exercise of stock options.

As at December 31, 2012, the Company had a twelve month revolving line of credit facility with Golomt Bank in Mongolia. The maximum draw-down available was $3.5 million and 8.1 billion Mongolian Tugriks (approximately $5.8 million) and the line of credit incurred interest at 11% for any U.S. Dollar amounts outstanding and 12% for any Mongolian Tugrik amounts outstanding. The line of credit was secured by operating equipment in Mongolia to a value of not less than 150% of the total facility amount.

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

The line of credit facility was used by the Company's Mongolian Coal Division as part of its working capital management. There were no amounts due under the line of credit facility at both December 31, 2012 and December 31, 2011. Subsequent to December 31, 2012, the line of credit facility expired and was not renewed.

Contractual Obligations and Guarantees

Day-to-day mining, expansionary and sustaining capital expenditures as well as administrative operations give rise to commitments for future minimum payments. Consistent with the Company's capital risk management strategy, the Company expects to have sufficient liquidity and capital resources to meet its ongoing obligations and future contractual commitments for at least twelve months from the end of the December 31, 2012 reporting period. The Company expects its liquidity to remain sufficient based on existing capital resources and income from mining operations. Liquidity beyond the twelve month period is dependent on the success of the recommencement of operations and ongoing demand and prices in the coal market. On March 22, 2013, the Company recommenced mining activities at the Ovoot Tolgoi Mine. As at December 31, 2012, the Company's operating and capital commitments were:

($ in thousands)	As at December 31, 2012			
	Within 1 year	**2-3 years**	**Over 3 years**	**Total**
Capital expenditure commitments	**$ 13,105**	**$ 21,406**	**$ -**	**$ 34,511**
Operating expenditure commitments [(i)]	**23,226**	**1,820**	**-**	**$ 25,045**
Commitments	**$ 36,331**	**$ 23,226**	**$ -**	**$ 59,556**

(i) Operating expenditure commitments include $17,500 in break fees related to the Company's toll wash plant agreement with Ejin Jinda.

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.

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Impairment analysis

As at December 31, 2012, the Company determined that the decline in the Company's common share price and continued curtailment of mining activities at the Ovoot Tolgoi Mine constituted impairment indicators. Therefore, the Company conducted an impairment test whereby the carrying values of the Company's property, plant and equipment, including mineral properties, related to the Ovoot Tolgoi Mine were compared to their "value-in-use" using a discounted future cash flow valuation model as at December 31, 2012. The Company's property, plant and equipment, including mineral properties, totaled $521.5 million as at December 31, 2012.

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

- Inland Chinese coking coal market coal prices;
- Life-of-mine coal production and operating costs; and
- A discount rate based on an analysis of market, country and company specific factors

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at December 31, 2012. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

Financial instruments

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

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

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

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

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

	As at	
Financial assets *($ in thousands)*	**December 31, 2012**	**December 31, 2011**
Loans-and-receivables		
Cash	**$ 19,674**	$ 123,567
Trade and other receivables	**17,430**	80,285
Available-for-sale		
Investment in Aspire	**8,727**	46,837
Fair value through profit or loss		
Investment in Kangaroo	**1,455**	7,431
Money market investments	**15,000**	44,967
Total financial assets	**$ 62,286**	$ 303,087
Financial liabilities *($ in thousands)*		
Fair value through profit or loss		
Convertible debenture - embedded derivatives	**$ 8,876**	$ 48,389
Other-financial-liabilities		
Trade and other payables	**10,216**	52,235
Convertible debenture - debt host	**97,092**	96,997
Total financial liabilities	**$ 116,184**	$ 197,621

Net income for the year ended December 31, 2012 and December 31, 2011 included the following amounts of unrealized losses/(gains) from the fair value adjustments to certain financial instruments which are classified as FVTPL:

	Year ended December 31,	
($ in thousands)	**2012**	**2011**
Unrealized loss on FVTPL investments	**$ 4,482**	$ 3,091
Unrealized gain on embedded derivatives in CIC debenture	**(39,512)**	(106,489)

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Other comprehensive income for the year ended December 31, 2012 consists of a reclassification of the unrealized gain (net of tax) on the Company's investment in Aspire. In 2012, the Company determined that objective evidence of impairment in the Company's investment in Aspire existed. Therefore, an impairment loss of $19.2 million was recognized in other operating expenses. Other comprehensive income for the year ended December 31, 2011 consists of an unrealized loss (net of tax) of $11.2 million related to the Company's investment in Aspire.

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

8. RELATED PARTY TRANSACTIONS

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

- Turquoise Hill – Turquoise Hill is the Company's immediate parent company and at December 31, 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 provided some office and investor relations services to Turquoise Hill in the Company's Hong Kong office and recovered the costs for those services on a cost-recovery basis. The Company's provision of office and investor relations services to Turquoise Hill ceased on June 30, 2012.
- Rio Tinto plc ("Rio Tinto") – Rio Tinto is the Company's ultimate parent company and at December 31, 2012 Rio Tinto controlled Turquoise Hill. The Company recovers administration and other costs incurred on behalf of Rio Tinto on a cost-recovery basis. Rio Tinto recovers from the Company the costs of salaries and benefits of employees assigned to work for the Company.
- Global Mining Management ("GMM") – GMM is a private company owned equally by seven companies, two of which include the Company and Turquoise Hill. GMM provides administration, accounting and other office services to the Company on a cost-recovery basis.
- 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 and previously had two directors in common with the Company. During the year ended December 31, 2012, Ivanhoe Energy ceased being a related party. The Company provided some office and investor relations services to Ivanhoe Energy in the Company's Hong Kong office and recovered the costs for those services on a cost-recovery basis. The Company's provision of office and investor relations services to Ivanhoe Energy ceased on June 30, 2012.

8. RELATED PARTY TRANSACTIONS (Continued)

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

($ in thousands)	Year ended December 31, 2012	Year ended December 31, 2011
Corporate administration	**$ 1,309**	$ 1,990
Salaries and benefits	**919**	1,389
Total related party expenses	**$ 2,228**	$ 3,379

($ in thousands)	Year ended December 31, 2012	Year ended December 31, 2011
GMM	**$ 1,012**	$ 2,014
Turquoise Hill	**7**	94
Rio Tinto	**68**	-
I2MS	**1,141**	1,271
Total related party expenses	**$ 2,228**	$ 3,379

The Company recorded recoveries of $0.6 million for the year ended December 31, 2012 compared to recoveries of $0.5 million for the year ended December 31, 2011 for administration expenses with Turquoise Hill, Ivanhoe Energy and Rio Tinto.

The Company had accounts receivable of $0.7 million as at December 31, 2012 (December 31, 2011: $0.6 million) and accounts payable of $0.1 million as at December 31, 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.

8. RELATED PARTY TRANSACTIONS (Continued)

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

The Company has also adopted an equity incentive plan to incentivize directors and eligible employees. Details of the plan are set out in Note 22 of the Consolidated Financial Statements.

As at December 31, 2012, the Company employed 465 employees, of which only 283 are active due to the curtailment of the mining operations.

9. 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 was also informed by its 58% major shareholder, Turquoise Hill, that Turquoise Hill had 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 was to be made by way of a takeover bid circular under British Columbia law and would be made to all SouthGobi shareholders. If shareholders tendered more than 60% of the outstanding common shares of SouthGobi to the takeover bid, a proportional amount of shares were to be taken up from each shareholder.

In conjunction with the Proportional Offer, CHALCO and SouthGobi entered into a cooperation agreement. CHALCO's obligations under the cooperation agreement were to become effective upon CHALCO acquiring a shareholding in SouthGobi.

SouthGobi had also been notified that CHALCO 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.

CHALCO 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. Finally, on September 3, 2012, SouthGobi was notified that CHALCO's Proportional Offer had been terminated, which also resulted in the termination of the cooperation agreement and the consultancy agreements.

10. 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 March 25, 2013, 181.9 million common shares were issued and outstanding. There are also incentive share options outstanding to acquire 4.8 million unissued common shares with exercise prices ranging from Cdn$1.92 to Cdn$18.86. There are no preferred shares outstanding.

As at March 25, 2013, Turquoise Hill directly owned 104.8 million common shares representing approximately 58% of the issued and outstanding common shares of the Company.

11. INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

Management, including the Chief Executive Officer and Principal Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. As of December 31, 2012, the Chief Executive Officer and Principal Financial Officer have each concluded that the Company's disclosure controls and procedures, as defined in NI 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to achieve the purpose for which they have been designed.

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS. Management is also responsible for the design of the Company's internal control over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

The Company's internal controls over financial reporting include policies and procedures that: pertain to the maintenance of records that, in reasonable detail accurately and fairly reflect the transactions and disposition of assets; provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with IFRS and that receipts and expenditures are being made only in accordance with authorization of management and directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements.

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

11. INTERNAL CONTROLS OVER FINANCIAL REPORTING (Continued)

The Company's management, under the supervision of the Chief Executive Officer and the Principal Financial Officer, has evaluated the effectiveness of the Company's internal controls over financial reporting using the framework and criteria established in *Internal Control-Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the evaluation, management has concluded that internal controls over financial reporting were effective as at December 31, 2012.

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.

12. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

A detailed summary of all of the Company's significant accounting policies is included in Note 3 to the annual Consolidated Financial Statements for the year ended December 31, 2012. Information about judgments and estimates in applying accounting policies that have the most significant effect on the amounts recognized in the Consolidated Financial Statements are as follows:

Liquidity and going concern assumption

In the determination of the Company's ability to meet its ongoing obligations and future contractual commitments for at least twelve months from the end of the December 31, 2012 reporting period, management relies on the Company's planning, budgeting and forecasting process to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans. The key inputs used by the Company in this process include forecasted capital deployment, results from operations, results from the exploration and development of its properties and general industry conditions. Changes in these inputs may alter the Company's ability to meet its ongoing obligations and future contractual commitments and could result in adjustments to the amounts and classifications of assets and liabilities should the Company be unable to continue as a going concern.

Valuation of embedded derivatives

The embedded derivatives in the Company's convertible debenture are valued using a Monte Carlo simulation valuation model. A Monte Carlo simulation model is a valuation model that relies on random sampling and is often used when modeling systems with a large number of inputs and where there is significant uncertainty in the future value of inputs and where the movement of the inputs can be independent of each other. The key inputs used by the Company in its Monte Carlo simulation are further disclosed in Note 19.2 and Note 19.3 to the annual Consolidated Financial Statements for the year ended December 31, 2012. Changes in the inputs to the valuation model could impact the carrying value of the embedded derivatives in the convertible debenture and the amount of unrealized gains or losses recognized in profit or loss.

12. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)

Review of carrying value of assets and impairment charges

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

Estimated recoverable reserves

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

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

Useful lives and depreciation rates for property, plant and equipment

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

12. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)

Income taxes and recoverability of deferred tax assets

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

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

13. RISK FACTORS

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

Risks Relating to the Company's Projects in Mongolia

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

The Company is subject to continuing investigations by the IAAC and other governmental and regulatory authorities in the Republic of Mongolia regarding allegations against SouthGobi and some of its employees involving possible breaches of Mongolian laws, including anti-corruption and taxation laws. See Section 3.1 of this MD&A – "Governmental, Regulatory and Internal Investigations".

Neither SouthGobi nor any of its employees have been charged in connection with the IAAC's investigation, but certain current and former employees have been advised that they are suspects. The IAAC has imposed orders placing a travel ban on those employees, and administrative restrictions on certain of the Company's Mongolian assets, including local bank accounts, in connection with its continuing investigation of those allegations.

Through its Audit Committee (comprised solely of independent directors), SouthGobi is conducting an internal investigation into possible breaches of law, internal corporate policies and codes of conduct arising from the allegations that have been raised.

The Chair of the Audit Committee is also participating in a tripartite committee, comprised of the Audit Committee Chairs of the Company and Turquoise Hill and a representative of Rio Tinto, which is focused on the investigation of those allegations, including possible violations of anti-corruption laws. All of these investigations are ongoing but are not yet complete. Information that has been provided to the IAAC by the Company has also been provided by the tripartite committee to Canadian and United States regulatory authorities that are monitoring the Mongolian investigations. The Company continues to cooperate with all relevant regulatory agencies in respect of the ongoing investigations.

13. RISK FACTORS (Continued)

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

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

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

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

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

13. RISK FACTORS (Continued)

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

Subsequent to December 31, 2012, the Mongolian IAAC informed the Company that orders, placing restrictions on certain of its Mongolian assets, had been imposed in connection with its continuing investigation. The orders relate to certain items of operating equipment and infrastructure and the Company's Mongolian bank accounts. The orders placing restrictions on certain of the Company's Mongolian assets could ultimately result in a breach of covenants under the convertible debenture. Furthermore, the terms of the convertible debenture provide for a 1.6% share interest payment in common shares of the Company. As a result of the FIL, the Company expected it would require parliamentary approval for common shares to be issued to CIC for the November 19, 2012 interest payment due pursuant to the terms of the Convertible Debenture. The Company settled the 1.6% share interest payment due through the payment of $4.0 million in cash. Pursuant to the terms of the convertible debenture, the Company is required to make annual interest payments in the form of common shares. Failure to issue common shares to CIC to discharge such interest payment could result in a breach of covenants pursuant to the convertible debenture. In the event that the Company breaches any of the covenants under the convertible debenture in any material respect and such breach remains uncured for ten business days, the principal amount owing and all accrued and unpaid interest will become immediately due and payable upon notice to the Company by CIC which would have a material adverse affect on the business and operations of the Company.

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

On May 17, 2012, the Parliament of Mongolia ("Parliament") approved a 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 $71.5 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 of the FIL, the Company will require parliamentary approval to issue the CIC their 1.6% share interest payments, in accordance with the terms of the convertible debenture. If the Company is not able to obtain either a waiver from the CIC for the payment of the share interest or parliamentary approval, it risks being in default of the terms of the Convertible Debenture.

13. RISK FACTORS (Continued)

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

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

In addition, the introduction of new Mongolian laws and regulations and the interpretation of existing ones may be subject to policy changes reflecting domestic political or social changes. For example, on July 16, 2009, Parliament enacted the Mining Prohibition in Specified Areas Law that prohibits minerals exploration and mining in areas such as headwaters of rivers and lakes, forest areas as defined in the Forest Law of Mongolia and areas adjacent to rivers and lakes as defined in the Water Law of Mongolia. Pursuant to the Mining Prohibition in Specified Areas Law, the Government of Mongolia was instructed to define the boundaries of 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. New exploration licenses and mining licenses overlapping the defined prohibited areas will not be granted, and previously granted licenses that overlap the defined prohibited areas will be terminated within five months following the adoption of the law. It is not clear whether such termination will only apply to the overlap areas. The Mining Prohibition in Specified Areas Law provides that affected license holders shall be compensated, but there are no specifics as to the way such compensation will be determined.

MRAM has prepared a draft list of licenses 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 Ministry of Mining. Subsequent to the Ministry of Mining's approval of this preliminary list, the Government of Mongolia must still give its final approval before the final list can be published. During the Ministry of Mining's and the Government of Mongolia's review of the draft list of licenses prepared by MRAM, licenses may be added or subtracted to the list at any time prior to approval and publication of the final list.

13. RISK FACTORS (Continued)

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 one other exploration license may be included on MRAM's draft list of licenses, and may be included on the final list published by the Government of Mongolia, potentially affecting the status of those licenses under the Mining Prohibition in Specified Areas Law. The Company has no immovable assets located in any of the potentially affected areas and the loss of any or all of the potentially affected properties would not materially and adversely affect its existing operations. However, the loss of the Tsagaan Tolgoi mining license and exploration licenses pertaining to the Zag Suuj Deposit and the South Biluut and Jargalant fields within the Soumber Deposit would impact the Company's resources.

In December 2012, the President's Office of Mongolia developed draft amendments to the Minerals Law and released it to the public for discussion. The main focus of this draft law is to encourage and enhance the involvement of local communities to participate more effectively in investment decisions and benefits arising from mine development. It also includes measures to tighten environmental protections and minimize challenges associated with the environmental impact of exploration and mining activities. To date the draft Minerals Law is still under stakeholder consultations initiated by the President's Office of Mongolia and no information has been released to the public on the timing of its submission to the Parliament for review and approval.

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

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

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

13. RISK FACTORS (Continued)

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

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

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

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

13. RISK FACTORS (Continued)

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

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

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

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

13. RISK FACTORS (Continued)

Risks relating to the Company's business and industry

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

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

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

The Ovoot Tolgoi Technical Report assumed that the Ejin Jinda wet wash plant at Ceke would process 1.5 million tonnes of coal in 2012. Construction of the wet wash plant was completed in 2012 but 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 Ovoot Tolgoi Technical Report also assumes that the Ejin Jinda wet wash plant is expanded to process 7.0 million tonnes annually from mid-2014. The Company has not commenced negotiations with Ejin Jinda to expand processing capacity due to the curtailment of its Ovoot Tolgoi Mine in the last three quarters of 2012. Any delay in expanding annual capacity to 7.0 million tonnes by mid-2014, would likely impact the project economics, as the coal would be sold as lower value coal; however, these delays would be unlikely to impact on total reserve estimates.

13. RISK FACTORS (Continued)

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

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

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

The Ovoot Tolgoi Technical Report assumes that the Company's mining activity will extend across its lease boundary and into the lease held by Mongolyn Alt Corporation ("MAK"). A memorandum of understanding covering mining across the lease boundary was signed in May 2007. Discussions are continuing with an in-principle agreement, subject to legal documentation and relevant authorities' expected approval to be finalized in 2013. The resource and reserve estimates in the Ovoot Tolgoi Technical Report do not include any coal within the MAK lease; however, the geological models and mining pits extend into the MAK lease. If an operational agreement cannot be finalized, then the reserve estimate could be materially affected.

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

13. RISK FACTORS (Continued)

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

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

The Company commenced mining in April 2008, and has recorded operating losses and operating cash outflows to date. From the second quarter of 2012 until March 22, 2013, the Company's operations at the Ovoot Tolgoi Mine were curtailed. Due to the Company's limited operating history and curtailment of operations, there may not be an adequate basis on which to evaluate the Company's future operating results and prospects. Investors may have difficulties evaluating the Company's business and prospects because the Company's past results may not be indicative of the Company's results in the future.

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

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

13. RISK FACTORS (Continued)

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

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

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

13. RISK FACTORS (Continued)

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

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

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

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

13. RISK FACTORS (Continued)

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

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

In 2012, the Company experienced a softening in the coal markets closest to its operations. The Company observed substantial deterioration in demand sentiment among its customers which led to a substantial decline in key reference prices and key end-use markets. The softening demand contributed to the decision to continue the curtailment of the Company's mining operations and has resulted in reduced revenue. If realized coal prices remain below the full cost of production of any of its future mining operations and remain at such a level for any sustained period, the Company could experience increased losses and may decide to discontinue operations, which could require the Company to incur closure costs and result in further reduced revenues.

13. RISK FACTORS (Continued)

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

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

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

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

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

13. RISK FACTORS (Continued)

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

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

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

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

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

13. RISK FACTORS (Continued)

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

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

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

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

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

Additionally, the Company has been selling its coal products only since September 2008. The Company currently has 6 active customers with the largest customer representing approximately 40%, the second largest customer representing approximately 31% and the remaining customers accounting for 29% of the Company's total sales for the year ended December 31, 2012. In order to mitigate this risk, the Company is continually expanding its customer base.

13. RISK FACTORS (Continued)

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

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

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

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

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

13. RISK FACTORS (Continued)

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

Foreign currency fluctuations could affect expenses and any future earnings

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

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

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

13. RISK FACTORS (Continued)

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

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

As of March 25, 2013, Turquoise Hill holds approximately 58% of the Company's issued and outstanding common shares. The interests of Turquoise Hill may conflict with the interests of the Company's other shareholders and there is no assurance that Turquoise Hill will vote its common shares in a way that benefits the Company's minority shareholders. Subject to the CIC's right to appoint a director, Turquoise Hill's ownership interest enables Turquoise Hill to elect the entire Board without the concurrence of any of the Company's other shareholders. Accordingly, unless applicable laws or regulations would require approval by the Company's minority shareholders, Turquoise Hill is in a position to: (i) control the Company's policies, management and affairs; (ii) subject to applicable laws, regulations and the Articles, adopt amendments to certain provisions of the Articles; and (iii) otherwise determine the outcome of most corporate actions, including a change in control, merger or sale of all or substantially all of the Company's assets.

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

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

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

13. RISK FACTORS (Continued)

Future stock market conditions may change

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

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

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

14. OUTLOOK

The year ended December 31, 2012 has been a tumultuous year for the Company with full curtailment of production from the end of June 2012 with the position unchanged at year end, the announcement of a proportional takeover bid by CHALCO and subsequent termination of the bid, ongoing investigations by the Mongolian authorities and claims of wrongdoing and involvement in investigations against Mongolian public figures. In addition, there were significant changes at the board and senior management level within the organization and the year culminated in the necessity to reduce the Company's overall workforce by nearly one third. The subsequent net loss of $103.0 million recorded by the Company in 2012 reflects these conditions.

The curtailment of production necessitated taking actions to suspend uncommitted capital expenditure and reduce spending in other areas in order to preserve the Company's financial resources whilst at the same time protecting the Company's existing assets. Exploration expenditure was reduced to the level required to protect the Company's rights under existing licenses and moneys were spent in defending the Company from ongoing investigations.

The outlook for 2013 still has a number of uncertainties that need to be overcome but the position going forward is much more positive. The Mongolian coal industry is quite dependent on the Chinese market and this market has been waiting for the conclusion of the Chinese Lunar New Year to get some direction as to what economic changes are likely to occur in China. Generally, most commentators' view is that the coking coal market is improving with demand in China to increase to levels which will support better market conditions for the producer. The strength of the potential supply response to this demand is likely to cap price increases and lead to less volatility in pricing and market conditions throughout 2013.

In March 2013, the Company recommenced mining activities at the Ovoot Tolgoi Mine; however, the production levels will reflect both market conditions and the Company's capability to produce. Production is forecast to be 3.2 million tonnes in 2013. The capability to begin supplying a washed semi-soft product in the second half of the year is another important step in improving both the Company's market position and access to end customers. Once toll washing commences, it will enable SouthGobi to develop a predominantly two product strategy of a premium and standard semi-soft coal product from the Ovoot Tolgoi Mine. The premium product will be washed and the standard product will be predominantly unwashed product. Although production has recommenced, the Company continues to minimize uncommitted capital expenditures and exploration expenditures in order to preserve the Company's financial resources. The Company's liquidity beyond December 31, 2013 is dependent on the success of the recommencement of operations and ongoing demand and prices in the coal market.

14. OUTLOOK (Continued)

Longer term, SouthGobi remains well 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 infrastructure to capture more of the value from the products it sells.
- Favorable cost structure – The long-term cost structure of SouthGobi provides a strong base for sustainable growth when access to end-user markets is obtained even though competition from other Chinese and Mongolian semi-soft coals indicate that capturing margins relative to other international coals is difficult.
- Substantial resource base – The Company's aggregate coal resources (including reserves) include measured and indicated resources of 533 million tonnes and inferred resources of 302 million tonnes.

Objectives

SouthGobi's objectives for 2012 were impacted by the external conditions faced by the Company. SouthGobi has attempted to mitigate the issues by reducing capital expenditures, operating costs and exploration to preserve the Company's financial resources.

The Company's objectives for 2013 are as follows:

- Resume production at the Ovoot Tolgoi Mine – The Company has reviewed the overall structure of its workforce and market conditions and has recommenced mining activities at the Ovoot Tolgoi Mine in March 2013 with the capacity to produce 3.2 million tonnes in 2013. The focus is to do this in a safe manner that provides a sustainable long-term operating base.
- Continue to develop regional infrastructure – The Company's priority is to complete the construction of the paved highway from Ovoot Tolgoi to the Shivee Khuren Border Crossing as part of the existing consortium that was awarded the tender by the end of 2013.
- Advance the Soumber Deposit – The Company intends to substantially advance the feasibility, planning and physical preparation for a mine at Soumber by 2014.

14. OUTLOOK (Continued)

- Value-adding/upgrading coal – Implement an effective and profitable utilization of the wet washing facility contracted with Ejin Jinda to toll-wash coal from the Ovoot Tolgoi Mine and further develop the Company's marketing plans on product mix and seek to expand the Company's customer base.
- Re-establish the Company's reputation – The Company's vision is to be a respected and profitable Mongolian coal company. This will require re-establishing good working relationships with all our external stakeholders.
- Operations – Continuing to focus on production safety, environmental protection, operational excellence and community relations.

March 25, 2013